

University of Rijeka
Faculty of Economics – Partner in EU Integration Jean Monnet Ad personam Chair
University of Antwerp
Jean Monnet Centre of Excellence
University of Ljubljana – Faculty of Economics – Chair Jean Monnet
Institute CEDIMES Paris
CEDIMES Rijeka
University of Belgrade – Faculty of Economics
University of Sarajevo – Faculty of Economics
University "St. Cyril and Methodius" in Skopje – Faculty of Economics
University of Podgorica – Faculty of Economics
University of Dokuz Eylül - Faculty of Economics and Administrative Sciences
"Aleksandër Moisiu" University of Durrës
Ternopil National Economic University
Academy of Public Administration Chişinău
University of Priştina, Faculty of Economics

ECONOMIC INTEGRATIONS, COMPETITION AND COOPERATION

Conference Proceedings

Editors:

Vinko Kandžija
Andrej Kumar



**Editors: Vinko Kandžija
Andrej Kumar**

ECONOMIC INTEGRATIONS, COMPETITION AND COOPERATION
Accession of the Western Balkan Countries to the European Union

Editorial Board:

Skender Ahmeti	University of Priština, Faculty of Economics, Kosovo
Claude Albagli	University of Paris XII (Val de Marne), France
Heri Bezić	University of Rijeka, Faculty of Economics, Croatia
Alain Bienaymé	University of Paris IX (Dauphine), France
Borislav Boričić	University of Belgrade, Faculty of Economics, Serbia
Bardhyl Ceku	"Alexandër Moisiu" University of Durres, Albania
Evrard Claessens	University of Antwerpen, Europacentrum Jean Monnet, Belgium
Maria Delivanis	CEDIMES Komotini, Greece
Ljubomir Drakulevski	University "St. Cyril & Methodius" in Skopje, Faculty of Economics, Macedonia
Milorad Jovović	University of Podgorica, Faculty of Economics, Montenegro
Yevhen P. Kachan	Ternopil National Economic University, Ukraine
Vasile Marina	Academy of Public Administration Chişinău, Moldova
Mit'hat Mema	"Alexandër Moisiu" University of Durres, Albania
Dušan Mramor	University of Ljubljana, Faculty of Economics, Slovenia
Mario Pines	University of Trieste, Italy
Christos Pitelis	University of Cambridge, UK
Alain Redslob	University of Pantheon-Assas (Paris II), France
Željko Šain	University of Sarajevo, Faculty of Economics, Bosnia & Herzegovina
Öcal Usta	University of Dokuz Eylül, Faculty of Economics and Business Administration, Turkey

Publisher and General Editor: University of Rijeka, Faculty of Economics, Ivana Filipovića 4,
HR-51000 Rijeka, Croatia
For the Publisher: Heri Bezić
Technical Editor: Vinko Zaninović
First Edition (2013): 200 copies

Design by: Tomislav Galović

ISBN 978-953-7813-16-1

**A CIP catalogue record for this book is available from
the University Library in Rijeka under number 130230017**

CONTENTS

INTRODUCTION.....	XI
-------------------	----

PART I: THEORY AND PRACTICE OF ECONOMIC INTEGRATION

Hrvoje Jošić Mislav Jošić WELFARE ENHANCING CUSTOMS UNION: KEMP-WAN ISSUE.....	3
Nina Ponikvar Katja Zajc Kejžar Barbara Mörec FINANCIAL CRISIS AND FINANCIAL CONSTRAINTS OF THE FIRMS: THE ROLE OF FIRM-SPECIFIC AND INDUSTRY-SPECIFIC FACTORS.....	10
Mario Pines MONETARY AND FISCAL POLICIES: LIMITS, FALLOUTS AND REMEDIES.....	26
Jean-Pierre Olsem CLEAR FEATURES AND UNCERTAINTIES IN THE DAWNING NEW ECONOMIC SYSTEM.....	41
Hrvoje Jošić Mislav Jošić STATIC AND DYNAMIC EFFECTS OF CUSTOMS UNION CREATION.....	53
Jernej Mencinger Aleksander Aristovnik Miroslav Verbič PUBLIC DEBT, DEBT TRAP AND ECONOMIC GROWTH: AN EMPIRICAL INVESTIGATION FOR THE EUROPEAN UNION AND OECD COUNTRIES.....	66
Radmila Jovančević Tomislav Globan THE IMPACT OF FDI FLOWS ON ECONOMIC CONVERGENCE IN CENTRAL AND EASTERN EUROPE.....	79

**PART II: REGULATORY ENVIRONMENT OF THE EU;
EU AND NATIONAL PERSPECTIVE**

Nevia Čičin-Šain

Sonja Cindori

**PROPOSED AMENDMENTS TO THE EU TAXATION SYSTEM
OF INCOME DERIVING FROM INTEREST.....97**

Sanja Gongeta

**COMBATING LATE PAYMENTS IN COMMERCIAL TRANSACTIONS –
THE CASE OF CROATIA.....116**

Barbara Mörec

Lea Peterka

**THE MANDATORY MULTILATERAL SET-OFF OF PAYABLES AND
RECEIVABLES IN SLOVENIA – A CASE STUDY.....128**

Renata Perić

Emina Jerković

**PERSONAL INCOME TAX SYSTEM: PROVISIONS REGARDING
FAIRNESS AND EQUALITY.....143**

Antonija Zubović

Mihaela Braut Filipović

**SIGNIFICANCE OF THE CISG FOR FRANCHISING AND DISTRIBUTION
AGREEMENTS IN THE EU MARKET.....154**

Edita Čulinović Herc

Nikolina Grković

**IMPACT OF THE MADOFF SCANDAL ON THE FORTHCOMING
UCITS V DIRECTIVE.....168**

**PART III: WESTERN BALKANS; TRADE, COOPERATION AND EU
INTEGRATION PERSPECTIVE**

Jiří Dušek

Lubomír Pána

**CURRENT SITUATION OF TURKEY'S ACCESSION TO THE
EUROPEAN UNION.....185**

Nebojša Savić

Goran Pitić

Snežana Konjikušić

**COMPETITIVENESS OF WESTERN BALKANS IN THE PROCESS OF EU
INTEGRATION.....195**

Gligor Bishev Dragica Odzaklieska EFFECTS OF THE GLOBAL ECONOMIC CRISIS ON THE ECONOMIES OF THE WESTERN BALKANS	210
Boban Stojanović Jelena Stanković Vesna Janković-Milić EUROPEAN INTEGRATION INFLUENCE ON BUSINESS CLIMATE IN SERBIA - PERCEPTIONS AND EXPECTATIONS OF BUSINESS COMMUNITY	221
Bogdana Vujnović-Gligorić Sanel Jakupović Nataša Zrilić BOSNIA AND HERZEGOVINA IN THE PROCESS OF FINANCIAL LIBERALIZATION	235
PART IV: EU ENLARGEMENTS IN BUSINESS PERSPECTIVE	
Anita Radman Peša Sanjin Stanković THE ROLE OF MoU AND ITS INSTRUMENTS BETWEEN CENTRAL BANKS OF TRANSITIONAL COUNTRIES AND INTERNATIONAL BANKS IN THE LIGHT OF FINANCIAL INTEGRATION	247
Edita Bečić Matej Lahovnik AGENCY THEORY AND FRANCHISING: A LITERATURE REVIEW	258
Dragan Mišetić Marko Tomljanović Tomislav Kandžija THE ROLE OF MANAGEMENT IN THE ACCESSION PROCESS OF B&H TO THE EU	268
Vera Boronenko Jelena Lonska WHY BUSINESS SUPPORT INSTRUMENTS ARE NOT WIDELY USED BY SMEs? CASE OF LATVIA	287
Mirko Palić Ivan Kovač Boris Sruk COOPERATIVE BUYING AS A SOURCE OF COMPETITIVE ADVANTAGE ON THE CROATIAN FMCG RETAIL MARKET	306

Hrvoje Katunar Dara Ljubić	
VALUE OF CAPITAL IN FAIR VALUE MEASUREMENT.....	314

PART V: CHALLENGES OF THE EU ENLARGEMENT

Gordana Đurović Nikola Milović	
EU ENLARGEMENT POLICY FRAMEWORK FOR THE WESTERN BALKANS: SIX “C” PRINCIPLES AND THE NEW NEGOTIATING RULES.....	325

Aleksander Aristovnik	
TECHNICAL EFFICIENCY OF PRIMARY EDUCATION: A COMPARATIVE ANALYSIS OF EU AND OECD COUNTRIES.....	339

Marino Golob Martin Golob	
EU ACCESSION OF THE REPUBLIC OF CROATIA AND ITS IMPLICATIONS ON THE CROATIAN INSURANCE MARKET.....	348

Mirko Tatalović Jasmin Bajić Srećko Šimunović	
FITTING THE FLEET AND THE SERVICE TO THE SEE MARKET DEMAND FUTURE OF SMALL EUROPEAN AIRLINES.....	356

PART VI: LA THÉORIE ET LA PRATIQUE DE L’INTÉGRATION ÉCONOMIQUE

Maria Negreponi-Delivanis	
LA FIN DE LA ZONE EURO: LE NORD DE L’EUROPE CONTRE SON SUD.....	371

Srdjan Redzepagic Jovan Zafiroski Vinko Kandžija	
LE MECHANISME DE SUPERVISION UNIQUE – LE PREMIER PAS VERS UNE UNION BANCAIRE EFFICACE.....	388

Elisabeth du Réau	
L’UNION EUROPEENNE ET LES BALKANS, ENJEUX GEOPOLITIQUES ET PROCESSUS D’ADHESION.....	400

Alain Redslob	
UNION EUROPEENNE, CAP SUR 2020. AMBITIONS ET CONTRAINTES.....	412

Mohamed Bouhezza Salah Salhi LE PARTENARIAT AVEC L'UE : CAS DE L'ALGÉRIE.....	423
--	-----

Jean-Paul Guichard LE SCENARIO DE LA FIN DES FIRMES MULTINATIONALES.....	443
--	-----

PART VII: INTEGRATION POLICIES: CASE STUDIES

Srdjan Redzepagic Xavier Richet Vinko Kandžija CATCHING-UP AND INTEGRATION IN NEW AND FUTURE EU MEMBER STATES THROUGH FDI.....	453
--	-----

Ivan Tolić Christian Panjol Tuflija Marko Tomljanović URBAN POLICIES AND POLICY OF CITY PUBLIC TRANSPORT OF THE REPUBLIC OF CROATIA IN THE LIGHT OF POTENTIAL USE OF EU FUNDS.....	473
--	-----

Heri Bezić Tomislav Galović REVEALED COMPARATIVE ADVANTAGES OF THE PHARMACEUTICAL INDUSTRY IN A GROUP OF SELECTED COUNTRIES.....	487
---	-----

Alen Host Vinko Zaninović Tina Mirkov REAL CONVERGENCE AND PERSPECTIVE OF INTEGRATION – THE ANALYSIS OF THE CROATIAN INTRA-INDUSTRY TRADE.....	504
--	-----

PART VIII: TRADE LIBERALIZATION AND REGIONAL COOPERATION

Irena Kikerkova TRADE LIBERALIZATION UNDER CEFTA 2006 – THE CHALLENGE OF ELIMINATION OF NONTRADE BARIERS.....	535
---	-----

Jiří Dušek IMPACT OF WTO MEMBERSHIP AND EU MEMBERSHIP ON FOREIGN TRADE OF THE CZECH REPUBLIC.....	548
---	-----

Michele Bertoni Bruno De Rosa Guido Grisi	MANAGERIAL CONTROL AND COST ACCOUNTING SYSTEMS IN NATIONAL HEALTH CARE SERVICES: A CASE STUDY	560
Željana Aljinović Barać Tina Vuko Tonči Vučak	EFFECTS OF WORKING CAPITAL MANAGEMENT ON PROFITABILITY: EVIDENCE FROM CROATIA	578
PART IX: WORKSHOP for Doctoral Students of Central and South-East European PhD Network (CESEENET)		
Kenan Spaho	CORPORATE SOCIAL RESPONSIBILITY, KEY FACTOR OF COMPANY SUCCESS	593
Miha Cimperman	MODELING THE PROCESS OF ELDERLY TELEMEDICINE SERVICES ACCEPTANCE	603
Dario Maradin Nina Ponikvar Ljerka Cerović	RENEWABLE ELECTRICITY IN CROATIA AND SLOVENIA FROM THE ASPECT OF THE EU ENERGY AND CLIMATE TARGETS FOR 2020	610
Tanja Fatur	THE ANALYSIS OF CAUSALITY BETWEEN GDP, CO2 EMISSIONS AND RENEWABLE ENERGY CONSUMPTION: THE CASE OF CROATIA	623
Metka Kogovšek Mojca Kogovšek	GLOBALIZATION AND HIGHER EDUCATION: A NEW PARADIGM FOR EDUCATIONAL MANAGEMENT	636
Mojca Kogovšek Metka Kogovšek	HUMAN CAPITAL AS THE SOURCE OF GREATEST COMPETITIVE ADVANTAGE IN KNOWLEDGE SOCIETY: AGEING WORKFORCE AND SKILL SHORTAGES	650

Aleksandar Zdravković	
STOCHASTIC APPROACH TO DEBT SUSTAINABILITY ANALYSIS APPLIED TO SERBIA	662

**PART X: ROUND TABLE “ABSORPTION EXPERIENCE OF SLOVENIA
AND SEE COUNTRIES”**

Alen Host	
Vladimira Ivandić	
ABSORPTION CAPACITIES FOR EU FUNDS	679

Tomislav Kandžija	
Marko Tomljanović	
CONVERGENCE INSTRUMENTS OF WESTERN BALKAN COUNTRIES	694

Margarita Shivergueva	
L’ABSORPTION DES FONDS STRUCTURELS ET LA COMPETITIVITE DE L’ECONOMIE BULGARE	713

Jamila Jaganjac	
USE OF PRE-ACCESSION FUNDS AND EXPERIENCES IN IMPLEMENTATION OF WB COUNTRIES	727

**PART XI: WORKSHOP “ABSORPTION EXPERIENCE OF CROATIA AND
WESTERN BALKAN COUNTRIES”**

Ivana Maletić	
Davor Vašiček	
Jelena Kandžija	
CROATIAN EXPERIENCE IN MANAGEMENT AND ABSORPTION OF THE EU PRE-ACCESSION FUNDS	737

Margarita Shivergueva	
L’ABSORPTION DES FONDS STRUCTURELS ET LA COMPÉTITIVITÉ DE LA ÉCONOMIE BULGARE	755

Lucica Matei	
Corina Lazar	
LA RATIONALISATION ADMINISTRATIVE ET LA PERFORMANCE ECONOMIQUE DANS CERTAINS ÉTATS DE L’EUROPE DU SUD-EST	774

Vladimira Ivandić Igor Cvečić	
EU FUNDS ABSORPTION PROBLEMS – EXPERIENCE SO FAR.....	791
Vinko Kandžija Marko Tomljanović Tomislav Kandžija	
POSSIBLE ECONOMIC EFFECTS OF EU CONVERGENCE INSTRUMENTS ON WESTERN BALKANS COUNTRIES.....	808
Jamila Jaganjac	
BOSNIA AND HERZEGOVINA EXPERIENCE IN THE PROCESS OF INTRODUCING DECENTRALIZED IMPLEMENTATION SYSTEM – FROM IPA I TO IPA II.....	821

INTRODUCTION

With the beginning of the world financial crisis in autumn 2008, the EU started to slide into increasingly complex economic, monetary, sovereign debt and formal functioning crises. What at first sight seemed just as a financial market crisis “imported” from the USA, gradually developed into a complex crisis of the EU functioning and its future. In the second part of 2012, the EU financial and economic crises are still present in their full and growing complexity. The impacts of the EU crisis brought about a strong unemployment growth in a number of EU member states. The crisis is further characterized by low, decreasing or even negative growth rates. The slow economic growth in EU is combined with the PIIGS group sovereign debt crisis. Unfortunately, the sovereign debt crisis gradually spread further to Slovenia, Cyprus and even some other EU members. The so-called core EU countries, in addition to the problems of the EU periphery, started to experience increasing economic slowdown in 2012. To the surprise of many, the general neo-liberal approach mostly focused on fast and strong reduction in national budget expenses, has not brought positive results neither within the EU core countries nor within the EU periphery. In the Netherlands, for example, the third quarter of 2012 brought a sharp drop in economic growth as well as in Germany, where it is also slowing down.

The policies and proposals to solve EU growth, employment, monetary, financial, and integration functional problems are based on strategies developed and advocated by the central EU nations, predominantly Germany, France, and Great Britain. The vision on how to handle the crises in France was partially amended after the 2012 presidential election. The neo-liberal attitude was partially replaced by more state intervention hoping to support the new economic growth. Nevertheless, towards the end of 2012, the main concept of the economic policies proposed for solving the complex EU crisis is still based on the so called neo-liberal approach.

The EU population and even the politicians, in more and more member states, are increasingly questioning the actual ability of the EU to further create and secure national welfare growth. Countries with problems of sovereign debt and unemployment and even those relatively successful EU member states are faced with an increasing number of citizens expressing their disappointment or are even rejecting the economic and employment results brought about by the functioning of the EU integration in last few years. The growing disappointment towards the EU achievements in combating the crises among the citizens of the EU presents a danger for the stability and sustainability of the EU in the future.

There are two evident levels of actions and activities necessary to change the negative trends. One level encompasses analyzing and providing explanations on the different specific aspects of the functioning of EU integration. These aspects include business development opportunities, realities of the EU internal market operation and impacts, methodologies and model implementations aimed at getting better insight into the general EU economy as well as the specific functioning of national economies and other specific questions regarding formal institutional change, enlargement or deepening of the EU. Besides such specific and important topics which should considerably help national governments and the EU to improve efficiency of their actions in dealing with the crisis, there is a second level of needed changes in improving EU and national efficiency in their coping with the crisis. This second level is related to the doctrinal approach of the EU and national attitude in terms of the level of economic action in overcoming the crisis. The available data and results of previous years show and prove that the neo-liberal doctrinal approach in solving the EU crisis was not effective. The concept is related to the supply-side economics or to the so-called Reaganomics, dating from the 1980s, when it was first implemented. The present neo-liberal approach used in EU economic practices was developed and implemented in the period when impacts of economic globalization started to be recognized. Theodor Levitt, in his famous 1983 article, was the first to point to the changes created by economic globalization. Among other, these changes included fast technological change and growing importance of innovations and productivity growth, which in addition, to the growing openness of national economies lead to an increasing and more complex competitive environment. Combining this description of economic impact created by globalization and Schumpeter's book from 1942¹, we might suggest that the neo-liberal doctrine used in the EU today is not best suited for solving current problems. Schumpeter stressed the importance of institutions, entrepreneurship, and technology as the three major engines in economic growth and success. These elements are important in the functioning of global economy and are not a part of the neo-liberal approach used in EU practice. Today, based on Schumpeter, innovation economics is being increasingly appreciated as the doctrine on which to successfully lead the economy in the globalized world.

In this monograph, we have collected papers which are important as they allow for a better understanding and eventually faster improvement and solutions to EU problems regarding both mentioned levels. The majority of articles analyze a number of very specific topics and problems related to the EU deepening and enlargement developments in the wake of the global and EU crises. A smaller number of articles is related to the issues of assessing and viewing the potentials of the mentioned new Innovation Economics doctrine as the conceptual background for coping with the different aspects of

¹ Schumpeter, Joseph; *Capitalism, Socialism, and Democracy*, New York: Harper, 1942

the EU crisis. Among these papers there are also those discussing the formal and legislative EU environment. They refer to the aspect of institutional efficiency, which is one of the cornerstones in the today's understanding of Innovation Economics.

We hope that the collected and published articles within this book will provide an insight and thus a better understanding of a number of specific developments in the EU as well as those in EU candidate and potential candidate countries. The articles will hopefully additionally help develop critical and objective attitude towards present policies used in the EU crisis. We hope that the book will stimulate development and creation of new ideas and a vision of a brighter and more economically effective future of the European Union.

**Vinko Kandžija
Andrej Kumar**

Rijeka – Ljubljana, November 2012

PART I

THEORY AND
PRACTICE OF
ECONOMIC
INTEGRATION

Mislav Jošić

University of Zagreb, Faculty of Economics and Business, Zagreb, Croatia

Hrvoje Jošić

University of Zagreb, Faculty of Economics and Business, Zagreb, Croatia

WELFARE ENHANCING CUSTOMS UNION: KEMP-WAN ISSUE

ABSTRACT

This paper ponders all aspects of Customs Union (CU) formation in order to explain welfare effects on countries involved. Viner's classical model of FTA/CU creation leaves more space for interpretation of welfare issues due to ambiguity of trade creation and trade diversion effects. An absence of tariffs in intra trade guarantees positive welfare effects for integrating countries through higher volume of trade. On the other side, trade diversion from the most efficient producer outside the CU to the less efficient producer in the CU leads to suboptimal allocation of scarce resources. Net effects are the ones that count and are the sum of trade creation and trade diversion effects. In this respect Kemp-Wan theorem is introduced as a mean of achieving Pareto improvement through free trade and lumpsum compensation scheme for all countries that form Customs Union and the world itself. According to Kemp-Wan proposition there exists common tariff vector that leads to competitive equilibrium in which each individual country is not worse off than before the customs union creation. Although theoretically feasible compensation scheme through transfers lacks political approval due to the fact that not all countries would be willing to make trade concessions without reciprocity. Special emphasis in this paper is set on accession of the Western Balkan countries to the European Union and possible consequences that may arise. Moreover, the case of Croatia is analysed as a most probable EU country member in a near future.

Keywords: *customs union, trade creation, trade diversion, Kemp-Wan theorem, lumpsum transfers*

JEL classification: *F14, F15*

1. INTRODUCTION

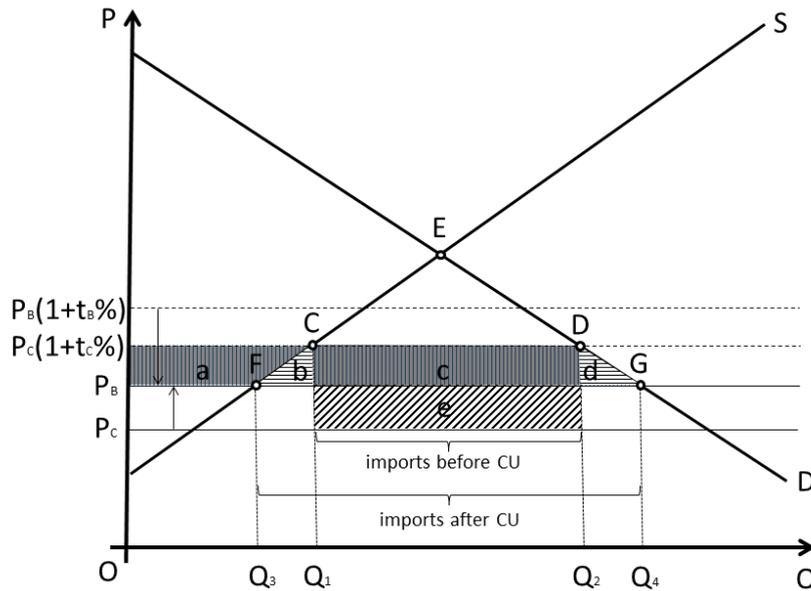
The need for country integration in one common trade area started with the research lead by Canadian economics Jacob Viner, an advocate of Chicago School of Economics. His first paper on the issue of customs union formation was published in 1950 (Viner, 1950) as a result of new trade rules incorporated in GATT in 1948. So far, tariffs were used as a common tool of protection in international trade resulting in

distortions in the goods and input markets as well. International trade theory suggests that free trade should be the first best solution for all countries involved in trade. In this respect competitive markets lead by Mr. Smith's "invisible hand" should allocate resources in a Pareto optimal way. This postulate is known as the First fundamental theorem of welfare economics and is valid only under certain assumptions. These assumptions rely on ideal conditions that aren't always met in practice.

Positive effects of trade integrations are known as trade creation effects that arise as a result of tariff nullification. Lowering tariffs to zero level in intra trade also lowers import prices of goods meeting the perfect market hypothesis. Trade creation effect displaces domestic production of goods from the less efficient to the most efficient producer of goods and thus redistributes real income from less efficient country to the most effective country according to Stolper-Samuelson theorem. Negative effect can be seen through the prism of trade diversion effects. Formation of FTA, or Customs Union specifically, diverts part of the trade from the most efficient country outside the union to the less efficient producer in the union. This diversion of outputs is merely a result of artificial change in prices through tariff nullification without any change in productivity levels or factor abundance in a country. In this way trade flows are directed by affecting the prices of tradable goods. With common external tariff rate set to the goods flow from the outside non-member countries it isn't possible to violate the rules of origins principle. In this paper we ponder on all aspects of trade policy resulting in welfare changes caused by trade shifting.

How can one nation be left unharmed if all others experience improvement in national welfare due to trade creation effects seriously reconsiders the Second fundamental theorem of welfare economics. Is it really possible to make one better off without someone being worse off? In order to solve this dilemma compensation scheme can be introduced by enacting lump-sum transfers to those countries with net welfare losses from customs union formation. The work of Murray Kemp and Henry Wan (1976) in the area of compensation might give us a solution to the welfare redistribution problem. In the following text static analysis will be provided through Viner's general equilibrium model of customs union formation. Let us assume there are two countries (A and B) involved in customs union formation where the third one (country C) is partner country outside the CU with the lowest price of production. Eliminating tariff barriers between country A and country B leads to trade creating and trade diversion effects graphically shown in Figure 1.

Figure 1: Viner's model of customs union formation



Source: Authors

Country A is importing \overline{CD} amount of goods at the price $P_c(1+t_c\%)$ from Country C which is the most efficient producer of the same good. With existing tariffs government collects budget revenues shaded by rectangle c . If Country A and Country B form a customs union tariffs are levied and intra trade is increased to the extent that imports equal \overline{FG} . These imports now come from Country B that has higher costs of production but lower price which is perplexing and paradoxical at the same time. This increase in volume of trade is called *trade creating effect* which substantially increases consumer's surplus, decreases producer's surplus and nullifies government revenues. Net effect represents welfare gains shown as shaded triangles b and d that are known as Harberger's triangles. Along with positive effects there are some concerns regarding the trade flows that are diverted from the most efficient producer outside the union to the less efficient producer in the union, i.e. from Country C to Country B. Rectangle e represents *trade diversion effects* that is interpreted as a loss of national welfare due to suboptimal reallocation of production inputs. According to Jacob Viner customs union has positive effect on national welfare as long as trade creating effects dominate trade diversion effects. Because all member countries of customs union share common tariffs to the outside countries, it is possible for some members to have higher efficiency losses than gains. In order to maintain the same level of welfare for integrating countries some kind of compensation mechanism is needed to improve disequilibrium situation. The solution to this problem is formulated by Murray Kemp and Henry Wan.

According to Kemp and Wan (1976) it is always possible to have Pareto improvement for individual countries in integration that will not negatively affect outside countries. Full compensation scheme generates implicit costs that are to be calculated in net effects of customs union formation.

2. KEMP-WAN POSTULATE

The Kemp-Wan proposition is independent on a number of countries involved, their size or development levels and as such is very useful in the analysis of customs union formation.. The Kemp-Wan proposition (Kemp, Wan, 1976) states: *“Consider any competitive world trading equilibrium, with any number of countries and commodities, and with no restrictions whatever on the tariffs and other commodity taxes of individual countries, and with costs of transport fully recognized. Now let any subset of the countries form a customs union. Then there exists a common tariff vector and a system of lump-sum compensatory payments, involving only members of the union, such that there is an associated tariff-ridden competitive equilibrium in which each individual, whether a member of the union or not, is not worse off than before the formation of the union.”*

If we assume there are n countries in the world willing to form a customs union then there is a finite number of steps possible to differentiate any welfare change between these steps. Every step leads to a new, enlarged customs union where no country is worse off than before its creation. The last step leads to the world that is one large customs union and no outsiders aside that could generate welfare losses in terms of trade diversion effects. The formal proof of Kemp-Wan theorem is based on a second fundamental theorem of welfare economics analysed in details by Debreu (1959). The pioneering work by Jacob Viner in 1950 was highly contributed by Lipsey (1957) with the introduction of Second Best Solution (SBS) in customs union creation. Lipsey assumed that there's always a unique solution which is not always Pareto optimal but can be Pareto improving. Dixit and Norman (1980) extend the analysis by showing that Pareto improvement in Kemp-Wan model can be made without the use of lump-sum compensation. Furthermore, they suggest taxes on intra trade of goods and use of subsidies. Panagariya and Krishna (2002) gave their contribution to the analysis of Kemp-Wan theorem by applying it to FTA creation. If any number of countries freeze their tariffs to the rest of the world countries along with lump-sum transfers and correct use of rules of origin it is indeed possible to have Pareto improvement.

3. IMPLICATIONS OF WESTERN BALKAN COUNTRIES ACCESSION TO THE EU

Is the Kemp-Wan applicable in practice and how it should be used properly is the key question of this paper. Will Western Balkan countries benefit from customs union creation while leaving CEFTA is also a legitimate question. Some of the raised issues of Kemp-Wan proposition are the direct result of failure to communicate the following problems:

- How do we decide who will be our trading partners?

- The lack of political agreement to compensate on countries that do not experience Pareto improvement in customs union creation.
- The complexity of tariff structures when choosing a common external tariff.
- Implicit costs associated to compensation and the need of financing them.

Current research in the area of trade creation and trade diversion effects associated with Western Balkan countries is mostly based on gravity model approach along with the use of factor proportion model. Current EU27 member countries differ among themselves in terms of relative factor abundance. Most of the new acceding countries are relatively abundant in labour which makes them attractive for labour intensive production with labour as a relatively cheaper factor of production. The structure of trade is also based on differences in relative abundance according to Heckscher-Ohlin's neoclassical model of trade.

In the last enlargement step Bulgaria and Romania joined European Union in 2007 while simultaneously leaving CEFTA that is mostly constituted of Western Balkan countries (Croatia, Macedonia, Albania, Bosnia and Herzegovina, Montenegro, Serbia and Kosovo). Western Balkans enlargement issue was recognized at the European Council summit in Thessaloniki in 2003 where potential problems and probable solutions were identified. All Western Balkan countries had to sign Stabilisation and Association Agreement (SAA) before starting the negotiation process. Current EU enlargement process is focused on Croatia that is to enter European Union on 1st of July, 2013. As of today the following Western Balkan countries are recognized as official candidates: Iceland, Macedonia, Montenegro, Serbia and Turkey while Albania, Bosnia and Herzegovina and Kosovo remain potential candidates.

Bulgaria and Romania, two subsequent countries that joined EU on 1st of January, 2007 were forced to leave CEFTA changing their position in the integration from free trade area (CEFTA) to customs union (EU). Expected trade flows according to Viner's static model of CU formation should reflect in both trade creation and trade diversion effects. On contrary, empirical findings for Bulgaria and Romania do not corroborate theory which is shown in the tables below.

Table 1: Trade creation and trade diversion effects in Bulgaria (2007-2012)

Partner country	2007 imports in bn EUR	2012 imports in bn EUR	2012/2007 change
CEFTA	1,6	2,3	43,7%
EU27	12,9	14,9	16,7%
World	21,9	24,3	11,3%
Total share in World imports			
CEFTA	7,2%	9,3%	
EU27	58,5%	61,3%	
Rest of the World	34,4%	29,4%	

Source: Eurostat

Table 2: Trade creation and trade diversion effects in Romania (2007-2012)

Partner country	2007 imports in bn EUR	2012 imports in bn EUR	2012/2007 change
CEFTA	1,2	2,3	99,5%
EU27	36,6	40,1	9,6%
World	51,3	51,7	0,8%
Total share in World imports			
CEFTA	5,3%	9,5%	
EU27	71,3%	77,5%	
Rest of the World	23,4%	13,0%	

Source: Eurostat

According to data gathered from Eurostat both countries have experienced an increase in total imports in selected period. Bulgaria increased its imports from EU27 member countries by 16.7% as a result of liberalised trade regime and zero intra trade tariffs. This effect is the direct result of trade creation effect. The same country didn't experience trade diversion effect from CEFTA countries as expected, but from the rest of the world¹ countries instead. Thus, net effect in Bulgaria is strictly positive due to an absence of trade diversion effect. The same conclusion can be made for Romania. Romania increased its imports from both EU27 and CEFTA countries increasing the total imports share from 76.6% to 87.0% consequently leading to trade diversion effects only from the rest of the world countries. In the case of these two countries Kemp-Wan compensation scheme is nonessential and customs union formation results only in positive welfare changes for acceding countries.

Today's EU trade policy is based on WTO principles of multilateralism and nondiscrimination in international trade. All members of WTO (EU members included) have agreed to lower their tariff barriers against other trading partners in order to achieve higher volume of trade, and consequently higher national welfare. EU currently stands for world's first exporter accounting for 15.5% of world trade in goods and is ranked first as the FDI recipient with €241.7 bn inflow of funds (EC, 2013). Regional trade agreements made with rest of the world FTAs and persistent EU enlargement process lead to trade creation effects while some of the trade is diverted due to common external tariff imposed on imports outside the EU. The possibility of compensating welfare losses in Kemp-Wan context is not considered in the official EU trade policy nor is it being implemented in the world trade system through WTO rounds of negotiations.

4. CONCLUSION

World trade order governed by WTO insists on lifting trade barriers and replacing the existing ones with tariffs. The final result in this process would be a creation of one large customs union where there will be no preferential treatment in trade nor there will

¹ Excluding EU27 and CEFTA member countries

be discrimination against others. Today's world trade trends reflect in FTA creation where multilateral agreements overlap. This "spaghetti bowl" results in distortion effects where different tariff rates apply to outside countries. Customs union as a more advanced type of economic integration goes further with introducing common external tariff vector. Positive welfare gains known as trade creation effects are usually complemented with trade diversion effects. Part of the trade is diverted from the most efficient producer of the good outside the union to the less efficient producer of the same homogeneous output inside the union. This leads to suboptimal allocation of scarce resources and unwanted loss of national welfare. Lumpsum transfers and appropriate compensation scheme used to compensate losing countries is in the heart of Kemp-Wan proposition. A possibility to compensate country with negative net gains from customs union formation is always a challenge. According to Kemp and Wan it is always possible to have Pareto improvement for individual countries in integration that will not negatively affect outside countries. Forming economic integrations doesn't necessarily result in negative net gains in practice. Empirical findings that exhibit only trade creation effects make Kemp-Wan suggestions inapplicable and impractical. The case of Western Balkans countries questions static effects of Viner's model and opens up space for further investigation in the area of international trade.

REFERENCES

- Debreu, G. (1959) "*Theory of Value*", Wiley, New York.
- Dixit, A. and Norman, V. (1980) "*Theory of international trade: A dual, general equilibrium approach*", Cambridge University Press.
- European Commission (2013) *The European Union Trade Policy* [online]. Available at: http://trade.ec.europa.eu/doclib/docs/2011/august/tradoc_148181.pdf [04/10/2013].
- Eurostat (2013) *International Trade Statistics* [online]. Available at: http://epp.eurostat.ec.europa.eu/portal/page/portal/international_trade/data/database [04/10/2013].
- Kemp, M. C. and Wan, H. Jr. (1976) "*An Elementary Proposition Concerning the Formation of Customs Unions*", *Journal of International Economics* 6, (February), pp. 95-97.
- Lipsey, R. G. (1957) "*The theory of customs unions: trade diversion and welfare*", *Economica* 24 (93): pp. 40-46.
- Panagariya, A. and Krishna, P. (2002) "*On necessarily welfare-enhancing free trade areas*", *Journal of International Economics*, Elsevier, vol. 57 (2), pp. 353. – 367.
- Viner, J. (1950) "*The Customs Union Issue*", New York: Carnegie Endowment for International Peace.

Nina Ponikvar

University of Ljubljana, Faculty of Economics, Ljubljana, Slovenia

Katja Zajc Kežar

University of Ljubljana, Faculty of Economics, Ljubljana, Slovenia

Barbara Mörec

University of Ljubljana, Faculty of Economics, Ljubljana, Slovenia

FINANCIAL CRISIS AND FINANCIAL CONSTRAINTS OF THE FIRMS: THE ROLE OF FIRM-SPECIFIC AND INDUSTRY-SPECIFIC FACTORS

ABSTRACT

Based on the data from the financial statements for the population of Slovenian firms in the period 2006-2011 this paper analyses the determinants of the firms' financial constraints in the wake of the financial crisis. The results on standard FC determinants are in line with theoretical predictions and previous empirical findings. Accordingly, firm size, ownership, productivity, export orientation are factors that impact firm's financial situation. Exporters are on average 2.9 percentage points less likely to become highly financially constrained compared to non-exporters and public firms turn out to be around 3 percentage points less likely to become financially challenged compared to private firms. Firm size and labour productivity positively affect firm's financial health. Financial constraints of Slovenian firms have significantly increased during financial crisis, i.e. from 2009 onwards but differently across industries.

Keywords: financial constraints, industry factors, firm characteristics, economic crisis

JEL classification: G32, L25, C23, C25

1. INTRODUCTION

In the recent decades it has been recognised in the empirical literature that firm finance carry important implications for firm performance either in terms of firm growth, profitability or even firm survival. During the recent financial crisis, firms in general have been reporting acute problems of access to finance. On the one hand, the deteriorated profitability of firms resulting from the economic crisis has led to decrease in availability of the internal financial sources while tightened credit standards on loans to non-financial corporations reduces accessibility of external funds. Because access to finance is widely perceived as a crucial factor for firms to maintain their day-to-day business as well to achieve growth in the long run, the worsened accessibility of financial sources may pose a major threat to the economy as a whole.

Based on the data from the financial statements for the population of Slovenian firms in the period 2006-2011 this paper analyses how the financial crisis affected the financial constraints of the manufacturing and service firms. More specifically, we investigate (i) the firm characteristics that affect financial constraints of Slovenian manufacturing and service sector firms, (ii) industries in which the financial constraints are most severe, and (iii) how the recent financial crisis changed the average financial constraints of Slovenian firms. Namely, theoretical and empirical literature shows a strong link between financial constraints and firms age and size (Kumar and Francisco, 2005; Artola and Genre, 2011; Hutchinson and Xavier, 2006), its presence on foreign markets (Silva, 2011 and Wagner, 2012) and industrial environment (Arteta and Hale, 2008).

We measure firms' financial health according to the methodology first proposed by Musso and Schiavo (2008) and extended by Bellone et al (2010). We construct a synthetic index from seven different variables that carry important information relative to the existence of financial constraints to the firm. They are (i) firm size, (ii) profitability, (iii) liquidity, (iv) cash-flow generating ability (v) firm solvency, (vi) trade credit over total assets, and (vii) debt repaying ability. Such a measure of firm's financial health is time-varying and continuous; it acknowledges the multiple features of financial constraints and captures different degrees of financial constraints (Silva, 2011). In order to identify the factors determining the financial health of firms from the manufacturing and service sector in Slovenia, we estimate the firm-level financial constraints model using a panel data econometric model which is applied to the dataset that covers the whole population of firms registered in Slovenia. We apply the panel data fixed effects estimator as well as ordered probit model.

2. FINANCIAL CONSTRAINTS AND ITS DETERMINANTS

2.1. Theoretical framework

In the neoclassical financial theoretical framework, complete information is available to all participants in the perfect capital markets, all firms have equal access to capital markets, any desired investment project can be financed and the firms' responses to changes in the cost of capital or tax-based investment incentives differ only due to differences in investment demand. In such circumstances, a firm's ability to obtain financial funds, firm's growth and its investment decisions are independent of its current financial condition such as internal liquidity, indebtedness or dividend payments (Hall and Jorgenson, 1967; Modigliani and Miller, 1958). In the real world, however, the access to financial markets is not the universal and equal for all firms, since firms face uncertain prospects and operate in imperfect or incomplete capital markets, where internal funds bring a cost advantage over external funds, with the latter also being called a 'financing hierarchy' (Fazzari, Hubbard and Petersen, 1988). The body of literature investigating the existence and the determinants of financing constraints is already very large and based on different theoretical considerations: transaction costs, the asymmetry of information, the agency problem, the cost of financial distress, the tax effects, and the pecking order theory.

One of the oldest and perhaps most obvious explanations of the financing hierarchy is based on the transaction costs of issuing debt and/or equity. These costs include compensation for the dealer placing the issue, registration fees, legal, accounting printing costs, taxes (Oliner and Rudebusch, 1992). Additionally, the accessibility of external funds is conditioned on revealing firm's strategic orientation by proposing investment projects to external financial sources (Sawyer, 1981). However, empirical tests show that transaction costs in their narrow meaning, including only dealer provisions, fees, physical costs and taxes, usually do not explain the hierarchy of finance (Oliner and Rudebusch, 1992).

The most popular explanation of financing hierarchy stresses the information problems in capital markets. The fundamental insight comes from Akerlof's (1970) analysis of the 'lemons' problem. The focus is on the potential asymmetry of information between the firm's managers and outside suppliers of finance about the quality of the firm's investment project and the behaviour of its managers. When the management has information about a project's returns but the investors do not have relevant knowledge about the competence of the managerial team and the true project's profitability, the investors (debt or/and equity providers) cannot distinguish between good and bad projects (adverse selection). They evaluate every project by some average project outcome (Oliner and Rudebusch, 1992). The cost of financing such projects with external funds exceeds that of financing with internal funds because of this asymmetry of information. The difference in the costs of internal and external financing, caused by such asymmetric information, represents the 'lemons premium' (Akerlof, 1970). Empirical studies give strong evidence of information asymmetries being an important source of the financing hierarchy (e.g. Athey and Reeser, 2000; Oliner and Rudebusch, 1992).

With asymmetric information, the firm's owners, represented by managers also have some scope to pursue their own interests at the expense of the firm's other stakeholders, especially debt holders. As shown in Jensen and Meckling (1976), the agency problems that arise from these conflicts of interest can boost the cost of obtaining external finance. The greater the debt-equity ratio, the more managers' incentives may diverge from the interests of the creditors. To protect themselves, creditors usually demand covenants that restrict management behaviour in various ways. These restrictions and the monitoring required for enforcement constitute the agency costs of debt. Keynes (1936) analysed a similar phenomenon, which he called the 'lender's risk'. As investments increase, holding the firm's internal financial resources fixed, the debt leverage will rise and lenders will require a higher interest rate to compensate for the increasing risk of default. As a result, the cost of new debt and equity may differ substantially from the opportunity (implicit) cost of internal finance generated through the cash flow and retained earnings (Fazzari, Hubbard and Petersen, 1988). The rationing of lending caused by informational asymmetry is also confirmed in empirical studies such as those by Bond and Meghir (1994), Levine (1997) and Van Ees et al. (1997).

In the trade-off model between potential bankruptcy costs and agency costs Fama and French (2002) incorporated tax effect on debt-equity ratio, first introduced by Miller (1977) and later upgraded by De Angelo and Masulis (1980). They concluded taxes

can have offsetting effects on capital structure decisions. On one hand unlike dividend payments interest payments are tax deductible and consequently corporate income tax encourages debt financing. At the same time various tax allowances and loss carry forwards reduces the advantage of indebtedness. If investors (equity or debt holders) are simultaneously subject to personal income tax, which frequently taxes interest more heavily than capital gains, firms would be more inclined towards capital issue. Firm's optimal capital structure is therefore dependent on firm-specific circumstances and tax provisions applicable to the investors.

Finally, pecking order theory (established by Myers and Majluf, 1984) integrates transaction costs theory and the asymmetry of information model to explain the firms' financing hierarchy. Namely, firms rank various financing sources by their cost, generated for various reasons already described by both theories. Commonly, firms' capital structure follow pecking order theory if they rather use internal than external financing and – in case they use external financing – they rather use debt than equity financing. However, there is an alternative definition of pecking order theory which builds on behaviour finance theory. So Petersen and Schulman (1987, in Hussain, Millman & Matlay, 2006) claim owners of small firms, who are at the same time managers, would rather omit profitable investment than to release the control of the firm.

Thus in the circumstances of imperfect information and uncertainty the importance of the internal earnings for financing investments derives not only from the limited attainability or high costs of the external finance due to the lender's risk, but also from the alleviation of the possible negative outcome of investing and thus a smaller borrower's risk and – in case of SMEs – the propensity of owners/managers towards creditors. Because investing is connected to risk, internal financial sources can alleviate the consequences of unexpected unfavourable results of investment activity.

2.2. Determinants of financial constraints

Since the late 1980s, a large number of empirical studies have addressed the issue of financial constraints, mainly in order to study the relation between firm investment and the availability of internal funds. Indeed, large and convincing evidence exists showing that, when a standard investment equation is augmented with cash flow availability, the fit of the equation improves (Musso and Schiavo, 2008). Theory and empirical evidence suggest that credit constraints are tighter for those firms expected to face relatively severe asymmetries of information. These firms are also the ones that depend more on the availability of internal funds. Firms which suffer less from asymmetric information and are thus more creditworthy rely less on internal funds to finance their investments (Fazzari, Hubbard and Petersen, 1988; Oliner and Rudebusch, 1992; Natke, 1999).

In practise, the asymmetry of information is a consequence of the behaviour of banks and financial institutions which are much more reluctant to finance firms for which they do not have sufficient information on their disposal. These firms are usually developing, young and small firms that are almost without performance history. On the other hand, well-established larger firms have already demonstrated their ability to run

successful projects and to make a profit. It is therefore easier and cheaper for large firms than for small firms to raise external funds, thus lowering the need for retained earnings to finance investment (Scherer and Ross, 1990). Further, very large, well-known firms are often considered to be less influenced by asymmetric information effect because they typically have greater experience in the capital market, can credibly enter long-term relationships and offer a lower average cost of obtaining required information (Athey and Reeser, 2000). The importance of size and age as a determinant of financial constraints is established also in Bougheas et al. (2006), using UK manufacturing firms from 1989 to 1999, Colluzi et al. (2009) and Canton et al. (2010) for EU firms in 2006. These authors all found that being young or small increases significantly the probability of facing financing obstacles and older firms perceive external financing as being less difficult. Based on the data collected during the recent economic crisis, Artola and Genre (2011) find that in the EU, firms who really experienced a credit crunch tended to be small and young, confirming the fact that SMEs tend to suffer more when credit standards are tightened.

Furthermore, financial constraint could be influenced by firm's ownership structure. There is no unanimous view whether ownership structure improve or hinder firm's ability to obtain external financing. Artola and Genre (2011) claim that state ownership reduces firm's value due to repeated politicians' interference and consequently imposes additional costs to external financing. On the other hand Blanchard and Shleifer (2000) claim state ownership reduce financial constraints due to preferential treatment by other market participants, e.g. banks.

The importance of internal financial funds also differs across industries. Worthington (1995) reported that the importance of internal financial funds for investment spending is greater for durable goods industries than for non-durable goods industries and, second, that the cash flow's effect is significantly larger in industries with high sunk costs than in those with low sunk costs. The latter could suggest that the availability of external finance is less important when the assets being financed are highly specific or are sunk and are thus less likely to be financed by a source external to the firm.

Exporting status is another firm characteristic that is arguably related to financial health of a firm. While there is strong empirical support for positive relationship observed between firms' financial health and their export status (e.g. Campa and Shaver, 2002; Guariglia and Mateut, 2010), the direction of causality is not that a clear-cut. On one hand, Greenaway, Guariglia and Kneller (2007) find that export participation improves firm's ex-post financial health; at least in case of continuous exporters while fail to confirm, similarly as Stiebale (2011) that firms enjoying better ex-ante financial health are more likely to start exporting. Several reasons for lower financial constraints of exporters are listed in the literature (e.g. in Campa and Shaver, 2002; Greenaway, et.al, 2007). Firstly, exporters are in a superior position to diversify their sources of financing and the associated risks since they have access to both internal and international financial markets. Secondly, the fact that a firm is an exporter also provides a signal that the firm is sufficiently productive to generate enough profits in foreign markets to recover the sunk costs, which in turn increases the likelihood that the firm will be able to service its external debt, and further relaxes the liquidity constraints that it faces. Finally, exporting firms are less tied to the domestic cycles, and less subject to those

financial constraints induced by tight monetary policy and recessions in their home country.

On the contrary, Bellone et.al (2011) provide evidence in favour of self-selecting of financially healthier firms into exporting. They find that firms starting to export display a significant *ex-ante* financial advantage compared to their non-exporting counterparts. Such result is in line with Chaney's (2005) theoretical prediction that limited access to external financial funds may prevent some firms that could otherwise profitably enter foreign markets from selling their products abroad. As stressed by Greenaway, et.al (2007) since starting of exporting involves an initial fixed investment, export market participation decisions are likely to be affected by financial variables in the same manner as investment in fixed capital. However, credit constraints seem to be more important in determining the extensive margin of trade in terms of number of newly served destinations than for intensive margin of trade (Muûls, 2008; Askenazy et.al, 2011).

2.3. Measurement of financial constraints

Although theory is relatively straightforward when it comes to their definition, financial constraints are not directly observable in practise. Consequently different measures are applied as proxies. On the one hand, several microeconomic studies use survey data, where firms and individuals provide their perception on financial constraints (e.g. Artola and Genre, 2011, Kumar and Francisco, 2005, overview in Musso and Schiavo, 2008) and are thus based on self-assessment together with all its disadvantages. The other empirical approach to detect financial constraints is based on segmentation of firms into groups based on one or more different criteria, such as dividend policy, size, age, and membership in a group of conglomerate, existence of bond rating or concentration of ownership (see Musso and Schiavo, 2008, for a comprehensive review of these studies). One of the main weaknesses of these studies is first its time invariance, second, when dividend policy is concerned, the analysis is restricted to quoted firms, which are usually also larger and more mature.

In defining financial constraints we follow the methodology first proposed by Musso and Schiavo (2008) and extended by Bellone et.al (2010), who constructed a synthetic index from seven dimensions of financial status of the firm, i.e. firm size, its profitability, liquidity, cash flow generating ability, firm's solvency, share of trade credit, and ability of repaying debt. Such a measure of firm's financial health acknowledges multiple features of financial constraints and captures different degrees of financial constraints (Silva, 2011).

3. DATA AND METHODOLOGY

3.1. Data and descriptive statistics

Our data source is the database of Slovenian firms' financial statements collected by the Agency of the Republic of Slovenia for Public Legal Records and Related Services (APLR). The database covers the whole population of firms registered in Slovenia

since reporting financial statements' data is obligatory for all business entities registered in Slovenia. Our analysis is based on the financial statements of Slovenian firms in the 2006-2011 period and includes 313,537 observations for 71,771 different firms.

Table 1: Firms by economic sectors in Slovenia in the 2008-2011 period

NACE	Economic sector	2008		2011		Index 11/08
		No.	%	No.	%	
A	Agriculture, forestry and fishing	356	0.68	372	0.64	104.5
B	Mining and quarrying	66	0.13	72	0.12	109.1
C	Manufacturing	6,676	12.84	7,033	12.17	105.3
D	Electricity, gas, steam and air conditioning supply	206	0.40	531	0.92	257.8
E	Water supply, sewerage, waste management and remediation activities	260	0.50	314	0.54	120.8
F	Construction	6,746	12.97	6,943	12.01	102.9
G	Wholesale and retail trade, repair of motor vehicles and motorcycles	13,456	25.88	14,263	24.68	106.0
H	Transportation and storage	2,253	4.33	2,643	4.57	117.3
I	Accommodation and food service activities	2,318	4.46	2,641	4.57	113.9
J	Information and communication	2,571	4.94	3,157	5.46	122.8
K	Financial and insurance activities	1,044	2.01	1,182	2.05	113.2
L	Real estate activities	1,725	3.32	1,891	3.27	109.6
M	Professional, scientific and technical activities	10,183	19.58	11,866	20.53	116.5
N	Administrative and support service activities	1,456	2.80	1,756	3.04	120.6
O-U	Other sectors	2,681	5.16	3,134	5.42	116.9
A-U	Total	51,997	100.0	57,798	100.0	111.2

Source: APLR and own calculations

Table 1 shows the structure of the analysed dataset according to the NACE classification of industries. In the 2008-2011 period, the number of firms in Slovenia increased by 11 percent. Economic sectors, in which the number of firms increased by more, include activities related to energy, water and waste management, transport, tourism, information and communication services, financial, insurance and real estate activities, professional, scientific, technical, administrative and support service activities.

Table 2 shows the size structure of the Slovenian economy. While the number of micro and small firms increased throughout the investigated period, number of large firms decreased for almost 8 percent. Number of medium sized firms remained almost unaltered.

Table 2: Firms by size in Slovenia in the period 2006-2011

Firm size	2006		2008		2011		Index 11/08	Index 11/06
	No.	%	No.	%	No.	%		
Micro	42,046	92.76	48,070	92.45	53,966	93.37	112.3	128.3
Small	1,784	3.94	2,390	4.60	2,397	4.15	100.3	134.4
Medium	745	1.64	763	1.47	740	1.28	97.0	99.3
Large	755	1.67	774	1.49	695	1.20	89.8	92.1
Total	45,330	100	51,997	100	57,798	100	111.2	127.5

Source: APLR and own calculations

Table 3: Ownership and export orientation of firms in the dataset

	No. of foreign firms*	Foreign firms in %	No. of state firms	State owned firms in %	Exports in total sales in %	Value added per employee in EUR
2006	4,452	9.82	450	0.99	9.1	32,098
2007	5,324	10.91	401	0.82	9.4	33,949
2008	5,937	11.41	394	0.76	9.6	32,705
2009	5,965	11.06	379	0.7	9.7	34,625
2010	6,051	10.85	366	0.66	9.9	32,955
2011	6,241	10.79	366	0.63	10.8	33,382
Index 11/06	140.2	109.9	81.3	63.6	118.7	104.0

Note: * 10 percentage foreign ownership threshold is considered

Source: APLR and own calculations

During the analysed period the number of firms with foreign ownership increased for 40 percent and their share among firms in Slovenia increased by 1 percentage point. At the same time the number of firms with state ownership decreased by almost 20 percent, while the average export orientation of Slovenian firms increased by almost 19 percent. However, the value added per employee in 2011 increased by only 4 percent relative to 2006, although in 2009, when it reached highest level in this period, it was almost 8 percent higher compared to the level of 2006.

3.2. Models specification and methodology

The specification of the empirical model for the analysis of factors that determine financial constraints of a particular firm follows theory and empirical findings discussed above. Our model's specification is thus:

$$FCindex_{ijt} = \beta_0 + \sum \beta_{1,ij} dsize + \beta_2 \ln Productivity_{ijt-1} + \beta_3 EXor_{ijt-1} + \beta_4 fdi_{ijt-1} + \beta_5 public_{ijt-1} + \sum \beta_{6,j} dindustry_j + \sum \beta_{7,t} dyear_t + u_{it} \quad (1)$$

where subscripts i , j and t refer to firms, industries and years, respectively. In variable names denotes that the variable enters the equation in its natural logarithm form. Following methodology proposed by Musso and Schiavo (2008), the dependent variable is a synthetic index of financial constraints (*FCindex*), constructed from seven different variables: (i) firm size, measured in terms of total assets, (ii) profitability in terms of return on total assets, (iii) liquidity as a ratio between current assets and current liabilities, (iv) cash flow generating ability in terms of a maximum amount of resources that a firm can devote to self-financing, corresponding to the sum of profits and depreciation, (v) firm solvency as own funds over total liabilities, measuring the ability by a firm to meet its long-term financial obligations, (vi) trade credit over total assets, and (vii) repaying ability, measured in terms of financial debt over cash flow. For each of the seven dimensions, a firm/year observation is placed in one of the quintiles of the firm distribution. Hence, each firm/year observation ends up with seven scores ranging from one to five. We use a simple sum of these seven scores to get a synthetic index of financial constraints, where smaller value of the index is related to financially more constrained firms. Musso and Schiavo (2008) use also other ways of combining seven scores and report the index of financial constraints to be very robust to the different ways to aggregate the information from the seven scores. u_{it} is composed of $u_{it} = \mu_i + v_{it}$, where μ_i is an unobserved individual-specific time-invariant effect which allows for heterogeneity in the means of the growth across individual firms and v_{it} is a disturbance term.

Among the most important firm characteristics that affect firm's financial constraints the theories postulate firm's size and age. In our model, we test for two different measures of firm size. First, firms are grouped into four size categories (*dsize*: micro, small, medium and large) based on three criteria average number of employees, sales revenues and the value of assets in line with European Commission's recommendations concerning the definition of micro, small and medium-sized enterprises. Second, firm size is measured based on the number of employees (L). Due to the limitations of the applied dataset, we are not able to include age in the model specification. Firm productivity (*Productivity*) is defined in terms of value added per employee. The impact of firm ownership on its financial constraints is analysed by inclusion of two dummy variables; one for foreign firms (*fdi*), where 10 percent threshold of foreign ownership is considered, and one for public ownership (*public*). To test whether exporting affects financial constraints of firms, we include export orientation (*EXor*) or dummy variable for selling in foreign markets (*exporter*). To avoid likely endogeneity issue, firm-specific variables enter the model specification in a one year lag form. Time-specific individual-invariant effect is captured with the set of time dummies among regressors, while the time-invariant effect of industry is captured by set of industry dummy variables. Industry membership is defined based on 2-digit NACE Rev. 2 classification of industries.

Since financial health of a firm is measured by a composed index, it is relatively hard to interpret the magnitude of estimated impact of various firm -, industry- and time-

specific determinants on financial health of a firm. To facilitate the more comprehensive interpretation of our results we form three broad categories. We base the categorisation on $FCindex$ and obtain three clearly ordered groups of firms ($FCgroup$) according to the severeness of their financial constraints. A firm is classified into group of “non-constrained firms” ($FCgroup=1$) if the value of its $FCindex$ is equal to or higher than 28, moderately constrained firms ($FCgroup=2$) in case of $FCindex$ between 14 and 28 and highly constrained firms ($FCgroup=3$) with $FCindex$ less than 14. We use $FCgroup$ variable as the dependent variable in an ordered probit model of firm’s financial constraints which we deem more appropriate than a linear regression model. Namely, in a linear regression a firm with $FCgroup$ of 2 would be considered twice as financially constrained as one with $FCgroup=1$, whereas in the ordered probit model no such presumption of cardinality is made; $FCgroup = 2$ simply indicates higher financial constraints than $FCgroup = 1$.

Following Greene (2003), the basic notion underlying the ordered probit model is the existence of a latent continuous variable, FC^* , ranging from $-\infty$ to $+\infty$ and indicating the degree of financial constraints of a firm. This latent variable is related to a set of explanatory variables as specified in (1). We cannot observe FC^* variable, but what we do observe is $FCgroup$ which is related to FC^* in the following way:

$$\begin{aligned} FCgroup=1 & \text{ if } FC^* \leq \mu_1, \\ FCgroup=2 & \text{ if } \mu_1 < FC^* \leq \mu_2, \\ FCgroup=3 & \text{ if } \mu_2 < FC^*, \end{aligned} \quad (2)$$

where μ_i are unobserved thresholds defining the boundary between the different levels of FC^* . With the normal distribution we obtain the following probabilities:

$$\begin{aligned} \text{Prob}(FCgroup = 1) &= \Phi(\mu_1 - \beta'x) \\ \text{Prob}(FCgroup = 2) &= \Phi(\mu_2 - \beta'x) - \Phi(\mu_1 - \beta'x) \\ \text{Prob}(FCgroup = 3) &= 1 - \Phi(\mu_2 - \beta'x). \end{aligned} \quad (3)$$

The value of the threshold μ is estimated as additional parameter of the model. Estimates are obtained by maximum likelihood.

4. RESULTS

In table 4 we first report the results of the standard panel model estimation of (1). According to the results of Hausman test, we report only fixed effects model results.

Results of the fixed effect estimation confirm that firm size and labour productivity are in general positively related to the degree of firm’s financial health. Yet, small firms are not significantly different in terms of their financial constraints compared to the group of micro firms, while medium and large firms exhibit similar difference compared to the benchmark group of micro firms. We fail to find significant impact of foreign and public ownership variables on financial constraints in fixed effects specification.

Table 4: Fixed effects estimation of firms' financial constraints model

<i>Dependent variable</i>		
FCindex	Coef.	Std. Err
<i>Size dummies</i>		
small	0.125	(0.0926)
medium	0.415**	(0.178)
large	0.447*	(0.238)
lnProductivity(-1)	0.217***	(0.0178)
fdi(-1)	-0.0572	(0.139)
public	0.479	(0.294)
EXor(-1)	0.216**	(0.102)
<i>Year dummies</i>		
2008	-0.0744	(0.0593)
2009	-0.390***	(0.0593)
2010	-0.494***	(0.0593)
2011	-0.590***	(0.0595)
Constant	20.46***	(0.424)
<i>Industry dummies</i>	INCLUDED	
financially constrained (sign. negative industry effect)	<i>Forestry and logging, Manufacture of wood and of products of wood and cork, except furniture, Accommodation, Creative, arts and entertainment activities</i>	
financially unconstrained (sign. positive industry effect)	<i>Mining of metal ores, Wholesale and retail trade and repair of motor vehicles and motorcycles, Legal and accounting activities, Human health activities, Activities of membership organisations</i>	
N	162,283	
Number of firms	44,418	
R-squared	0.0640	
F test that all $u_i=0$	F(44417, 117769) = 4.76***	(0.000)
Hausman test	chi2(96) = 8247.61	Prob>chi2 = 0.0000

Results of the fixed effect estimation confirm that firm size and labour productivity are in general positively related to the degree of firm's financial health. Yet, small firms are not significantly different in terms of their financial constraints compared to the group of micro firms, while medium and large firms exhibit similar advantage compared to the benchmark group of micro firms. We fail to find significant impact of foreign and public ownership variables on financial constraints in fixed effects specification. However, when firms are grouped into three classes according to the severeness of their financial constraints, publicly owned firms turn to be less

financially challenged. This finding is in line with Blanchard and Shleifer (2000), who argue that state ownership reduces financial constraints due to preferential treatment by other market participants, e.g. banks. The significant impact of firm's share of sales in exporting markets on firm's financial constraints is in line with Greenaway et.al, (2007) supporting evidence on the prediction that exporters face smaller financial constraints. As a result of the recent financial and economic crisis, during the investigated period average financial conditions in the Slovenian economy have worsened. The negative sign of the year dummy regression coefficients confirm the negative effect of financial crisis on financial constraints of firms, while the increasing absolute size of these coefficients from 2009 onwards indicate the growing deterioration of financial health of Slovenian firms throughout this period. Yet, the worsening of the access to finance was not the same for all firms across all economic sectors and industries. From the estimated time-invariant industry-specific effect, measured by regression coefficients of set of industry dummy variables (Table 4) it is evident, that the degree of financial constraints of some industries significantly deviates from others. When all other determinants of financial constraints are controlled for, industries that exhibit superior financial health are the following 2-digit NACE industries: 02-Forestry and logging, 16-Manufacture of wood and of products of wood and cork, except furniture, 55-Accommodation, and 90-Creative, arts and entertainment activities. On the contrary, firms from industries 7-Mining of metal ores, 45-Wholesale and retail trade and repair of motor vehicles and motorcycles, 69-Legal and accounting activities, 86-Human health activities, and 94-Activities of membership organisations are found to be in weaker financial position than firms with equal characteristics from other industries.

In order to release the assumption of cardinality of the dependent variable and increase the comprehensiveness of our results, we show also results of the ordered probit estimation. Model specification (1) from Table 5 is identical to the specification of the fixed effects estimation from Table 4, while specification (2) uses alternative specification of size and export status to test the robustness of the model.

Results of ordered probit estimation confirm results of fixed effects model estimates with respect to significance and direction of all determinants of financial constraints that are considered in our model. Exporters are on average 2.9 percentage points less likely to become highly financially constrained compared to non-exporters. Probability that public firms, i.e. with state ownership, will become highly financially constrained, is 2.5 to 3.4 percentage points lower compared to privately owned firms, while the effect of foreign ownership is not statistically significant. Increase in firm's productivity for 1 percent decreases the likelihood of becoming highly financially constrained for 6.6 percentage points. Results also show that the increase in employment for additional 10 employees means 0.2 percentage points lower probability of becoming severely financially constrained. Marginal annual effects, measuring the change in probability of firms becoming highly financially constrained, show that the most critical year with respect to firm financial constraints was 2009, although also 2010 and 2011 show tight financial conditions. In these three years probability of Slovenian firms being critically financially constrained was 1.2 to 1.6 percentage points higher than in 2007 all else being equal.

Table 5: Ordered probit estimation of firms' financial constraints model

Dependent variable <i>FCgroup</i>	Coef. (Std. Err.)	Average marginal effects (dy/dx) Pr(FCgroup=3)	Coef. (Std. Err.)	Average marginal effects (dy/dx) Pr(FCgroup=3)
	(1)	(1)	(2)	(2)
L(-1)			-0.000164** (7.51e-05)	-0.00002** (0.13e-06)
<i>Size dummies</i>				
small	-0.306*** (0.0203)	-0.031*** (0.0017)		
medium	-0.287*** (0.0346)	-0.029*** (0.0029)		
large	0.107*** (0.0408)	0.014*** (0.0058)		
lnProductivity(-1)	-0.555*** (0.00695)	-0.067*** (0.0009)	-0.546*** (0.00683)	-0.066*** (0.0009)
fdi(-1)	0.0039 (0.0180)	0.0005 (0.0022)	-0.00214 (0.0178)	-0.0003 (0.0022)
public	-0.208*** (0.0561)	-0.025*** (0.0068)	-0.283*** (0.0567)	-0.034*** (0.0069)
EXor(-1)	-0.208*** (0.0206)	-0.025*** (0.0025)		
exporter(-1)			-0.241*** (0.0101)	-0.029*** (0.0013)
<i>Year dummies</i>				
2008	0.0562*** (0.00823)	0.006*** (0.0009)	0.0537*** (0.00822)	0.006*** (0.0009)
2009	0.136*** (0.00875)	0.016*** (0.0011)	0.132*** (0.00873)	0.016*** (0.0011)
2010	0.0863*** (0.00893)	0.010*** (0.0010)	0.0839*** (0.00892)	0.0098*** (0.0010)
2011	0.101*** (0.00915)	0.0118*** (0.0011)	0.100*** (0.00913)	0.012*** (0.0011)
cut ₁ (μ ₁)	-6.705*** (0.0700)		-6.657*** (0.0686)	
cut ₂ (μ ₂)	-3.903*** (0.0668)		-3.852*** (0.0655)	
pseudo R2	0.1118		0.1121	
Log (pseudo-) likelihood	-96468.226		-96640.655	
N	162,283		162,598	

Note: Robust standard errors in parentheses
dy/dx for factor levels is the discrete change from the base level.
*** p<0.01, ** p<0.05, * p<0.1

5. CONCLUSIONS

The results of our analysis of determinants of financial constraints in the period before and during the recent economic crisis are in line with theoretical predictions and

previous empirical findings. Accordingly, firm size, ownership, productivity, export orientation are factors that impact firm's financial situation. Exporters are on average 2.9 percentage points less likely to become highly financially constrained compared to non-exporters and public firms turn out to be around 3 percentage points less likely to become financially challenged compared to private firms. Firm size and labour productivity positively affect firm's financial health.

Further, the financial situation of Slovenian firms on average deteriorated from 2009 onwards, although financial constraints did not increase equally across all economic sectors and industries. Our results show that in the investigated period, when all other determinants of financial constraints are controlled for, industries with superior financial health are the following 2-digit NACE industries: 02-Forestry and logging, 16-Manufacture of wood and of products of wood and cork, except furniture, 55-Accommodation, and 90-Creative, arts and entertainment activities. On the contrary, firms from industries 7-Mining of metal ores, 45-Wholesale and retail trade and repair of motor vehicles and motorcycles, 69-Legal and accounting activities, 86-Human health activities, and 94-Activities of membership organisations are found to be in weaker financial position than firms with equal characteristics from other industries.

Because Slovenian economic crisis is to a large extent related to banking crisis, banking sector revival seem to be crucial for improving financial health of Slovenian firms. Nevertheless, our results suggest that economic policy should also focus on promoting firm's growth, both in terms of employment and productivity with support of innovative practises and employment stimulation.

REFERENCES

- Akerlof, G. A. (1970), *The Market for Lemons: Quality Uncertainty of the Market Mechanism*, Quarterly Journal of Economics, Cambridge, Vol. 84 (3), 488-500.
- Arteta, C., Galina, H. (2008), *Sovereign debt crises and credit to the private sector*, Journal of International Economics, Vol. 74 (1), 53-69.
- Artola, C. and Genre, V. (2011), *Euro Area SMEs under Financial Constraints: Belief or Reality?*, CESifo Working Paper no. 3650.
- Askenazy, P., Caldera, A., Gaulier, G. and Irac, D. (2011), *Financial Constraints and Foreign Market Entries or Exits: Firm-Level Evidence from France*, Banque de France Working Paper No. 328. Available at SSRN: <http://ssrn.com/abstract=1832647> or <http://dx.doi.org/10.2139/ssrn.1832647>
- Athey, M. J. and Reeser, W. D. (2000), *Asymmetric Information, Industrial Policy and Corporate Investment in India*, Oxford Bulletin of Economics and Statistics, Vol. 62 (2), 267-292.
- Bellone, F., Musso, P., Nesta, L. and Schiavo, S. (2010), *Financial Constraints and Firm Export Behaviour*, World Economy, Vol. 33 (3), 347-373.
- Blanchard, O., Shleifer, S., (2000), *Federalism with and without political centralization: China versus Russia*, NBER Working Paper No. 7616.
- Bond, S. and Meghir C. (1994), *Dynamic Investment Models and the Firm's Financial Policy*, Review of Economic Studies, Vol. 61 (2), 197-222.
- Bougheas S., Mizen P. and Yalcin C. (2006), *Access to external finance: Theory and evidence on the impact of monetary policy and firm-specific characteristics*, Journal of Banking & Finance, Vol. 30 (1), 199-227.

- Campa, J. M. and J. M. Shaver (2002), *Exporting and Capital Investment: On the Strategic Behavior of Exporters*, IESE Business School, Research Paper 469.
- Canton E., Grilo I., Monteagudo J. And van der Zwan P. (2010), *Investigating the perceptions of credit constraints in the European Union*, ERIM Report Series No ERS-2010-001-ORG.
- Chaney, T. (2005b), *Liquidity Constrained Exporters*, mimeo, University of Chicago.
- Coluzzi, C., Ferrando, A., and Martinez-Carrascal, C. (2009), *Financing obstacles and growth: an analysis for euro area non-financial corporations*, ECB Working Paper No. 997.
- DeAngelo, H. and R.W. Masulis (1980), *Optimal Capital Structure under Corporate and Personal Taxation*, Journal of Financial Economics Vol. 8, 3-29.
- Fama, E.F., and K.R. French (2002), *Testing Trade-off and Pecking Order Predictions about Dividends and Debt*, Review of Financial Studies, Vol. 15 (1), 1-33.
- Fazzari, S. M., Hubbard, G. R. and Petersen, B. C. (1988), *Financing Constraints and Corporate Investment*, Brooking Papers on Economic Activity, Vol. 1, 141-206.
- Greenaway, D., Guariglia, A. and R. Kneller (2007), *Financial factors and exporting decisions*, Journal of International Economics, Vol. 7 3(2), 377-95.
- Greene, W.H., 2003. *Econometric Analysis*, Prentice Hall, Englewood Cliffs.
- Guariglia, A. and S. Mateut (2010), *Inventory Investment, Global Engagement, and Financial Constraints in the UK: Evidence from Micro Data*, Journal of Macroeconomics, Vol. 32 (1), 239–250.
- Hall, R. E. and Jorgenson, D. W. (1967), *Tax Policy and Investment Behaviour*, American Economic Review, Vol. 57 (3), 391-414.
- Hussain, J., Millman, C. and Matlay, H. (2006), *SME Financing in the UK and China: A Comparative Perspective*, Journal of Small Business and Enterprise Development, 13 (4), 584-599.
- Hutchinson, J. and Xavier, A. (2006), *Comparing the Impact of Credit Constraints on the Growth of SMEs in a Transition Country with an Established Market Economy*, Small Business Economics, Vol. 27, 169-179.
- Jensen, M. C. and Meckling, W. H. (1976), *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, Journal of Financial Economics, Vol. 3 (4), 305-360.
- Keynes, J. M. (1936), *The General Theory of Employment, Interest and Money*, Macmillan, London.
- Kumar, A. and Francisco, M. (2005), *Enterprise Size, Financing Patterns, and Credit Constraints in Brazil: Analysis of Data from the Investment Climate Assessment Survey*, World Bank Working Paper no. 49.
- Levine, R. (1997), *Financial Development and Economic Growth: Views and Agenda*, Journal of Economic Literature, Vol. 35 (2), 688-726.
- Miller, M. H. (1977), *Debt and Taxes*, Journal of Finance, Vol. 32 (2), Papers and Proceedings of the Thirty-Fifth Annual Meeting of the American Finance Association, Atlantic City, New Jersey, September 16-18, 1976 (May, 1977), 261-275.
- Modigliani, F. and Miller, M. H. (1985), *The Cost of Capital, Corporate Finance and the Theory of Investment*, American Economic Review, Vol. 48 (3), 261-297.
- Musso, P. and Schiavo, S. (2008), *The Impact of Financial Constraints on Firm Survival and Growth*, Journal of Evolutionary Economics, Vol. 18, 135-149.
- Muûls, M. (2008), *Exporters and Credit Constraints. A Firm-level Approach*, National Bank of Belgium Discussion Paper 139.
- Myers, S. C. and Majluf N. S. (1984), *Corporate Financing and Investment Decisions When Firms Have Information That Investors Do Not Have*, Journal of Financial Economics, Vol. 13, 187-221.
- Natke, P. A. (1999), *Financial Repression and Firm Self-Financing of Investment: Empirical Evidence from Brazil*, Applied Economics, Vol. 31(8), 1009-1019.

- Oliner, S. D. and Rudebusch, G. D. (1992), *Sources of the Financing Hierarchy for Business Investment*, Review of Economics and Statistics, Vol. 74 (4), 643-654.
- Petersen, R., Schulman, J. (1987), *Entrepreneur and banking in Canada*, Journal of Small Business and Entrepreneurship, Vol. 4 (2), 68-74.
- Sawyer, M. C. (1981), *The Economics of Industries and Firms: Theories, Evidence and Policy*, Routledge, London.
- Scherer, F.M. and Ross, David (1990), *Industrial Market Structure and Economic Performance*, Houghton Mifflin, Boston.
- Silva, A. (2011), *Financial Constraints and Exports: Evidence from Portuguese Manufacturing Firms*, International Journal of Economics Sciences and Applied Research. Vol. 3, 7-19.
- Stiebale J. (2011), *Do Financial Constraints Matter for Foreign Market Entry? A Firm-level Examination*, The World Economy, Vol. 34 (1), 123–153.
- Van Ees, H., Kuper, G. H. and Sterken, E. (1997), *Investment, Finance and the Business Cycle: Evidence from the Dutch Manufacturing Sector*, Cambridge Journal of Economics, Vol. 21 (3), 395-407.
- Wagner, J. (2012), *Credit constraints and Exports: Evidence for German Manufacturing Enterprises*, Working Paper Series in Economics no. 251, University of Luneburg.
- Worthington, P. R. (1995), *Investment, Cash Flows and Sunk Costs*, Journal of Industrial Economics, Vol. 43 (1), 49-61.

Mario Pines

University of Trieste, Faculty of Economics, Trieste, Italy

MONETARY AND FISCAL POLICIES: LIMITS, FALLOUTS AND REMEDIES

ABSTRACT

Financial and Economic development through integration processes is a complex and slow event, in which market fallouts and policy actions are intricately linked, unpredictable and hardly manageable as well. While local market factors perform a primary role and hold up responsibility in shaping the single financial market, policymakers need to understand and support these global mutual developments by providing an adequate framework for cross-border expansion of financial institutions and related actions. Such conduct, in order to escape private investing, cross border exploitation of financial resources and fallout effects of wrong monetary and fiscal policies, must consider the morphology of world logistics and linked branch and subsidiaries global production networks. Progress in financial integration crucially depends on similar private and public choices, when not competing and out crowding each other.

Keywords: *monetary, fiscal policy, efficacy, recession, crisis*

JEL classification: *G210*

1. INTRODUCTION

The global growing economic convergence, within the EU financial markets, may be explained by stressing the ongoing fallout of interstate finance activities, after the mutual recognition agreement, and the consequent Central Banks' ruling functions in all related financial matters, but particularly in the monetary policy. The mutual recognition principle, as adopted by the EU Commission and ratified by all the member states, in the US was implemented after the corresponding Riegle – Neal Interstate Banking and Branching Efficiency Act, enacted in the year 1994, and both legislative frameworks have been showing almost identical developments and corporate governance attitudes.

Cross-border activities and related financial in and out sourcing and investments, have received a major impetus during the recent years, mainly by the introduction of the single currency, the euro and its general positive public adoption. This opportunity has been restrained by the prevailing growing sovereign debt increases, the consequent financial bubbles eruptions, the recurring financial and trade imbalances and the general framework may only be understood at full range when the remaining policy obstacles to cross-border banking and finance networks are removed, the resulting

financial stability local challenges detected and properly addressed by adequate remedies.

2. PRELIMINARY REMARKS

I would, first of all, recall with Baumol the necessary clarifying attitude in facing such intricate problems: “*A primary aim of the economist is to understand business behavior rather than to make recommendations to businessmen. His understanding of economic processes provides part of the foundations for the analysis of the operation researcher.*” (BAUMOL, 1972,5) EU policymakers have already adopted several actions with this regard, in order to provide adequate and ready resources to face the new world financial scenario:

- European Financial Stability Facility (EFSF),
- European Stability Mechanism (ESM),
- European Fiscal Compact (EFC),
- European Banking Authority (EBA),
- Economic and Financial Affairs Council (ECOFIN),
- Emergency Liquidity Assistance (ELA),
- Long-term refinancing operation (LTRO),
- Single Supervisory Mechanism (SSM),

as evidenced by the underway infrastructure work, to release potential prudential barriers to financial market extremes. Unfortunately, the diverging European public imbalances are showing a long trend discrepancy in what was the original set of financial standards, the inflation rate should be no more than 1.5 % above the rate for the three EU member states with the lowest inflation over the previous year; *Maastricht criteria* for budget deficit: deficit must generally be below 3% of gross domestic product (GDP). Debt is also closely watched by the Maastricht criteria; the national debt should not exceed 60% of GDP.

As a general rule, the different taxation patterns, diverging labor costs and standards, enlarging logistic facilities and related communication technology, have definitely induced a widespread delocalization and outsourcing process that have dramatically changed the geography of world industrialization activities. Meanwhile, finance, communication processes and numeric controlled production, have transformed in few decades all world industrial production chains and displacement towards a modularized global structure, the local national markets have become part of larger entities heading toward globalized single connected markets (Hofman, Wiggins, 2008).

The concept of modularity interaction between local area markets and a global single market, is the only path to understand the present economic crisis. In economics, a surviving module is a structure part of a larger system but it should also work detached on its own, in much the same way that a modular piece of complex structure might function either by itself or as part of larger agglomerate. In real economy, modularity is operating at any level, from a state to a broader system like the UE, the NAFTA, the ASEAN, the globalized open single market. Modularly arises spontaneously in systems when institutional frameworks evolution occurs relatively slow and where information - like technology - may be swapped throughout the area, free and in real time.

After the reunification of a split world, as relict of the cold war at its end in 1991, the finance network and the international corporations have started an evolving mutation, and innovation process, in the form of business practices and financial products and have sharply relocated themselves through a new world trade network in real time.

3. THE EVOLUTION

From previously centralized managed multinational structures, corporations have become global, a tree-like organization that reflects local producing branches, autonomous while strictly connected by means of projects, design, patents, technology, trademarks and similar joining relationships. The amount of interchangeability among single units create the modularity which can be exploited in taking advantage of local facilities, or competitive factors, implying increased efficiency, lower costs, better quality, and finally chances of survival, modernization and useful allocation of resources.

The network structure allows single local units to shift from local markets to global market in an increasing profitability and speed.

At same time, this deep model transformation has changed itself within the slow model evolution from a neoclassical *laissez faire* market vision, to a Keynesian and neo Keynesian State interference trough the planning, Central Authorities like the Tennessee Valley Authority ² clearly reflected in the literature left by American New Deal which, as long as the post war economic planning, in a deep State redistribution policy, which was especially addressed to increase the purchasing power in the economy concerned about demand much more than about supply.

Nevertheless the quotations reached by the Dow Jones index at the beginning of 1928, before the great depression, were again on the financial screens only in the year 1954. The political tensions and the huge depression, in common judgment by both (Mundell, 1998) and (Keynes, 1920, 1988) lead to the second world war and the Bretton Woods reform *de facto* reinstalled the gold standard trough the Monetary Fund alignments and a soft *laissez faire* market adjustment until the 15th August 1971 Nixon declaration restarted the *fiat money* scenario, which had already been the root of the great depression as a consequence of the monetary financing of the first world war trough the suppression *de facto* of the gold standard.

Gold itself has never been a special commodity with powers linked to growth, welfare and prosperity, it might have been be a barbarian relic too, but it has represented

² “No, our basic trouble was not an insufficiency of capital. It was an insufficient distribution of buying power coupled with an over-sufficient speculation in production. While wages rose in many of our industries, they did not as a whole rise proportionately to the reward to capital, and at the same time the purchasing power of other great groups of our population was permitted to shrink. We accumulated such a superabundance of capital that our great bankers were vying with each other, some of them employing questionable methods, in their efforts to lend this capital at home and abroad.” Point 17, <Address at Oglethorpe University> Roosevelt, Franklin D. May 22, 1932 Reprinted in *The Public Papers and Addresses of Franklin D. Roosevelt*, Vol. 1, 1928-32, (New York City: Random House, 1938), p. 639.

always an exogenous limit to political *fiat money* expansion, which as evident in the last forty years monetary disorder led to the huge internal imbalance and political struggle grounds that has now been generally choking the economy through the fiscal burden, the sovereign huge debt and the Western crumbling economies.

4. THE DOLLAR FUNCTIONS AND TREND

The US internal and external deficits have been supporting each other because of the international monetary function of the dollar, as long as the gas and oil and external imbalances are cleared by means of the US currency, but for all the remnant Countries, no foreseeable solution appears likely to readdress the global financial public imbalances, which have been leading to larger local political coalitions, in most of the countries left without reliable currency, with imbalanced budgets and foreign trade prevailing liabilities.

Public spending, public mismanagement and public corruption have been the fallouts of the *fiat money* Central Banks' policies linked more to political pressures than to Keynesian and post Keynesians justifications.

As a matter of fact, the extraordinary monetary growth is the only explanation to the huge financial stock exchange excursions up to the 14.500 D.J. index value, to the recurring bubbles in the financial market, starting since the 1987 one, the dot com and Enron – Worldcom – LTCM collapses around year 2000 and the subprime lending with the linked derivative bubbles bursting in year 2007 – 2008 and the financial dead end we are all facing nowadays.

The subsequent TARP remedies, the huge monetary base inflows of the last decades are interesting points from two points of view:

- why such a huge monetary expansion has not stimulated the economic activity in any visible way, apart from the Keynesian liquidity trap explanation, which may not be valid over such a long span of time, there is no classic solution to this everlasting inefficiency of both monetary and fiscal policies,
- why such a huge monetary expansion has not affected the level of prices and has not had any inflationary fallout.

The answer, undoubtedly lies in two simple explanations, considering the basic ground of two epochal events that have affected the whole world economy at the beginning of the last twentieth century decade.

The first huge impact comes from the end of the Yalta order and the end of the cold war which was splitting the world into two different areas. The end of the Cold War may be seen when the Soviet Union released its grip on its eastern European satellite countries. One by one, in 1989 those countries declared themselves democracies. The Berlin Wall fell, the disintegration continued until Moscow dissolved the Soviet Union in 1991. The Commonwealth of Independent States replaced the Soviet Union; the end of the Cold War came on December 26, 1991.

The end of the Cold War left a world in which the United States was the last remaining super power. No other nation challenged the United States militarily, economically or politically. The last time something like this was real was just during the Roman Empire times. That is when Roman civilization defeated its enemies to become the unchallenged power in its day.

The second epochal scenario comes out of the collapse of the dollar standard in 1971, releasing the huge monetary expansion which led to the inflationary seventies.

The two concurring events, the monetary expansion and its political fallout coupled with the end of the cold war are at the base of the resurgence of the global economy since the last nineteenth century first globalization which had already produced a huge economic and population growth with large scale migrations and new allocations, especially in the booming Argentina and US. The new twentieth century globalization produced a traumatic imbalance upgrading and revaluating three basic economic resources:

the OPEC oil revenues enlarging the euro dollar financial resources in the London interbank market, already booming when the oil barrel price for a long time below twenty dollars, surged to new 100 dollars level, the new gas rich countries with large gas fields like Russia and Middle and Eastern Countries joining the suppliers in the rich energy market, the fall of the Berlin wall opening the access to Eastern and Far Eastern 2 billion workers tendering low cost labor, crowding out the too expensive labor in the welfare Western Countries finally starting the ongoing large scale mass reallocation of industrial facilities in Asia.

Meanwhile, the new industrial huge Asia output has been swelling up the world GP from 23 to about 85 US\$ trill, in the fastest, swiftest, largest economic growth ever seen under the sun, out of any known development model. The relevant factor is the outbreak of the free market forces, in a pure *laissez faire* model based mostly on the financial circuit China - America based on supply allocation from one side and financial internal deficit offset on the other.

5. REMEDIES AND LIMITS

The new model, without any previous example, has induced to many spread misunderstandings, the most immediate remedy was the linkage about the monetary policies and the missing local response from a Keynesian point of view, especially in Countries like Japan, but any European Country may be considered as well suffering such an inconsistency in economic policies.

The fact is that three competing economic theories have been fighting each other over two centuries, neoclassical, Keynesian and Marxian, leaving a paradox final victorious side, the Asian overriding competitor in a complex political infrastructure, a free market, a free economy and a contradictory single party democracy.

The concentration of the financial reserves in Asia, the low labor costs of that area, the presence of huge natural resources in both OPEC Countries and Russia especially, have reshaped the economic geography of the world, leaving Europe out of development contest. The single currency, introduced in the 1999 have not reached the original aim to introduce a new world reserve currency.

The traditional monetary policy and the fiscal income redistribution programs have created the same common unexpected goals of promoting foreign trade imbalances since most of consumption has been directed towards Asian productions, which have substituted most of western production on a large scale basis.

On the other side, the high labor costs and the high taxation rates have induced a large scale migration toward Asia of most of the high technology and large scale mass productions, in almost all the production classes. This further event has severed the traditional inflation effects into two different paths, the financial instruments price increase called *capital gains*, while the traditional services and products inflation tendencies have been outset by low and steady Asian prices, especially after the remimbi 1994 devaluation as China was releasing its Marxian schemes.

The low cost Asian productions have actually offset most of the Western industries leaving most of Western Countries to face identical labor unemployment levels and financial distressed intermediaries.

At same time, the Asian surpluses have been financing the internal American deficits becoming the first most indebted Country in the history.

In Europe, the Keynesian theory has failed in promoting any kind of growth. Despite the significance of economic growth and other major social goals, there is no longer a widely accepted theory about this issue. The Keynesian system that regulated Western economies for more than two decades has been discredited, the New Classical economics that destroyed the old Keynesianism is widely believed to be against the Western welfare State, and the New Keynesian economics, that has risen from the ashes of the old one, is a thin and meagre doctrine that casts no light on money, capital, trade cycles, unemployment or deficient demand. Of course, pragmatism rules and macroeconomic policies are often implemented even in the absence of a theory.

However, pragmatism without principles means policy without consistency or direction, and it leaves policy makers with no systematic way to evaluate and understand their failures or develop an improved new approach.

The New Classical school emerged during the 1970s as a general failure of Keynesian economics to explain both inflation, largely affecting world currencies and general recessions with large scale unemployment. New Classical and monetarist criticisms led by Robert Lucas, Jr. and Milton Friedman respectively forced the rethinking of Keynesian economics. In particular, Lucas made the Lucas critique that cast doubt on Keynesian model synthesized in Hoover study (Hoover, 1992). This strengthened the case for macro models to be mostly based on microeconomics. Meanwhile, Friedman considering the stagflation proposed that the Phillips curve did not exist and would fail.

He theorized of an existence of a natural rate of unemployment that contradicts the then accepted relationship between inflation and unemployment rate. The stagflation of the 1970s seemed to prove him right and has been appearing in the twentieth century on a large scale but offset in its price indexes by the industrial Chinese revolution.

This intellectual crisis has arisen out of the conflicting demands of theory and the globalization fallouts. Some form of Keynesian theory is the only way to explain aggregate demand phenomena:

- appropriate adjustment between demand and supply of money,
- price stability,
- credit control,
- creation and expansion of financial institutions,
- suitable interest rate structure,
- debt adjustment,

but economists have come to realize that Keynesian theory has shown inconsistencies, as the fundamental principles of modern mainstream microeconomics requires new answers to delocalization and new global macroeconomics disorders: supply, demand and production, therefore employment and progressive large imbalances.

There has been a strong desire to save the theory (Krugman, 2008), but the old brand of Keynesian economics has become unacceptable, partly because it relied on an assumption that markets are persistently irrational and not integrating (Hunter, 2009) and never self adjusting.

The New Keynesian economics can be regarded as a reductionist attempt to escape the present dilemma, by refusing any Keynesian assumptions that may seem inconsistent with classic standard microeconomics, but of course it concludes by rejecting Keynesian core phenomena as well.

Dubious methods are employed to reject the salient facts in order to save the theory and the preferable way is to extend the theory, so that it does explain the present dead end. This is, in the first instance, a microeconomic issue arising out of a macroeconomic approach.

6. SOME NEW APPROACH

New classical macroeconomics emerged as a school in macroeconomics during the 1970s. As opposed to Keynesian macroeconomics, it builds its analysis on an entirely neoclassical framework. Specifically, new classical macroeconomics (NCM) emphasises the importance of rigorous foundations, in which the macroeconomic model is built in analogy to the actions of individual agents, whose behaviour should be modelled by microeconomics. New Keynesian economics was developed partly in response to NCM - it strives to provide micro foundations for Keynesian economic analysis but, apart from everything else, there lies the major obstacle.

It took people a long time to realize that government officials are self-interested individuals, and that government involvement in economic activity is especially

pernicious because the government can't fail. Revenues have to cover costs, the government is not subject to that micro economic constraint and this general rule seems to affect the whole world community, without exceptions.

Several assumptions are common to most New Classical models. Primarily, all agents are assumed to be infinitely live, rational (utility-maximising) and possess rational expectations. At any one time, the macro economy is assumed to have a unique equilibrium at full employment or potential output and this equilibrium is assumed to always have been achieved via price and wage adjustment (market clearing).

New classical economics has also pioneered the use of representative agent models. Such models have recently received severe neoclassical criticism, pointing to the clear disjuncture between microeconomic behaviour and macroeconomic results, as indicated by Kirman (1992), and the fallacy of such composition. In some ways, this critique is akin to the Cambridge capital controversy, which discredited the neoclassical aggregate production function.

The most famous New Classical model is that of Real Business Cycles, developed originally by Robert Lucas, Jr., Finn E. Kydland, and Edward C. Prescott, building upon the ideas of, among others, John Muth (Kydland, Prescott, 1990).

Body of macroeconomic thought based on the role of rational economic agents and the theory of rational expectations, emerging during the 1970s. It is characterized by an extreme form of Chicago monetarism, which argues that demand management intervention by governments is ineffective, even in the short run, and advocates far reaching tax cuts, the return to gold (Laffer, 1979) and the new supply side economy. It is based largely on the ideas of the US economists John Muth (1930-2005) and 1995 Nobel laureate Robert Lucas, Jr. (born 1937), and the co-recipients of 2004 Nobel prize in economics - US economist Edward Prescott (born 1940) and Norwegian economist Finn Kydland (born 1943).

The Neoclassical-Keynesian Synthesis was wildly successful and dominated macroeconomics in the post war reconstruction period. For a long time, the Neo-Keynesian system was synonymous with the *Keynesian Revolution* and was highly influential in both theoretical, applied and policy work. Abba Lerner (1944, 1951) was among the first to recognize the implications of the Keynesian system for government macroeconomic policy: by appropriate fiscal and monetary policies, a government could try to "steer" the economy away from extremes and thus smooth out the business cycle (Hart, 2011). This policy effectiveness was given an enormous boost by the new econometric model-building techniques and optimal policy design criteria, developed by many researchers which helped governments design and estimate the impact of various fiscal and monetary policies on employment and inflation.

The Neo-Keynesian system came firstly under sustained attack in, the late 1960s and early 1970s, when the full effects of the unrestricted monetary supply, due to the unexpected Nixon declaration, took effect; it was suggested that instead of pursuing *unemployment equilibrium* in an imperfect system, *prolonged disequilibrium* should be analyzed in a system without ad hoc rigidities. The proposition "Walrasian Keynesian"

synthesis could not have offset the imbalances from an equilibrium and monetary stimulus, the only pro tempore solution was, as long as it lasted the *supply side* solution. Same assumptions appear in the British Monetary Policy committee reports, responsible of the monetary policy in UK: what the Committee relevantly considers in its reports as land historical mark, is:

- the integration of China, India and the former Communist countries of Eastern Europe into the world economy;
- the ICT revolution and the associated dotcom boom-bust;
- the emerging-market debt crisis and the collapse of Shoals - Merton LTCM in 1998;
- the sharp correction in international equity prices and the associated global slowdown since 2001;
- the attacks on the World Trade Centre and subsequent conflicts in Afghanistan and Iraq; and
- the tripling of oil prices over the past three years.

While at a domestic level, the MPC has also had to contend with:

- the effects of the 25% rise in sterling between 1996 and 1998;
- the tripling in house prices between 1997 and 2006;
- ongoing labor market reforms, including the introduction of a National Minimum Wage and substantial, and highly uncertain, net inward migration, particularly from the Accession countries.

The reasons for the change in the MPC's operational target and the effects of this change on the level of inflation and its control - the significance and response by the MPC to

- the high levels of house price inflation and mortgage borrowing;
- the impact of oil price changes on inflation;
- the forecasting record of the MPC;
- the expertise of recently appointed MPC members;
- the conduct of fiscal policy, the UK fiscal rules, the suitability of the stability and growth pact, and the inter-relations between monetary and fiscal policy; and
- improving the supply side of the economy.

The Committee also examined a number of other issues, but these come to be the likely facts that have affected the European and world economy most of any other event.³

On the German side of European monetary attitudes, it appears meaningful what Stephen King has been writing: "*Pre crisis, it was assumed the achievement of price stability would keep everybody happy ... monetary policy could be regarded as politically neutral. No longer. Since the recession developed world economies have stagnate and central bankers have had little choice but to keep rates close to zero and*

³ <<http://www.bankofengland.co.uk/publications/Documents/other/treasurycommittee/mpc/tsc070219.pdf>>

to pursue increasingly unconventional monetary policies, in the hope that they will trigger a robust recovery”.⁴

From the debt point of view, the fiscal policy seems not to have produced a relevant effect on the US and European economies during the last twenty years since both the trade balance and the employment rate have increased according to the deficit spending policy.

7. THE PRESENT DILEMMA

Here are the actual figures of what the total debt was when each US President left office and the specific percentage increase.

Table 1: US Internal deficit according to the presidencies 1970 - 2010⁵

Ford	USD 0.654 trillion
Carter	USD 0.930 trillion, 42%
Reagan	USD 2.68 trillion, 189%
Bush	USD 4.18 trillion, 55.6%
Clinton	USD 5.7 trillion, 36%
Bush	USD 10.7 trillion, 75%
Obama	USD 16.00 current

The fiscal policy connected to the Reagan flat rate and the monetary policy linked to the deficit spending actually seem no to have affected significantly the macroeconomic variables as most of the US production have been shifting to Asia. From an analytical quantitative point of view, with (Hunter, 2009) I would say *Where Keynes went wrong*. The combined effects of internal and external deficits produced a combined balanced effect, due to the role of the dollar as a global currency, notwithstanding its declining value: “*The most compelling explanation for the historic rise in the US current account deficit is that it stems from a broad set of forces The rise appears to have coincided with a pronounced new phase of globalization.*” (Greenspan, 2007,350).

⁴ “*The era of independent central banks is coming to an end*”. Deutsche Bundesbank Auszüge aus Pressenartikel Nr. 3 16 Januar 2013, seite 14, Stephen King Financial Times, January 11, 2013-04-15.

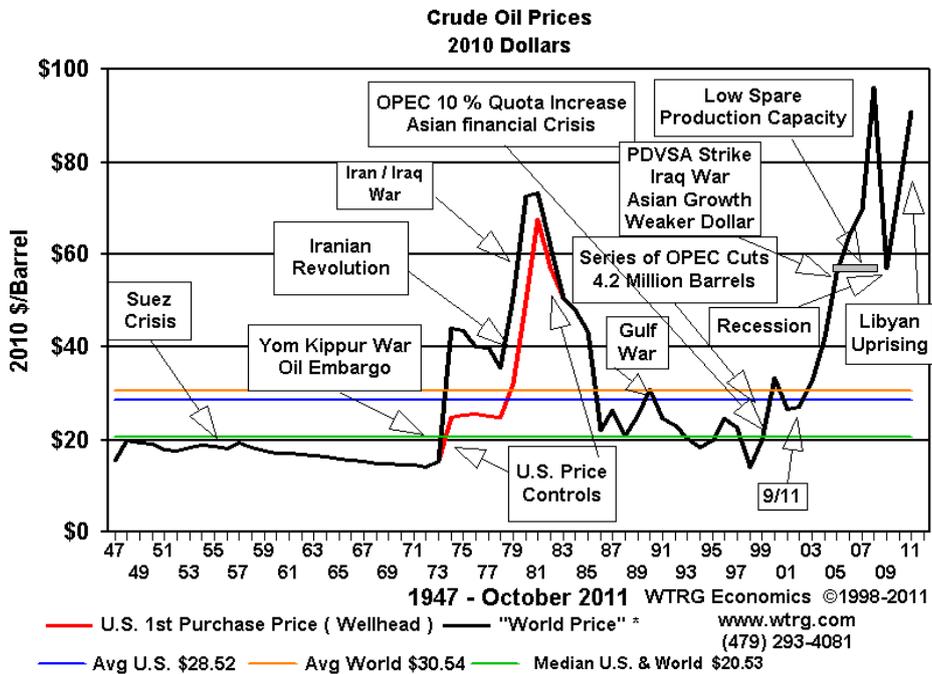
⁵ <<http://www.presidentialdebt.org>>

Table 2: World GDP from year 2000

Year	2000	2005	2007	2008	2011
GDP (cur. USD bil)	32,001.93	45,232.14	54,891.06	60,587.02	81,172.27
GDP gr. (yr.%)	4.1	3.5	3.8	2.0	1.7
Inflation, GDP deflator (yr. %)	4.7	4.9	5.4	8.1	4.0

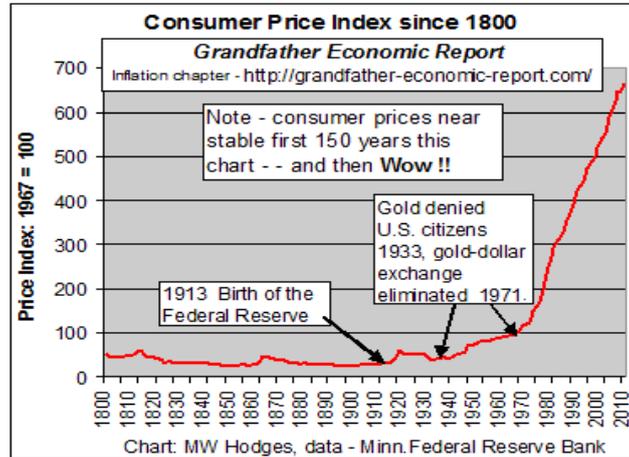
Source: <<http://www.worldbank.or/>>

Figure 1: Crude Oil Prices 1947 – October 2011



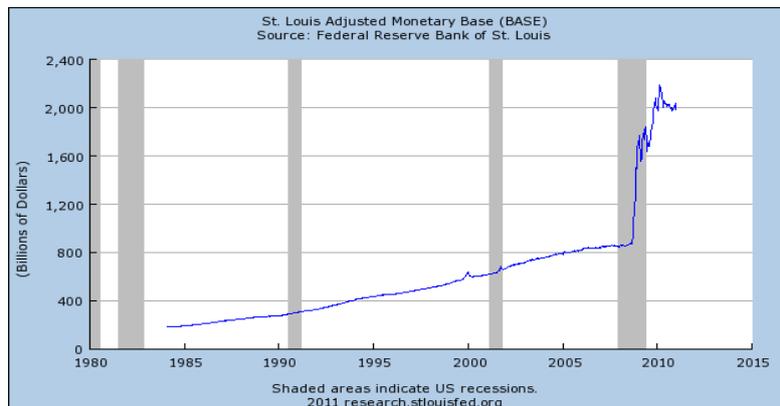
Source <<http://www.wtrg.com/prices.htm>>

Figure 2: Consumer Price Index 1800 – 2010



Source: <<http://grandfather-economic-report.com/inflation.htm>>

Figure 3: Monetary Base USA 1980 – 2012



Source: <<http://research.stlouisfed.org/fred2/series/BASE>>

Same risk has been outlined in considering the financial side of the crisis affecting Western financial markets and the OTC over the counter derivative transactions and bubbles, originating from the huge financial inflow of capitals from China, after the 1999 modernization Act (González-Páramo, 2011)⁶, the Gramm Leach Bliley Financial

⁶ “It would be foolish to argue that what we have experienced in the last four years is the sole result of an exceptionally large adverse shock. Major structural changes in financial markets gave life to a gigantic securitization market which allowed financial intermediaries to diversify their portfolios and, hence, to reduce their exposure to risk. Or so market participants liked to believe. As in the case of collateralized mortgage obligations (CMOs) and credit default swaps on CMOs and CDOs, many securitised products had an unknown or very uncertain risk profile due to the novelty of the financial products and the lack of data.

Services Modernization Act actually allowed the Enron and Worldcom disasters associated just after the black box LTCM hedge fund fall, created with a shortsighted leap from the Academy to the trading floor by Shoales and Merton, 1997 Nobel prize winners for Economy, and declared bankrupt in 1998 after the LTCM sudden impressive collapse.

8. CONCLUSIONS

Meanwhile, the Keynesian liquidity trap has distrusted all the Krugman and other Keynesian believers as Summers, Geithner, Stieglitz, still believe that an economy boost might arrive either from a monetary expansion fiscally produced or paper made, as the three printed TRAP experiences. The only balancing armistice in such a monetary impasse is a steady economic decline and a growing unemployment and unavoidable social tensions growth. I personally believe that we are going through a new economic epoch, where all the previous instruments and perspectives are not valid any more.

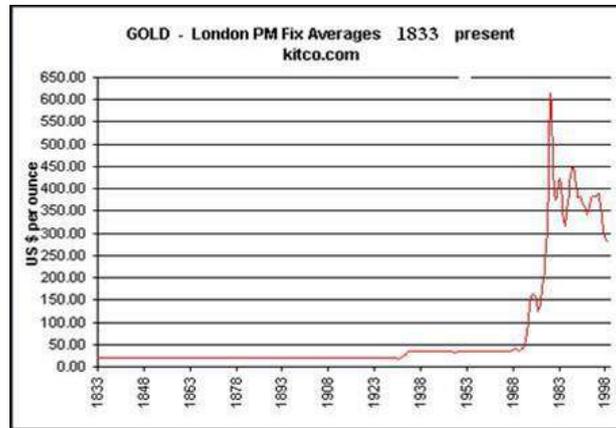
The first real problem is to devise a new real gold rule, may be gold itself, as the cold war fears, which have always dismantle any attempt to reinstall the gold standard, had shown too many political implications, but the monetary functions must be reestablished in a new free contest, in a global economy and as long as saving, value measuring and consumption deferring necessities are not resolved, the free market forces and their strength will surprise everyone in new global reshaping of our market reality where even mistakes take a part in shaping a new scenario every day.

The modularity and the integration in the global market seems to be the only way out in this perspective since there is no way back to the past. The custom barriers are impracticable and the protection would be only apparent: the critical size to be competitive and survive in the global market is, for any firm the only chance to pursue a long life and successful activity, when its productions are easily tenderable in the global market and in the general productions likely successful outside national borders and local consumption.

Monetary policy and fiscal redistribution are short sighted and could only survive in an old framework far from the modern goals and prerequisite to survive, both as a brand and as a likely requested production.

The systemic risk associated with these assets was naively underpriced, and the consequence was an excessive exposure to risk”.

Figure 4: Gold Value 1833 – 1999



Source: < http://www.kitco.com/scripts/hist_charts/yearly_graphs.plx>

Financial markets and financial evolution reflect the symbiotic relationship between public exigencies and states, larger or smaller and the everyday life of any single living person, in its choices dilemmas which require a clear and valuable mean of exchange generally called money in the mankind history.

REFERENCE

- Baumol J. W. (1972), *Economic theory and operational analysis*, Englewood Cliffs.
- Gonzalez Paramour M. J. (2011) *Monetary and fiscal policies in times of crisis*, Speech by José Manuel Gonzalez Paramo, Executive Board of the ECB, conference of the Monetary and Fiscal Policies Network (MONFISPOL), Goethe Universität Frankfurt, 19 September 2011.
- Greenspan A. (2007), *The age of turbulence*, N.Y.
- Hart, N. (2011), Macroeconomic Policy and Abba Lerner's System of Functional Finance. *Economic Papers: A journal of applied economics and policy*, 30: 208–217. doi: 10.1111/j.1759-3441.2011.00117.
- Hofman, J.M., Wiggins C.H. (2008), *A Bayesian approach to network modularity*, *Physical Review Letters*, Volume 100, p.258701, <http://link.aps.org/abstract/PRL/v100/e 258701>
- Hoover H. D. (1992) *The New Classical Macroeconomics*, N.Y.
- Hunter L. (2009), *Where Keynes went wrong*, Mount Jackson, VA 2009.
- Keynes, J. M. (1920), *The economic consequences of the peace*, N.Y. 1920 ed. 1988
- Kydland, Finn E, Edward C. Prescott, (1990), *Business Cycles: Real Facts and a Monetary Myth*, Federal Reserve Bank of Minneapolis, Quarterly Review Vol. 14, No. 2.
- Kirman A. in, David Colander & Hans Föllmer & Armin Haas & Michael Goldberg & Katarina Juselius & Alan Kirman & Thomas Lux & Brigitte Sloth, (2009). *"The Financial Crisis and the Systemic Failure of Academic Economics."* *Middlebury College Working Paper Series* 0901, Middlebury College, Department of Economics
- Krugman, P. (2008), *The Return of Depression Economics*, N.Y. , 2008.Laffer Arthur B. (1979), *A Return To Convertibility*, L.A. Times 10/30/79

Mundell, P. K R. (2008), A Reconsideration Of The Twentieth Century, NY 1999 <[http://www. columbia.edu/~ram15/nobelLecture. html](http://www.columbia.edu/~ram15/nobelLecture.html)> KRUGMAN, the return of depression Economics, London, p. 182

Jean-Pierre Olsem
CEDIMES, Paris, France

CLEAR FEATURES AND UNCERTAINTIES IN THE DAWNING NEW ECONOMIC SYSTEM

ABSTRACT

For the first time in History, world economy combines three features: (1) high integration through trade and investment, (2) a common reference economic model and (3) undisputed dominance of economic considerations in shaping the latter. Mercantilism was the common economic model between 11th and 18th century but it is by definition contrary to recognition of the economic sphere's autonomy. High integration featured the world prior to 1914 and was coming again in the twenties, but the deep features of nations and empires differed widely from each other and economic logic within them was faltering.

The 30's crisis led to highly significant changes and reforms such as the Securities Acts in the US and the awareness of, broadly speaking, Keynesianism. But it took time to spread the logic of the Securities Acts. And Keynesianism was quickly misunderstood and overestimated: the low price of oil, maybe the only near universal substitute to so many goods, led to a collective lapse of memory, to the incredible oblivion of what had to be rediscovered under the name of supply side policy, precisely when unlimited and cheap oil vanished. All in all the current crisis is therefore the first one affecting a common world economic system. The answers to this common challenge are diverse, changing and hesitating. What is most worrying is that in some fields, such as financial regulation, hesitations are growing, not receding, whereas convergences in fields such as sovereign crises and implementation of so called structural reforms are fragile and maybe ambiguous.

Therefore a review of the clear and obscure areas of the dawning new economic system seems essential. The proposed review will be divided along the three areas of the three pronged crisis: the financial sphere, the working of supply and demand and the sovereign crisis. These clear or obscure aspects of the coming economic system are determined and affected not only by policies aiming at overcoming the crisis but also by long range structural evolutions. The new economic system is neither entirely determined nor, at first glance, deeply different from the pre-crisis one. But it is already changing public policies and business strategies, so that a new European and world economic order is actually dawning.

Keywords: *integration, sovereign crisis, new European and world economic order*

JEL classification: *GO1*

1. INTRODUCTION

The economic system can be defined in itself, starting from the working of the prices mechanism. But the present crisis is systemic, which implies that the evolutions that it has set into motion reach and cover the entire system. Therefore it is possible to rediscover the system in a reversed picture, like in a mirror, starting from the strikes and symptoms of the crisis and finding again the fundamental working of the competitive pricing mechanism, of its constraints and of its demands. In other words, all the issues that are raised by the crisis converge to a unique interrogation: can the competitive system be restored in a renewed diversity inherent to its irreplaceable interdependence?

In order to answer this question, it seems natural to address the three aspects of the crisis which is (1) financial, (2) functional, i.e. which hurts the working of supply and demand throughout the markets of the real economy and (3) sovereign. Some clear features and many uncertainties are present in each component of these three aspects. However the sovereign crisis is a consequence of the two other ones. Its bouts restarted them, and maybe will do it again, but in no way triggered them. Therefore the first version of the present research, to be presented at the 9th international conference on economic integration in Opatija, will focus on the financial and functional crises. A future paper will deal with the third aspects of the crisis.

2. THE ELUSIVE FINANCIAL REGULATION AND PARADIGM

Activities' financing in the new economic system will be shaped mostly by new regulation and also by changing practices. The main fields concerned by those changes are in the first place banking, and, in the second place, a range of financial tools and practices, particularly rating activity, derivatives, securitization and insurance. The purposes of the new regulations and the stakes of the new practices are clear but their content and prospects are not.

2.1. Banking regulation: the seductive obviousness of mirages?

The elusiveness of banking regulation appears in its first three main fields, (1) separation of activities, (2) capital requirements and (3) the broad supervision and orderly failure issue. The fourth field of regulation, (4) liquidity coverage requirement, was strongly modified but doesn't seem to be contested any more. The legal status of corporate banking (5) is not even discussed. The structural consequences of new banking regulation, that is to say (6) the development and prospects of shadow banking, are surrounded by a disturbing opacity.

2.1.1. Separation of activities: the everlasting return?

The prospects are disturbing, not only because the issue is controversial but also because it appears that the seven main arguments are practically reversible, translating into indeterminateness or even dilemmas.

1. “Too complex to price” (Haldane, 2012). This argument falls under the same logic as dismembering conglomerates, which is at present trendy but which was not in a not so distant past. In fact this argument widens a practice, the separation of toxic assets in defeasance units. Defeasance is undoubtedly useful, and even necessary. But the difficulty to value banking is a different question. Above all, unbundling will eliminate opportunities for banks’ customers (argument 5) which entails that one would destroy value in order to measure it.
2. Confusion between bank as a lender and as an owner. Ringfencing seems justified on conceptual grounds but universal banking cannot seriously be taken as responsible for the present crisis (Oudéa, 2011).
3. Moral hazard and “too big to fail”. Taxpayers should not bear the consequences of excessive risk-taking by banks. But risk management is at stake and should not be muddled up with banking specialization (Larosière, 2012). And specialization should be muddled up with size. Banking in USA prior to financial deregulation was under Glass-Steagall Act (and also Pepper Mc Fadden...) and also under stringent Antitrust enforcement (Olsem, 1991).
4. Borrowing terms on wholesale markets are volatile while outsourcing hedging activity is expensive. No definitive decision on separation of banking activities can be taken on such a dilemma.
5. Ringfencing contributes to maintain competition while destroying opportunities for banks’ customers. “The separation between commercial and investment banking deprived investment banks of access to cheap funds (in the form of deposits) forcing to limit ...the size of their bets. With the repeal of Glass-Steagall Act, investment banks exploded in size... (Zingales 2012). On the contrary, separation “could have a detrimental impact on the effectiveness of banks ... to serve customers”(Larosière, 2012). One should also recall the responsibility of GSA in unfitted financial schemes which, combined with ill-founded or poorly planned industrial projects, led to white elephants such as Itaipu Dam.
6. The practical delimitation of activities forbidden to retail banks is difficult, not to say impossible and in any case controversial. In particular it is impossible to draw a clear border between proprietary trading and market making, which explains why coming into force of the Volcker Rule has been repeatedly delayed for two years (Braithwate, 2011).
7. Big financial conglomerates hold a political power but their contribution to the liquidity of markets, particularly in sovereign bonds trading, is crucial as it is proved by Canadian protests against the limitation of the exception to proprietary trading prohibition (FT reporters 2012).

2.1.2. Are Basel 3 equity requirements real or apparent?

The definition of Risk Weighted Assets is both obscure and lax, open to highly diverging interpretations as it is proved by the fact that a same risk can be weighed by a factor ranging from 1 to 8 from one bank to another one (Nasiripour et al., 2013). The so called leverage ratio is in fact a “gross” equity ratio. It will be set at about 3%, while the traditional ratio for British banks was equal or higher than 5%. Therefore the safety brought by Basel 3 equity requirements is rather dubious.

2.1.3. Banks' orderly failure: tests and discussions

The principles of orderly failure are commonly agreed: there should be an improved supervision, a Resolution Authority and bail-in rules. But the implementation of those basic rules is still uncertain, although banking supervision in EU was agreed upon. As long as there will be no World Resolution Authority, cross border issues will blur the prospects of orderly failure: one should not underestimate the deep differences in bankruptcy rules and practices from one country to another. The fact that Icesave decision came as a surprise for some observers confirm these differences in understanding failures' settlement. Moreover bail-in rules practically depend on financial tools such as CoCos, which are still in a testing period. That is proved by the fact that the market for those bonds could exceed €400bn, while the present tradable market is € 19bn (Watkins, 2013).

2.1.4. Liquidity Coverage Ratio's softening: correcting an obvious exaggeration

In itself the softening of Jan 6 2013 in LCR is, naturally, welcome). But it is also worrying by what it reveals about the awareness of real risks. There was no bank run after Lehman's collapse and neither since then. In other words a credit crunch could have been brought about by an apparently protective but wrongly calculated ratio: a case of drug induced sickness (Masters, 2013).

2.1.5. Banks' legal status: the neglected issue

In partnerships, senior managers are responsible of corporate liabilities on their own wealth. Therefore this status is fitted to investment banking, where big bets are decided by senior managers, who can be disciplined only by the risks which they take on behalf of the bank. In mutuals, owners are also customers. This status is fitted to retail banking, where small depositors are risk adverse. In public companies, no such self restraint of risk taking is available, and this absence is aggravated by the self sustained race to yields and dividends (Jacomb, 2012). More relevant than ringfencing would be the obligation that at least investment banking, broadly understood, be incorporated under partnership status. Mutuality for retail banking could impose itself by marketing. Unfortunately this differentiation does not seem to be taken into account in the current international negotiations on banking.

2.1.6. Shadow Banking, shadowy future

Unlike legal incorporation, shadow banking is frequently mentioned. That is justified, at least because of the weight of this financial activity. Moreover its size is increasing as a consequence of the withdrawal of banks from a number of lending operations. One could add that shadow banking, along with peer-to peer lending, falls under the same broad logic of spontaneous disintermediation, which adds a new worry. For shadow banking is not cut off from traditional (and regulated) banking. In short, a number of financial operations, that are being dropped by traditional banks because they are not protected enough under the new and tougher regulation, will not be protected at all, which will feed back new threats on traditional banks. At last the importance of shadow

banking in China is particularly worrying (Alloway, 2011; Gorton, 2012; Masters, 2011; Rabinovitch, 2011).

2.2. Other financial tools and practices

2.2.1. The paradox inherent to rating

S&P was recently sentenced to damages to a number of local councils in Australia for having misled them in derivatives investments. On another hand some new restrictions were adopted by EU in order to sustain the objectivity and improve the quality of rating agencies' assessments. However the prospects of unbiased ratings are dubious. The main hurdle is not the constitutional argument of free expression in the USA. Contrarily to the most widespread argument, let us say that the main hurdle to good rating does not even lie in the economic model according to which rating agencies are financed, first of all, by the rated entities (Boisseau, Honorat, 2012; Foley, 2013; Hume, 2012). Flawless rating itself is by nature unreachable. That is precisely proved by the wide dependency on rating. Why could rating agencies value, understand and forecast what no other observer can value, understand and forecast, which is precisely why the valuation task has been outsourced to them? The rating practice itself takes its origin in a contradiction.

2.2.2. The conflicting ends in derivatives' regulation

Four basic issues are at stake in derivatives' regulation: (a) access to trading requirements, such as collateral on transactions, (b) transparency, which implies substitution of exchanges or trading platforms to OTC, (c) clearing houses providing Central Counterparty-CCP- in order to eliminate the risk associated with OTC and (d) repression of market manipulation and abuses. The fourth issue does not raise objections. But the three other issues are related to OTC being brought into attack and are controversial. (a) & (c): Raising collateral requirements for none centrally cleared trades would cause a credit crunch maybe as high as 10tn\$. (b) Standardised products traded on platforms will not fit hedging needs as precisely as specially-tailored OTC derivatives. (c) Clearing houses are not absolutely sheltered from failing, as proved by historical records, so that the question of their access to central banks' lending was raised (Atkins, Stafford, 2012; Atkins, 2013; Gensler, 2010; Grant, 2010; McKenzie, Foley, 2012; Meyer, 2011)

2.2.3. Securitization: could subprimes come again?

As far as the past is concerned, there is ground for some optimism. In the first place, the "cultural" (epistemological) explanation of the subprimes' crisis should serve as a lesson: anything like the gap between ABS and CDO valuation should be avoided. In the second place, the legal and financial settlement of the crisis seems to be on the right track. But, as far as future is concerned, every uncertainty is not removed. The fundamental rule that banks should remain involved in the securitized loans that they granted first ("skin in the game") is admittedly not questioned. Moreover the persistent success of covered bonds confirms this demand for an involvement of banks in the loans that they transform into securities. And new "skin in the game" rules are in force,

as it is the case in EU. But what is needed is a universal set of rules, as widely discussed and binding as Basel 3 ones. And such a set does not seem to come, while a new wave of securitization is looming (Alloway, 2012; Bullock, 2012; Drif, Ech, 2012; Ech, 2011; Foley, Rodrigues, 2012; Hughes, 2011; McKenzie, 2009; Ech, 2012; Watkins, Wigglesworth, 2012; Watkins, 2013; Watkins, 2012).

2.2.4. Insurance and Solvency 2: ominous safety

The overhauling of funding rules for insurers in EU is very controversial. The date when the Solvency 2 directive will come into force was and might again be postponed. The debate is as intense as it was the case in Basel 3 LCR before the considerable softening which was agreed upon on Jan 6, 2013. The standards to be imposed on EU's insurers are designed to prevent insurance companies from going bust with more than a one in 200 chances in any given year. This practically translates into a twofold increase in capital requirements and in a shift away from equities and long term investments. Critics of Solvency 2 point out a risk of confusion between short and long term considerations and a risk of drying up financing for the productive sector (Davies, 2011; Ech, 2011; Grene, 2012; Spitz, Hoenen, 2011).

3. SUPPLY AND DEMAND CRISIS: FROM TABOOS TO DEADLOCKS

The two main policies aiming at overcoming economic crises are the demand side and the supply side one.

3.1. Demand side policy: nothing is sacred any more, and nothing is clear either

3.1.1. The end of monetary autonomy

The first tool of demand side policy, deficit spending, is so much constrained that it can be considered unusable as such. The scale and the tempo of deficit reduction are the only practical issues at stake. This is a very clear feature of the new economic system but a depressing one: disappearance of this weapon against insufficient consumers' spending, at least for a while. More precisely, deficit spending depends on the second tool, monetary policy, which is undergoing a revolution, the outcome of which is unpredictable.

In 2012, the twin pillars of monetary order collapsed. This collapse could only be simultaneous because inflation target and independence of central bank are two faces of distribution of powers between the political and the monetary authorities. This distribution rested on the logical reasoning according to which economic imbalances could only fall under the central bank competence if they affected the level of inflation. It is true that the Employment Act in the USA assigned two duties to the Fed, full employment alongside with price stability. But this dual mandate can precisely be considered as an implicit questioning and an incipient weakening of the central bank independence.

In any case, the model according to which independent central banks watch on price stability only belongs now to the past. It is true that the last questioning of independence, which has just occurred in Japan, has so far been formally translated in a rise of the inflation target. But there is no doubt that the political pressure aims at reinvigorating growth. In the USA, the explicit announcement of an unemployment rate of 6.5% came alongside with implicit indications of a raised inflation target, and the targeted unemployment rate is obviously shared with a political consensus. In the EMU, the Outright Monetary Transaction is a trade-off between national governments and ECB, the latter one's target being the spread weighing on peripheral states' borrowing.

3.1.2. Jumping into the unknown

The unknown is double sided, the two sides of the unknown being, obviously, interdependent. In the first place, a new frame of monetary policy has to be defined. In the second place, the consequences of actions taken by central banks have to be appreciated.

Firstly, the new frame of monetary policy should be translated in clear guidelines but the task has still to be carried out. For instance it is desirable to define which very low interest rates (possibly negative) are sustainable. Otherwise, defining a nominal income target (NGDP) seems alluring to a number of experts but the risk to overstretch this prospective guideline should not be underestimated because it doesn't take into account crucial issues such as the transmission of monetary policy.

Secondly, the consequences of quantitative easing (under its different schemes) are uncertain. They fall under two mechanisms. From the standpoint of financial markets, the very low interest rates made possible by QE have set in motion a run to bonds, including junk ones, a move to releveraging and shares buyback schemes. Share buyback schemes are stabilizing in itself because they widen the choices open to shareholders looking the balance between short term gains and long range opportunities. Releveraging with very low interest rates is more worrying because of the risk of a bonds' crash.

From the standpoint of international trade and exchanges, QE undeniably contributed to volatility of exchange rates and therefore to increase the risk of a return to currency wars (Atkins, 2013; Authers, 2013; Goodhart, 2013; Harding, 2013; King, 2013; Lacour, Ech, 2013; Lyons, 2013; McLannahan, Jones, Ross, 2013; McLannahan, 2013; Mohi-uddin, 2013; Nakamoto, 2013; Plender, 2013; Robequain, Ech, 2013; Rousseau, 2013; Soble, 2013; Steen, Ross, 2013)

3.2. Supply-side policy: braving the power of contrary winds

3.2.1. The knot of labor cost

The subprimes' crisis must partly be attributed to stagnating income of mid-range workers in the USA and rising inequality still hinders the rebound. The stagnation and the inequality can in turn be imputed to two main factors. In the first place one should

mention various forms of breaches to the competitive order widely understood. The de facto dictatorship of a given ROE, not long ago, could namely be assimilated to an open price fixing agreement. And the excessive fiscal levies on wages are an abuse of the State's power. Structural rigidities such as excessive dependency on unemployment compensation can also be considered as breaches to fair competitive rule. In the second place one must recall the logic of HOS theorem.

The two factors strengthen each other and create a vicious circle where excessive offshoring and unemployment of young people in old industrialized countries are two sides of the same reality. ROE dictatorship seems to have weakened for the time being. HOS logic will not vanish. Therefore old industrial countries are bound to reduce their labor costs and, in the same time, to increase their productivity in order to keep jobs at home and to justify wages higher than in emerging economies. That is easier said than done, and the prospects of this new course are uncertain. But a new range of agreements where wage earners accept labor flexibility against massive hiring (BMW) or maintaining employment (Renault) give some hope (Easton, 2011; Harding, 2011; Kennard, Bond, 2011; Lacour, 2012; Perrotte, 2012; Politi, 2012; Prandi, 2011; Roubini, 2011; Schaeffer; 2011).

3.2.2. Financing productive activity: money is tight

The two main hurdles to financing productive activity are the crowding out effects, either of public expenditures on private investment or within the private sphere, and the unbalance between long term saving and investment. The crowding out effect was lamented even in the Tarp which "failed US Main Street". It is at work in France, where it threatens to cripple any manufacturing rebound. This negative action can be imputed to public investments but also to inroads of big firms into small ones which are their suppliers. The unbalance between long term saving and investment needs is the more worrying the more severe standards constrain banks. In some countries, as in France, the two constraints are alleviated by a high saving rate. But the constraints alleviated or not remain present in many countries (Lefèbvre, Schaeffer, 2012; Maujean, 2013; Péresse, 2013; Polity, 2010; Renaud, 2012; Seux, 2012; Wigglesworth, 2012). China is the only important country where savings is superabundant but efficiency of capital is low.

3.2.3. Joker? Natural and historical endowments

It seems that the wished rebound may come from exploiting natural or historical endowments. Shale gas brings new industrial opportunities to the USA, thanks to technological advances. On the contrary, historical endowments and other tourist appeal features of France are still underexploited, in other words they have not found yet their economic model. However one can reasonably extrapolate and forecast that, in a number of old industrial countries, some impetus to a renewed growth will come from a better use of the third production factor (Crooks, 2012; Delanglade, 2012; Palierse, 2013).

3.2.4. The double nature of housing and property

Housing and property is a consumer's good and a production factor as well. Therefore it retains, for better or for worse, a unique absorption capacity of savings, up to and including to be, in some circumstances, the only wise investment. The last housing bubble is a case in point because it can be attributed in part to a long range drying up of innovation and manufacturing investment in the world. According to McKinsey Global Institute, investments from 1980 to 2008 in mature economies total 20tn\$ less than if the investment rate had remained stable. This excessive investments and losses must now be spread and absorbed, in order to make possible a return to a moderate growth in the sector. This return to normality is in progress but it takes time, which is not surprising if one takes into account the size of overinvestment in some countries such as Spain, and the resulting interaction with the sovereign crisis

In other countries such as France, a better management of housing as a production factor is still more at stake than the resorption of the crisis. Housing costs hamper competitiveness and this remains a challenge (Altman, 2012; McCrum, 2012a; McCrum, 2012b; Nasiripour, Harding, 2013; Plender, 2011; Sabbah, 2012; Scannell, 2013; Schaeffer, 2013; Vittori, 2013; Watkins, 2012)

3.2.5. Industrial dynamics and innovation

The return to growth and innovation involves the whole economic system and many public policies. It is impossible not to mention the incredible length of time it took to agree on a common European patent (1975-2013). One can also but notice the underuse of the opportunities brought by the Euro. It should have induced the settlement of an innovation scheme similar to the one at work in the USA, the triptych: venture capital-Nasdaq-defence appropriations. The introduction of Euro made possible to create a unified and dynamic European sphere. It ended up so far in the contrary of the latter. It is true that the German model differs from the American one: the Mittelstand tradition combined with a strong Euro supports namely a self sustained innovation course. From such a standpoint, the American scheme rests on a substitution of the continuous industrial upgrading, induced by a strong currency, by an autonomous innovation sphere where, however, market discipline is at work, thanks to the networks and tests on markets, which intervene in the process starting with the start-up and culminating in Nasdaq success. But the fact that there is a German model is no ground for ignoring the lessons of innovation in America. From a theoretical standpoint, that leads to a reconstruction of the economic system, based on an enlarged definition of Pareto Optimum (Olsem, 2009).

4. CONCLUSION

Uncertainty is high and clear features of the dawning new economic system are few. It is true that this review has still to be extended to the sovereign crisis. But it would be a surprise if this extension added clarity to the tenets of the new economic order and to the components of the new economic system. The phrase "triple dip crisis" begins to appear. However two considerations may be somewhat reassuring. In the first place a

deleveraging process for households and for many firms is in progress. In the second place central banks have kept reacting audaciously and wisely to unexpected situations since the beginning of the crisis. The first priority of public authorities should be to complete this reactivity by putting innovation into the center of the new economic system, that is to say by redesigning it around the enlarged version of Pareto Optimum put forward in above quoted and related papers.

REFERENCES

- Alloway T. FT 26-27.05.12 "Invasion of the covered bond runs into battle of US regulation"
- Alloway T. FT 29.12.11 "Traditional lenders shiver as shadow banking grows"
- Altman R. FT 12.10.12 "A new housing boom is set to lift America's economy", E. 18.02.12 "America's mortgage deal – A deserved penalty or an opportunistic shakedown?", E. 26.11.11 "House of horrors, part 2 – The bursting of the global housing bubble is only halfway through", Ech. 20-21.01.11 "Les recommandations de l'OCDE pour stabiliser le marché du logement"
- Atkins R. & Stafford P. FT 05.12.12 "Regulators wrestle with hidden risks in swaps shake-up"
- Atkins R. FT 06.02.13 "Planned new collateral rules heighten risk of crunch"
- Atkins R. FT 09.01.13. "Central banks must ensure safety whatever the definition"
- Authers J. FT 21.01.13. "Confusion follows the distortion caused by low yields"
- Barré N. Ech. 29.01.13. "La prochaine crise financière"
- Boisseau L. & Honorat R. Ech. 29.11.12) " Le Conseil et le Parlement européen imposent de nouvelles contraintes aux agences"
- Boisseau L. Ech. 11-12.01.13 " L'épargne de précaution explose dans les entreprises "
- Braithwaite T. FT 20.12.11 "Volcker conundrums fuel confusion over bank rules", Landier A. & Thesmar D. Ech. 14.02.13 "Réforme bancaire: louvoyer ne suffit pas"
- Bullock N. FT 09.02.12 "Goldman in \$6.2bn toxic asset deal"
- Crooks E. FT 15-16.12.12 "US shale boom brings \$90bn boost"
- Davies P. FT 13.07.11 "Insurance shake-up raises fears on funding for groups"
- Davies P.J. FT 27.05.11 "Insurers buy into wave of "safe" covered bond issues"
- Delanglade S. Ech. 20.12.12 "Comment les groupes profitent (quand même) des gaz de schiste"
- Drif A. Ech. 05.06.12 " Des investisseurs craignent un retour au système des "subprimes", Ech. 01.12.11 " Lehman Brothers: les créanciers approuvent massivement le plan de liquidation"
- Easton N. F. 05.02.11 "Politicians need to face harsh realities about the US jobs crisis"
- Foley S. & Rodrigues V. FT 13.09.12 "Bundled US car loan deals enjoy comeback",
- Foley S. FT 15.01.13 "Outlook unchanged",
- Gasquet P. Ech. 15.02.12 "Le lobby bancaire américain tente de suborder la Volcker Rule"
- Gensler G. FT 25.02.10 "How we can stop another derivatives inferno"
- Goodhart C. FT 31.01.13 " Central banks asked to walk inflation's razor edge"
- Gorton G. FT 21.11.12" Banking must not be left to lurk in the shadows"
- Grant J. FT 08.06.10, E. 07.04.12 "New push to give clearing houses solid foundations"

Haldane A. FT 08.10.12 “We should go further still in unbundling banks”

Harding R. FT 15.12.11 “ \$ 740bn pay gap threat to US recovery”

Harding R. FT 23.01.13 “Fed seeks to improve how it communicates with markets”

Hughes J. FT 25.03.11 “ Brussels keep brake on Europe’s CLO sector”

Hume S. FT 06.11.12 “Judge rules S&P misled derivative investors”

Iturbide P. Ech. 30.01.13 “Erreurs de politique monétaire: un risque sous-estimé?”

Jacomb M. FT 12.09.12 “Prudent finance requires a return to partnership”

Kay J. FT 19.01.11 “How trust in finance was carried off by the carpetbaggers”

Kennard M. & Bond S. FT 14.09.11 “US wealth gap raises concerns”

King S. FT 11.01.13 “The era of independent banks is coming to an end“,

Lacour J.-P. Ech. 23.01.13 “L’indépendance des banques centrales à l’épreuve de la crise financière”

Lacour J.P. Ech. 28-29.09.12 “BMW va recruter massivement grâce à un accord de flexibilité“

Larosière J. FT 27.09.12 “Do not be seduced by the simplicity of ringfencing”

Lefèbvre E. & Schaeffer F. Ech. 14.11.12 “Après la compétitivité, place à la réforme de l’Etat”

Lyons G. FT 29.01.13 “Inflation still a temptation for dealing with western debt“

Masters B. & Grant J. FT 03.02.11 “Shadow boxes”

Masters B. FT 07.01.13 “Massive softening of Basel bank rules”

Maujean G. Ech. 08.01.13 “Les défenseurs de l’épargne longue montent au créneau”

McCrum D. FT 10.10.12 “ Funds enjoy Fed boost for bundled debt deals“

McCrum D. FT 14-15.07.12 “San Bernardino opens door to US housing slump solution”

McKenzie & Foley S. FT 12.12.12 “High costs to hit made to measure derivatives”Meyer G. FT 08.07.11
“Greater firepower for US regulator”

McKenzie D. FT 26.11.09 “Beneath all the toxic acronyms lies a basic cultural issue”

McLannahan B. FT 26-27.01.13 “Falling wages threaten “Abenomics” plan to lift prices”

McLannahan B., Jones C. & Ross A. FT 23.01.13 “BoJ bows to political pressure for action to defeat deflation”

Mohi-uddin M. FT 24.01.13 “Stable prices no longer the sole target of central banks”

Motte M. Ech. 11-12.01.13 “Deux temps, trois mouvements“

Nakamoto M. FT 10.01.13 “Japan’s new economic stimulus plan fails to excite analysts“

Nasiripour S. & Harding R. FT 19.02.13 “ The long climb back”

Nasiripour S., Masters B. & Alloway T. FT 18.02.13 “Banks’ risk tactic under fire”

Olsem J.P. “Pour un ordre concurrentiel” *Economica* 1983, “ Economie industrielle” Armand Colin 1991

Olsem J.P. “Logique parétienne et innovation mondialisée “ in “Mélanges en hommage à J.C. Dischamps”
Cucui I. , Negrepointi-Delivanis M. et Stegaroui I. *Bibliotheca Targoviste* 2009

Oudéa F. Ech. 20.12.11 (Interview)

Paliere C. Ech. 31.12.12-01.01.13 “Le tourisme,un atout mal exploité par la France”

Pécresse J.F. 18.02.13 “La spirale fiscale infernale”

Perrotte D. Ech. 31.10.12 "Durée légale, temps de travail reel, assouplissements: les clefs d'un débat recurrent"

Plender J. FT 16.01.13 "Too much rides on central banks steering stable course"

Plender J. FT 27-28.01.11 "Property..."

Politi J. FT 13.09.12 "US median income lowest since 1995"

Polity J. FT 22.07.10 "Overseer says Tarp failed US Main St",

Prandi M. Ech. 16-17.09.11 "La Grande Récession a détruit 13 millions d'emplois"

Rabinovitch S. FT 03.02.12 "Uncertain foundations"

Renaud N. Ech. 01.10.12 "Le Livret A, inusable bras armé financier de l'Etat"

Robequain L. Ech. 29.01.13 "La stratégie de la Fed commence à inquiéter les investisseurs"

Robert V. Ech. 10-11.02.12 "Saisies immobilières : l'administration Obama impose un accord à 25 milliards de dollars"

Roubini N. Ech. 24.10.11 "L'inégalité, source de l'instabilité"

Rousseau Y. Ech. 14.01.13 "Retour vers le futur au Japon"

Rousseau Y. Ech. 23.01.13 "Tokyo s'aventure dans une stratégie monétaire périlleuse"

Sabbah C. Ech. 29.11.12 "Marché immobilier: cette baisse qui ne vient pas"

Scannell K. FT 08.01.13 "US Housing After the gold rush"

Schaeffer F. Ech. 04-05.01.13 "Pourquoi Bercy veut voir baisser les prix de l'immobilier"

Schaeffer F. Ech.06.02.11 "La France relativement épargnée par le bond des inégalités de revenus au sein de l'OCDE"

Seux D. Ech. 12.12.12 "Impôts des entreprises:(-1)+(+1)=0"

Soble J. FT 23.01.13 "BoJ wary over deflation role"

Spitz B. & Hoenen R.P. Ech. 31.01.11 "Pour une regulation intelligente de l'assurance"

Steen M. & Ross A. FT 23.01.13 "First shot fired in new round of currency wars"

Vittori J.M. Ech. 04-05.01.13 "Lutter contre l'inflation immobilière"

Watkins & Wigglesworth R. FT 20.04.12 "Private equity swoops for toxic mortgage debt"

Watkins M. FT 04.12.12 "Europe's property loans unpaid"

Watkins M. FT 12.02.13 "Covered bond to test risk appetite"

Watkins M. FT 23.11.12 "Barclays' total loss bond poses test for "coco" market"

Watkins M. FT 29.03.12 "Stigma of "toxic" securities recedes in hunt for yield"

Wigglesworth R. FT 03.05.12 "Funding gap puts infrastructure projects in peril"

Zingales L. FT 11.06.12 "Why I was won over by the merits of Glass-Steagall"

Hrvoje Jošić

University of Zagreb, Faculty of Economics and Business, Zagreb, Croatia

Mislav Jošić

University of Zagreb, Faculty of Economics and Business, Zagreb, Croatia

STATIC AND DYNAMIC EFFECTS OF CUSTOMS UNION CREATION

ABSTRACT

The benefits of free trade arrangements in regard to autarky were known from the time of classical economists. The process of regional and global economic integration started in the second half of the twentieth century. Regional economic integrations can be expressed in the form of free trade area, customs union, common market and economic (monetary and political union). There are benefits and costs of accession into these regional economic integrations. In this paper customs union as a form of regional economic integration is presented and explained. If the positive effect of customs union accession (trade creation) outweighs the negative one (trade diversion), country should join the custom union. The goal of this paper is to demonstrate and explain the benefits and costs of customs union creation using microeconomic apparatus and quantitative analysis. The anticipated accession of Croatia into European Union Customs Union (EUCU) is considered and presented using static and dynamic effects of customs union creation which are thoroughly analysed. The importance of CEFTA market for Croatia is specially highlighted and explained. The analysis has shown that the anticipated 2013. Croatia-EUCU accession will have small positive static and potentially positive dynamic effect on country's welfare.

Keywords: *customs union, static and dynamic effects, Croatia-EUCU accession*

JEL classification: *F15*

1. INTRODUCTION

The benefits of free trade arrangements in regard to autarky were known from the time of classical economists. The process of regional and global economic integration started in the second half of the twentieth century. Regional economic integrations can be expressed in the form of free trade area, customs union, common market and economic (monetary and political union). There are benefits and costs of accession into these regional economic integrations. Trade creation and trade diversion effects of customs union creation were firstly introduced by Jacob Viner (1950) in his classical work „*The Customs Union Issue*“ setting a corner stone in classic theory of international economic integration up-to-date. These are static effects of custom union

creation; trade creating effect has a positive effect while on the other side trade diverting effect has a negative effect on country's welfare. Bela Balassa (1961) in his paper „*The Theory of Economic Integration*“ was the first to introduce dynamic effects of customs union creation: increased competition between member countries, external economies of scale, rapid spread of technology, terms of trade, etc. Dynamic effect of customs union creation are less analysed in economic literature compared to static effects but have many times greater impact on country's welfare. If the positive effect of customs union creation outweighs the negative one, country should join the custom union. In this paper customs union as a form of regional economic integration will be presented and explained in the case of anticipated EU-CU customs union. In the second chapter is given empirical literature on the subject of customs union creation, in third chapter are presented types of regional economic integrations and explained customs union static and dynamic effects while in the fourth chapter are analysed static and dynamic effects of the anticipated Croatia-EUCU. At the end of the paper are given final considerations and concluding remarks.

2. EMPIRICAL LITERATURE ON THE SUBJECT OF CUSTOMS UNION CREATION

The empirical literature on customs union formation is associated with the work of Viner (1950), Meade (1955) and Lipsey (1957). They have analysed the consequences of joining regional trade agreements from the viewpoint of welfare effects. The focus was especially on the difference between the free trade area (FTA) and customs union and the removal of tariffs and introduction of the common external tariff on trade. Jacob Viner was the first one to pointed out that regional trade agreements do not necessarily result in gains to member countries. He defined and analysed the static effects of customs union creation; trade creation and trade diversion effect. According to Viner customs union can postulate, either trade creation, or trade diversion which, raises or lowers the country's welfare accordingly, on the other hand, Lipsey argues that trade diversion can raise welfare, Androniki *et al* (2010). Bhagwati (1970) also examined the issue of the welfare impact of regional economic integrations and proved that trade-diverting customs union may lead to a net increase in welfare. According to the Kemp-Wan proposition (1976) there exists common tariff vector that leads to competitive equilibrium in which each individual country is not worse off than before the customs union creation. Although theoretically feasible compensation scheme through transfers lacks political approval due to the fact that not all countries would be willing to make trade concessions without reciprocity. Below is presented empirical literature in the last two decades on the subject of customs union creation.

Michalopolous and Tarr (1997) analyses the economic implications of the establishment of a customs union between four CIS members countries (Belarus, Kazakstan, the Kyrgyz Republic and Russia). The static effects would tend to be mixed but would be especially adverse for countries that had already established relatively liberal trade regimes with a lower average and less differentiated tariff structure than that under the common external tariff contemplated for the proposed customs union. They conclude that the dynamic effects of the customs union are likely to be negative because it would tend to lock the countries into the old technology of the Soviet Union.

Aksen and Tochitskaya (2001) also analyse the costs and benefits of the Belarus' participation in the customs union of the CIS countries based on the study of the static and dynamic economic effects and their impact on the nation's welfare, and the Belarus' economy growth rate. The results of the analysis have shown that prevalence of trade diversion effect and hence welfare losses were experienced in chemistry and petrochemistry, light, wood and wood-proceeding, machine-building and metal-working industries. Abrego and Riezman (2003) use computational techniques to assess whether or not various propositions that have been advanced as plausible in the literature on the theory of customs unions actually hold. Karaman and Lerzan Ozkale (2005) investigate Turkey's import demand function using an econometric panel data application. Findings show that Turkey's import demand is income elastic and price inelastic. The analysis was repeated for the main import sectors and empirical findings indicate that Customs Union Agreement has trade creation effects among some sectors and trade diversion effects among some others, while no effects at all could be calculated for the remaining. Cakmak and Eruygur (2008) investigate trade implications of the Turkey-EU customs union agreement to agricultural products. Their findings show that the winners of a possible Turkey-EU customs union enlargement are EU countries. Dalimov (2009) in his research develops dynamic tools to the analysis of trade creation and trade diversion effects under economic integration based on the model developed for interregional flow of the goods between member states of the union and the rest of the world. Analysis has shown that interregional flow of the goods as well as trade creation and trade diversion effects are correctly described by one-dimensional Navier-Stokes equation, with the method itself complementing static analysis of Viner's trade creation and diversion effects. Aydin, L. and Demirci, N. (2011). focuses on the effects of common external tariff to Turkey's trade. The simulation results has show that Turkey has been benefiting from the noticeable tariff liberalization as well as improved market conditions in line with EU since it ratified custom union with EU. Pala (2011) analyzes why the customs union between Turkey and the EU does not manifest the expected static effects, why the trade share of the EU decreased over four time in spite of the customs union agreement and what measures should be taken in order to increase the trade between Turkey and the EU.

3. TYPES OF REGIONAL ECONOMIC INTEGRATIONS AND CUSTOMS UNION STATIC AND DYNAMIC EFFECTS

Regional economic integrations has become largely popular after the Second World War. Main characteristic of these integrations is that a group of countries abolish all trade barriers among the integrated countries in order to achieve free international trade on a regional rather than a global scale. It can be distinguished between following types of economic integration agreements (presented in table 1):

- Preferential trade agreement (PTA): In this form of agreement there is no general reduction on internal tariffs nor a common external tariff. Tariffs between the members of the agreement are reduced (or eliminated) only for some goods or services, sometimes unilaterally.
- Free trade area (FTA): Member countries eliminate internal tariffs on regional trade without any common trade policy relative to other countries. However it is possible for one country to import all of a certain good that the other country

previously imported, only to turn around and trade it to another country in its free trade area. That problem is called trade deflection and it requires the use of certificates of origin for goods crossing the border.

- Customs union: Like in a free trade area member countries abolish internal tariffs on free regional trade and adopt a common external tariff against the rest of the world.
- Common market: In this type of economic integration member countries allow not only for the free movement of goods and services but also for the free movement of factors of production such as labor and capital.
- Economic and Monetary/Political Union: An economic union can be considered as an economic integration comprising a common market and common economic policies along with asupranational power that makes binding decisions, lessening the power of member countries much further on making their own decisions, Krueger, (1995). The economic union provides grounds for creation of monetary union and adoption of one currency in integrated region.

A customs union (CU) is a form of trade agreement under which certain countries preferentially grant tariff-free market access to each other's imports and agree to apply a common set of external tariffs to imports from the rest of the world (Andriamananjara, 2011:111). Early examples of customs unions include the Zollverein, formed in 1834 by several German principalities and the 1847 customs union between Moldavian and Walachia, a precursor to the creation of Romania. Customs unions have two types of economic effects; static effects and dynamic effects. Static effects include *trade creation* effect and *trade diversion* effect.

Table 1: Types and characteristics of economic integrations

Strength of integration	Level of integration	The elimination of tariff on intraregional trade	Adoption of external tariff against the ROW	Free trade of labor and capital	Coordination of economic policies and harmonisation of standards
	PTA	✓	-	-	-
	Free Trade Area (FTA)	✓	-	-	-
	Customs Union	✓	✓	-	-
	Common market	✓	✓	✓	-
	Economic and Monetary Union	✓	✓	✓	✓
	Political Union	✓	✓	✓	✓

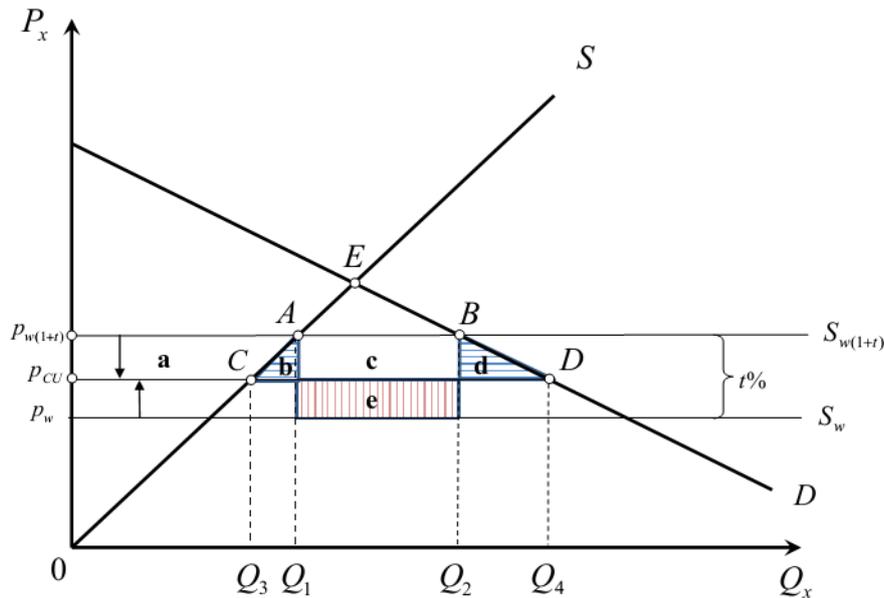
Source: Authors

Trade creation occurs when the domestic production of a good in a member country is replaced by the imports of the same good from another member country within the customs union because of the lower cost production. Trade diversion occurs when the imports from a non-member country are replaced by the imports of a member country

because of the removal of tariffs between members and the application of common customs tariffs to non-member countries.

Static and dynamic effects of customs union creation are presented on the partial equilibrium framework (microeconomic model) in the figure 1. Let us assume this is a microeconomic model of a small country. In the point E there is an equilibrium level (autarky) of domestic supply S and demand D . Price of good X on the international free market is equal to p_w with perfectly elastic supply curve S_w for the good X in the small country. Small country now imposes an *ad valorem* tariff in the amount of $t\%$. New price of good X in a small country is now $p_{w(1+t)}$ with perfectly elastic supply curve $S_{w(1+t)}$. Excess demand over supply \overline{AB} is equal to the quantity of imports $\overline{Q_1Q_2}$ into small country. Small country is now entering into regional customs union eliminating the tariff on intraregional trade and adopting the common external tariff⁷.

Figure 1: Static effects of customs union creation



Source: Marrewijk, C. (2012) and authors' illustration

After the formation of the customs union the tariff t is eliminated, price of good X falls to p_{cu} , demand increases from Q_2 to Q_4 , supply decreases from Q_1 to Q_3 while imports from customs union rise from $\overline{Q_1Q_2}$ to $\overline{Q_3Q_4}$. Lets see what has happened to the welfare of producers, consumers and government in the small country. Welfare for producers falls measured by the area a , consumers gain areas a , b , c and d while the government

⁷ In this case small country is entering into customs union with an inefficient producer: therefore will be trade creation and trade diversion effect.

loses revenues from the tariff (areas *c* and *e*). The positive welfare effect of customs union accession for small country is equal to the areas *b* and *d* and is called trade creation effect (the so called Harberger triangle, Harberger (1954)). On the other side negative welfare effect represents the area *e*. Net welfare effect of customs union accession is equal to $b + d - e$. If the trade creation effect is larger than trade diversion effect small country should enter the customs union.

As apposed to static effects of customs union creation the less known but much more important are dynamic effects. The first systematic investigation of dynamic effects of economic integration was carried out by Balassa (1961). According to Balassa dynamic effects of customs union creation are:

- *Effects on competition*: Accessing the customs union enlarges the market in comparison to protected trade and makes a producer subject to new forms of competition. The increase in competition among business firms forces the economic subjects to be efficient as possible in order to gain a new market share.
- *Effects on economies of scale*: As the economic subjects are obliged to be optimal efficient, the economies of scale will overwhelm the diseconomies of production. Scale economies are associated with the use of expensive and specialised equipment.
- *Effects on capital formation and investment*: Customs union could enhance the investment from outside investors and provide stimulus to economic growth. Investments are attracted to the most productive and competitive sectors which are able to survive on the market.
- *Effects on technological advances (innovations)*: Customs union can improve technological innovations and progress through research and development programmes.
- *Effects on terms of trade*: Terms of trade of member countries may improve because they can now have greater bargaining power.

4. STATIC AND DYNAMIC EFFECTS OF CUSTOMS UNION CREATION: THE ANTICIPATED CROATIA-EUCU ACCESSION

Croatia is anticipated to access the European Union by 1th July 2013. Membership in the EU also means the establishment of a customs union between Croatia and EU. New member countries adopt a common external tariffs against third countries (Common External Tariff, CET) while removing remaining non-tariff barriers to international trade. Weighted average common external tariff (measured based on the share of each product in total imports) is 3,2% which is less than the current average tariff protection in Croatia of 4,5%⁸. The lowering and elimination of tariffs on mutual trade between Croatia and EU was realized under the Stabilisation and Association Agreement signed on 29th October 2001. Transitional period commencing upon the entry into force was six years. Entering the full membership the remaining non-tariff barriers to international trade, such as discriminatory technical regulations or incentives to buy local (national) products will be removed. Entering the EUCU Croatia will assume the rights and obligations under EU agreements with Albania, Bosnia and Herzegovina,

⁸ Not including imports of duty-free products.

Montenegro, Macedonia and Serbia. It also means that it will continue duty-free Croatian trade with these countries and there will be no major negative consequences of placing outside forces agreements with CEFTA (Central European Free Trade Agreement) countries. The exception are exports of some agricultural and food products in CEFTA countries for which the government will retain tariff protection or have a quantitative restriction (quota) on preferential imports (IIR (2012)).⁹

Size of static effects of a customs union formation between Croatian and EU can be estimated by formulas that can be derived directly from the partial equilibrium model of traditional theories of the customs union (Cline *et al.*, 1978). Using these formulas the Institute for International Relations (IIR) has calculated in 1998 the static effects of Croatian integration into the EU (Samardžija *et al.*, 1998). Vizjak (2001) analyses and calculates static and dynamic effects of Croatia's potential accession to the European Union. Trade creation effect on imports amounted at 7,4% while on the other hand trade diversion effect on imports amounted at 0,7%. Using gravity model dynamic effects were estimated on 37% increase in Croatian imports from the EU. Đukec *et al* (2003) also quantificates static and dynamic effects of customs union creation between Croatia and EU. Trade creation effect on imports equaled 7,14% while the trade diversion effect equalled 0,49%. Total net welfare effect on Croatia was estimated to be positive with 0,357%.

If we look at the results of the past analysis it can be seen that in this way calculated consequences on the international trade and welfare in Croatia were relatively small. From today's perspective they are even much smaller because the tariffs rates in the recent years were lowered especially after the signing Stabilisation and Association Agreement in 2001 and joining CEFTA in 2003. It's one of the reasons why there has been a sharp increase in imports in Croatia in the last decade with the resulting growth of the external debt. The goal of this chapter is to calculate static and net-welfare effects of anticipated Croatia-EUCU accession on Croatian economy and explain the most important dynamic effects. In the figure 2 are presented static effects of the anticipated Croatia-EUCU accession. Figure 2 differentiates from the figure 1 (theoretical partial equilibrium model with one product) because it takes into account total imports of goods in Croatia. Customs union creation between Croatia and EU will not affect all government revenues, only part of trade between Croatia and EU. In this case government will lose only area *c* while domestic consumers would get areas $a + b + c + d$ and producers would lose area *a*. Total net welfare effect on Croatia's welfare would be areas $b + d$ which is positive effect on Croatia's welfare.¹⁰ Before starting the quantitative analysis it is important to say that the magnitude of the effects of the elimination of tariffs on the trade and welfare following the establishment of a customs union will depend upon four major factors:

- (a) The height of the original tariff rates to be eliminated
- (b) The size of the fall in prices brought about by the abolition of tariffs

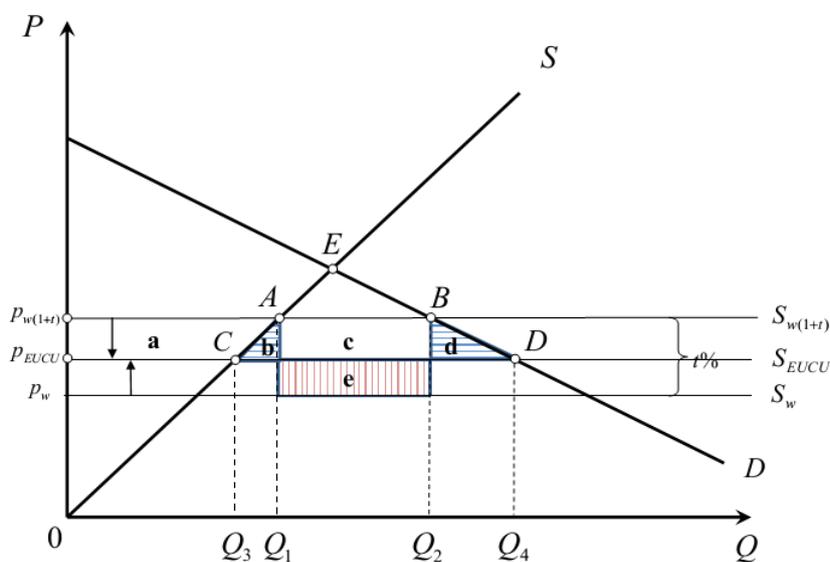
⁹ Croatia's trade in non-agricultural goods with its largest trading partners is virtually duty free; for example, the average tariff on non- agricultural imports (WTO definition) from the EU is 0,1% (WTO, 2010).

¹⁰ It can be said that the imports from the EU countries are from the most efficient producer so the negative effect on Croatia's welfare would not exist.

- (c) The responsiveness of the import demand to changes in price in the individual countries, i.e. the price elasticity of demand for imports
- (d) The initial volume of imports from the partners, i.e. before the formation of the union.

The greater the magnitude of each of the above factors, the greater will be the increase in the total volume as well as value of imports (Rahman *et al*, 1981:62).

Figure 2: Static effects of the anticipated Croatia-EUCU accession



Source: Authors' illustration

Using the Clein model earlier used by Samardžija *et al*, Vizjak and Đukec *et al*, trade creation and trade diversion effect of the anticipated Croatia-EUCU will be calculated¹¹. In the relation 1 is presented and calculated trade creation effect:

$$TC = \eta * T * M_{EU} = -0,84 * -0,007 * 0,618 = 0,00363 = 0,363\% \quad (1)$$

η – price elasticity of import demand for Croatia¹²

T – percentage change of import prices due to tariff elimination in EUCU

M_{EU} – relative value of imports from the EU countries in total imports for Croatia¹³

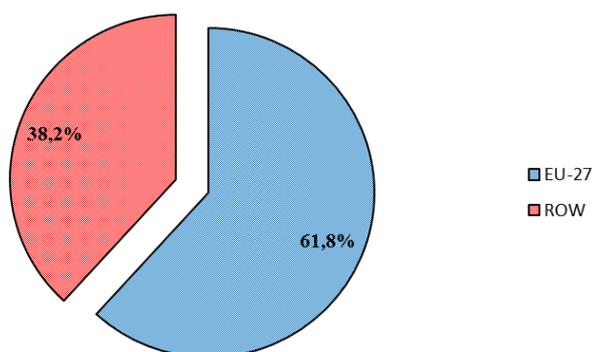
¹¹ Analysis will be conducted for the year 2011.

¹² Price elasticity of import demand for Croatia is taken from the Bobić (2010) and is calculated for the period between 2000 and 2007 under 1% significance.

¹³ Presented in figure 3.

Percentage change of import prices due to tariff elimination in customs union is equal to the difference between the price change of imports before and after customs union creation ($p_{w(1+t)} - p_{EUCU}$) presented in the figure 2. Price change due to tariff impose before customs union creation $p_{w(1+t)}$ was calculated by dividing government tariff revenue (1,6 billion of kunas) with the value of imports in 2011 (118,363 billion of kunas) and equals 1,35% of price without any tariff rate p_w . On the other hand, price change after the customs union creation p_{EUCU} is calculated by dividing expected government tariff revenue after the customs union creation (770,1 million of kuna) with the import value and equals 0,65%. Expected government tariff revenue is calculated by multiplying expected non-preferential imports of goods after the customs union creation (20% of the market) with the average common external tariff in the EU which equals 3,2%. Difference between the two import price changes equals 0,7% of import price. Calculated trade creation effect from the anticipated Croatia-EUCU equals to 0,363% of total imports in Croatia.

Figure 3: Imports in Croatia from EU-27 and ROW (2011)



Source: DZS and authors' illustration

In the relation 2 is presented and calculated trade diversion effect of the anticipated Croatia-EUCU accession for the year 2011.

$$TD = (M_{ROW} * M_{EU} * s * T) / (1 + (M_{ROW} * s * T)) \quad (2)$$

$$TD = (M_{ROW} * M_{EU} * s * T) / (1 + (M_{ROW} * s * T)) = (0,382 * 0,618 * 0,3 * 0,007) / (1 + (0,382 * 0,3 * 0,007)) = 0,0005 = 0,05\%$$

M_{ROW} – level of imports from rest of the world (outside the customs union)

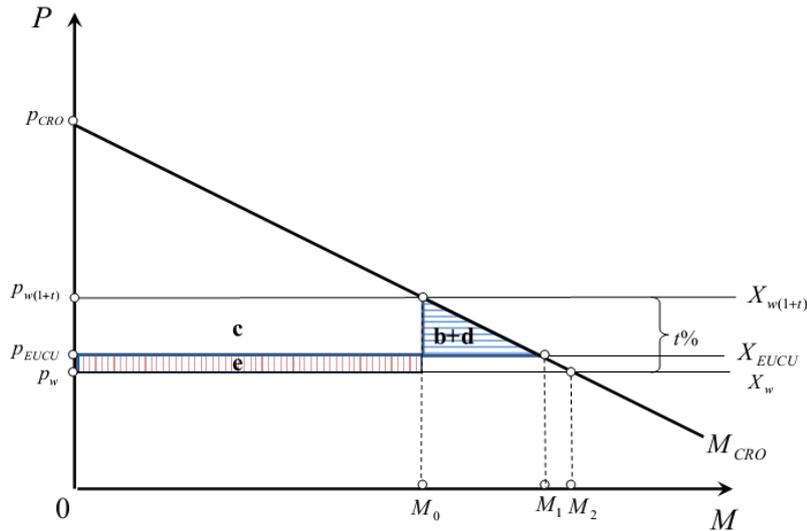
s – coefficient of elasticity of substitution ¹⁴

Calculated trade diversion effect from the anticipated Croatia-EUCU equals to 0,05% of total imports in Croatia. Net trade effect of the anticipated Croatia-EUCU creation is

¹⁴ For the purposes of the analysis it is assumed that the value of coefficient is equal to 0,3 like in previous studies.

equal to the difference between the trade creation and trade diversion effect and equals 0,313%. In the figure 4 is presented net welfare static effect in Croatia of the anticipated Croatia-EUCU accession.

Figure 4: Net welfare static effect in Croatia of the anticipated Croatia-EUCU accession



Source: Authors' illustration

In order to calculate net welfare static effects in Croatia of the anticipated Croatia-EUCU accession it is necessary to calculate revenue effect (loss of government revenue from tariff elimination) and welfare effect (change in welfare of domestic producers and consumers). Loss of government revenue equals area c while the net effect on domestic consumers and producers welfare are areas $b + d + c$. Total net welfare effect on Croatia's welfare equals areas $(b + d)$. It can be calculated using relation 3:

$$W = \frac{T * \Delta M}{2} \quad (3)$$

where W is total net welfare gain, T is percentage change of import prices due to tariff elimination in customs union and ΔM is net trade effect $\overline{M_0 M_1}$.

$$W = \frac{T * \Delta M}{2} = \frac{0,007 * 0,00313 * 118363,1}{2} = 2,593 \text{ million of kunas}$$

Net welfare effect on Croatian economy would amount to 2,593 million of kunas which represents only 0,00076% of Croatian GDP, that is in the range of statistical error. The value of area e equals 770,1 million of kunas. Since the government is obligated to pay 75% of collected tariff revenues into common EU fund, revenue loss for Croatian

government would be additional 577,575 million of kunas while the government revenues would be only 192,525 million of kunas. Negative net welfare effect of customs union creation would be 574,982 million of kunas which represents 0,168 % of Croatian GDP.

As opposed to the static effects of abolishing tariffs in the Croatia-EU customs union there are dynamic effects of customs union creation that can not be measured using previously explained model. Two main effects that could cause the expansion of trade after the customs union creation are reduction of formalities at the border and the elimination of non-tariff barriers to trade. It can result in immediate time and cost savings for enterprises which can lead to lower prices and expansion of trade. Integration into the European Union will increase the market share and thus enable exploitation of returns to scale. Increased competition will led to closure of unprofitable enterprises and repeal of monopolistic and oligopolistic structures. Croatian economy will also benefit from a number of mechanisms that encourage export competitiveness, for example development of basic and business infrastructure, increasing and improving efficient investment in energy and telecommunications networks, better availability of business services and support mechanisms to improve the development of education, science and technology (IIR, 2012:54). From the point of investment activity particularly important would be foreign direct investment (FDI) from EU countries in order to boost domestic growth and facilitate structural changes.

5. CONCLUSION

Regional economic integrations have become largely popular after the Second World War. Main characteristic of these integrations is that a group of countries abolish all trade barriers among the integrated countries in order to achieve free international trade on a regional rather than a global scale. A customs union (CU) is a form of trade agreement under which certain countries preferentially grant tariff-free market access to each other's imports and agree to apply a common set of external tariffs to imports from the rest of the world. Customs unions have two types of economic effects; static effects and dynamic effects. Static effects include trade creation effect and trade diversion effect. The goal of the paper was to calculate and explain static effects of the anticipated Croatia-EUCU creation and demonstrate the most important dynamic effects of customs union.

Analysis of static effects was conducted using Cline model and data for the year 2011. Results of the analysis have shown that net trade effect of the anticipated Croatia-EUCU creation is equal to 0,313% of total imports. Calculated consequences on the international trade are very small because the tariffs rates in the recent years were lowered especially after the Stabilisation and Association Agreement. Net welfare effect on Croatian economy would be positive but also very small, in the range of statistical error. Since the government is obligated to pay 75% of collected tariff revenues into common EU fond, in this case negative net welfare effect of customs union creation would represents 0,168 % of Croatian GDP.

As opposed to the static effects of anticipated Croatia-EUCU creation the most important dynamic effects are reduction of formalities at the border, elimination of non-tariff barriers to trade, increased competition and returns to scale, repeal of monopolistic and oligopolistic structures, development of basic and business infrastructure, increasing and improving efficient investment in energy and telecommunications networks, better availability of business services and support mechanisms to improve the development of education, science and technology. Another important dynamic effect would be foreign direct investment (FDI) from EU countries in order to boost economic domestic growth and facilitate structural changes.

REFERENCES

- Abrego, L. and Riezman, R. (2003), *Computation and the Theory of Customs Unions*. Available at: [<http://www.wallis.rochester.edu/jones04/ccu3.pdf>].
- Aksen, E. and Tochitskaya, I. (2001), *Economic Effects of Belarus' Participation in the CIS Countries Customs Union*, Economic Education and Research Consortium – Russia and CIS. Available at: [<http://pdc.ceu.hu/archive/00001984/01/00-443e.pdf>].
- Andriamananjara, S. (2011), *Customs Unions*. Available at: [<http://siteresources.worldbank.org/INTRANETTRADE/Resources/C5.pdf>].
- Androniki, K. et al (2010), *Customs Union Welfare*. MIBES 2010 – Poster, Katarachia, Tsampouris, Konstantinidis, 546 – 553. Available at: [http://mibes.teilar.gr/proceedings/2010/poster/55_final.pdf].
- Aydin, L. and Demirci, N. (2011), *Long-Run Effects of Customs Union between European Union and Turkey: Is It Zero-Sum Game?*, *Modern Economy*, 2011, 2, 132-141. Available at: [<http://www.scirp.org/Journal/PaperInformation.aspx?paperID=4891>].
- Bhagwati, J. N. (1970), *Trade Diverting Customs Unions and Welfare Improvement: A Clarification*. Working Paper Number 56, Department of Economics, MIT, July 1970. Available at: [<http://dspace.mit.edu/bitstream/handle/1721.1/64272/tradedivertingcu00bhag.pdf?sequence=1>].
- Balassa, B. (1961), *The Theory of Economic Integration*, Homewood, IL: R. D. Irwin, Inc., 1961. Available at: [<http://www.jstor.org/discover/10.2307/2228684?uid=3738200&uid=2&uid=4&sid=21101488102823>].
- Bobić, V. (2010), *Dohodovna i cjenovna elastičnost hrvatske robne razmjene – analiza panel-podataka, Istraživanja I-29*, HNB, prosinac 2010. Available at: : [<http://www.hnb.hr/publikac/istrazivanja/i-029.htm>].
- Cakmak, E. H. and Eryugur, H.O. (2008), *Trade implications of extending the Turkey-EU customs union agreement to agricultural products*, Preliminary draft. Available at: [http://mpra.ub.uni-muenchen.de/12438/1/MPRA_paper_12438.pdf].
- Cline, W. R. (1978), *Benefits and Costs of Economic Integration in CACM*, In Cline, W. R. and Delgado, E. (eds). *Economic Integration in Central America*. Washington: the Bookings institution.
- Dalimov, R.T. (2009), *The Dynamics of Trade Creation and Trade Diversion Effects Under International Economic Integration*, *Current Research Journal of Economic Theory* 1(1):1-4, 2009. Available at: [<http://maxwellsci.com/print/crjet/1-4.pdf>].
- Dukec, Z. et al (2003), *Cost-benefit analysis of integration of Croatia into the European Union*, *Ekonomski pregled*, 54 (7-8) 651-677 (2003). Available at: [http://hrcak.srce.hr/index.php?show=clanak&id_clanak_jezik=40200].
- Harberger, A. C. (1954), *Monopoly and resource allocation*, *American Economic Review*, May 1954, 44 (2), 77-87. Available at:[<http://econdse.org/wp-content/uploads/2011/12/Harberger1954-Monopoly-and-resource-allocation-AER.pdf>].

- IIR (2012), Hrvatska i Europska Unija – Prednosti i izazovi članstva, Institute for International Relations – IMO Zagreb, 2012. Available at: [http://www.imo.hr/files/hrvatska_i_eu_prednosti_izazovi_1.pdf].
- Karaman, F.N. and Lerzan Ozkale, N. (2005), Static effects of the EU-Turkey Customs Union, Available at: [<http://www.etsg.org/ETSG2006/papers/KARAMAN.pdf>].
- Kemp, M. C. and Wan, H. Y. Jr. (1976), An Elementary Proposition Concerning the Formation of Customs Unions, *Journal of International Economics* 6 (1, February): 95–98. Available at: [<http://www2.econ.iastate.edu/classes/econ655/lapan/Readings/ElementaryPropositionConcerningCustomsUnionsKEMPWAN.pdf>].
- Krueger, A. O. (1995), Free Trade Agreements versus Customs Unions, NBER Working Paper 5084, National Bureau of Economic Research, Cambridge, MA. Available at: [<http://www.nber.org/papers/w5084.pdf>].
- Lipsev, R. (1957), The Theory of Customs Unions: Trade Diversion and Welfare, *Economica*, 24, February, 40-46. Available at: [<http://www.jstor.org/discover/10.2307/2551626?uid=3738200&uid=2&uid=4&sid=21101667221167>].
- Meade, J. (1955), The Theory of Customs Unions, Amsterdam: North-Holland. Available at: [<http://www.getcited.org/pub/10205796>].
- Michalopolous, C. and Tarr, D. (1997), The Economics of Customs Unions in the Commonwealth of Independent States, Available at: [http://papers.ssrn.com/sol3/papers.cfm?abstract_id=604945].
- Ministarstvo financija Republike Hrvatske (2010), Godišnje izvješće Ministarstva financija za 2010. Godinu, Available at: [<http://www.mfin.hr/adminmax/docs/Godisnjak%202010.pdf>].
- Nicholls, S.M. (1995), Welfare effects of economic integration in the Caribbean Community (CARICOM), Available at: [[http://www.centralbank.org.bb/webcbb.nsf/WorkingPapers/252C666D635C9A5C04257864004A3705/\\$FILE/WP1995-05.PDF](http://www.centralbank.org.bb/webcbb.nsf/WorkingPapers/252C666D635C9A5C04257864004A3705/$FILE/WP1995-05.PDF)].
- Othieno, L. and Shinyekwa, I. (2011), Trade, revenue and welfare effects of the East African Community Customs Union principle of assymetry on Uganda: An application of Wits-Smart simulation model, Economic policy research centre, Research series No. 79. Available at: [http://www.eprc.or.ug/pdf_files/series79.pdf].
- Pala, A.M. (2011), The customs union between Turkey and the European Union and its effects on the Turkish economy, Economics Master' s Theses. Paper 1. Available at: [http://iris.lib.neu.edu/cgi/viewcontent.cgi?article=1000&context=econ_theses].
- Rahman, M. A. et al (1981), The Trade Effects of a South Asian Customs Union: An Expository Study, *The Pakistan Development Review*, Vol. XX, No.1. Spring (1981). Available at: [<http://www.jstor.org/discover/10.2307/41258538?uid=3738200&uid=2&uid=4&sid=21101662767417>].
- Samardžija, V. et al (1998), Hrvatska i EU – koristi i troškovi integriranja, Institut za međunarodne odnose, Zagreb.
- Sopek, P. (2012), Proračunska perspektiva Hrvatske nakon ulaska u EU, Available at: [http://zec.zsem.hr/index.php/hr/o-konferenciji/etvrta-ekonomskakonferencija/radovi?download=17%3Aproraunska-perspektiva-hrvatske-nakon-ulaska-u-eu_petar-sopek].
- Viner, J. (1950), The Customs Union Issue, *Carnegie Endowment for International Peace*, pp:41-55; ASIN: B000OFG CS0. Available at: [<http://catalogue.nla.gov.au/Record/307499>].
- Vizjak, A. (2001), Gospodarske koristi od suradnje Republike Hrvatske i Europske Unije, *Ekonomski pregljed*, 52 (7-8) 856-872 (2001). Available at: [<http://hrcak.srce.hr/28762>].
- WTO (2010), Trade policy review – Croatia, Trade Policy Review Body, WT/TPR/S/227. Available at: [<http://hrcak.srce.hr/28762>].

Jernej Mencinger

University of Ljubljana, Faculty of Administration, Ljubljana, Slovenia

Aleksander Aristovnik

University of Ljubljana, Faculty of Administration, Ljubljana, Slovenia

Miroslav Verbič

University of Ljubljana, Faculty of Economics, Ljubljana, Slovenia

PUBLIC DEBT, DEBT TRAP AND ECONOMIC GROWTH: AN EMPIRICAL INVESTIGATION FOR THE EUROPEAN UNION AND OECD COUNTRIES

ABSTRACT

The paper attempts to empirically explore the transmission mechanism regarding the short-term impact of public debt and growth. We examine and evaluate the direct effect of higher indebtedness on economic growth for countries in the EU which are in the epicentre of the current sovereign debt crisis. In addition, our sample includes some OECD countries that are used to provide robustness in the estimated values. In comparison to similar empirical studies, our research will add to the existing literature by extending the sample of countries and providing the latest empirical evidence for a non-linear and concave (i.e. inverted U-shape) relationship. The empirical analysis primarily includes a panel dataset of a total of 36 countries. Our sample is divided into subgroups distinguishing between so-called developed economies, covering the period 1980–2010, and emerging economies, covering the period 1995–2010. In order to account for the impact of the level of the debt-to-GDP ratio on the real growth rate of GDP, we employ a panel estimation on a generalized economic growth model augmented with a debt variable, while also considering some methodological issues like the problems of heterogeneity and endogeneity. The results across all models indicate a statistically significant non-linear impact of public debt ratios on annual GDP per capita growth rates. Further, the calculated debt-to-GDP turning point, where the positive effect of accumulated public debt inverts into a negative effect, is roughly between 90% and 94% for the developed economies. Yet for the emerging economies the debt-to-GDP turning point is lower, namely between 44% and 45%. Therefore, we may conclude that the threshold value for the developed countries is lower than for the emerging countries. In general, the research may contribute to a better understanding of the problem of high public debt and its effect on economic activity.

Keywords: public debt, economic growth, turning points

JEL classification: H63, O40, E62

1. INTRODUCTION

The development of many industrial countries over the last few decades was associated with relatively high public deficits, causing further rises in public debt and therefore a deterioration of the countries' fiscal positions. According to Tanzi and Schuknecht (1997), these former debt build ups were generally accompanied by an expansion of general government expenditures. In addition, the recent global financial and economic crisis has also led to a sharp increase in government debt in many advanced economies. Namely, in response to the financial crisis governments have employed fiscal measures to revive aggregate demand by recapitalizing banks and adopting sizeable fiscal stimulus packages mostly based on higher government expenditures. This has created serious concerns about fiscal sustainability, which has an adverse impact on the financial market and causes distortions in economic implications. Moreover, the recent financial crisis has shown that such sharp increases in public debt have a possible negative impact on sustained economic growth and a stable economic environment (Cecchetti et al., 2010).

The relationship between economic growth and fiscal policy is complex and critically important for policymakers. Fiscal policy holds crucial implications for economic growth in both the short and long run. In particular, a persistent high level of public debt can consequently trigger detrimental effects on capital accumulation and productivity, which potentially has a negative impact on economic growth (Kumar and Woo, 2010). Cecchetti, Mohanty and Zampolli (2010) argue that, without changes in fiscal policy, debt accumulation will continue to rise due to the persistent growth of government expenditures in comparison to declining revenues. They suggest that the higher risk premia for issuing government bonds and the rapidly ageing population may lead to unstable debt dynamics. They conclude in particular that these structural problems without corrective actions by government will lead to persistent fiscal deficits even during a cyclical recovery.

Therefore, the current debt crisis has revived the academic and policy debate on the economic impact of public debt. Despite the upsurge of related studies on the relationship between public and economic activity, the empirical literature on this topic is quite scarce and shows a lack of systematic evidence on the impact of public debt on potential growth (Kumar and Woo, 2010; Checherita and Rother, 2010). In the past the problem of high and persistent public debt was mainly associated with developing countries, whereas today's high debt levels are causing disruptions to financial cycles for advanced economies leading to an unsustainable credit-fuelled boom followed by a default-driven bust (Cecchetti et al., 2010). This consequently leads to a situation known as a debt trap in which these countries are facing the simultaneous occurrence of adverse effects due to high and growing fiscal deficits and debt levels, as well as sharp rises in risk premia on sovereign bonds that tend to lower economic activity (Padoan et al., 2012).

Therefore, our main aim is to empirically explore the transmission mechanism regarding the short-term impact of public debt and growth. We will examine and evaluate the direct effect of higher indebtedness on economic growth for countries in the EU which are in the epicentre of today's sovereign debt crisis. In addition, our

sample includes some OECD countries that are used to provide robustness in the estimated values. Our examination will shed light on the current debt problem by identifying a possible non-linear relationship between the level of public debt and economic growth, with an explicit focus on determining the threshold values for our sample of countries. In comparison to similar empirical studies, our research will add to the existing literature by extending the sample of countries and providing the latest empirical evidence of a non-linear and concave (i.e. inverted U-shape) relationship (Clements et al., 2003; Reinhart and Rogoff, 2010a, 2010b; Kumar and Woo, 2010; Partillo et al., 2002, 2004 etc.).

The paper is structured as follows. In the next section we provide a literature review on the relationship between public debt and economic growth focusing solely on empirical studies. Then we describe the applied methodology and the data used in the estimation models for evaluating the direct impact of public debt on growth. In the fourth section of the paper, we present the results and determine the debt turning point for a particular group of countries. The last section concludes with the main findings and limitations.

2. LITERATURE REVIEW

When considering the theoretical literature about the connection between public debt and economic growth we found a lack of empirical evidence to investigate and confirm the theoretical findings and discussions. According to Abbas and Christensen (2007), there are several reasons for this lack of interest in formally investigating the impact of public debt on growth. The most important ones are: (1) weak and inadequate availability of reliable and comparable datasets for public debt among countries; (2) the consideration that the public debt variable is an endogenous rather than an exogenous variable which can be used as an instrument to control and affect the macro-financial outcome; and (3) the fact that public debt has so far not been regarded as problematic due to its relatively small size in most developed countries. Namely, previous theoretical and empirical studies focused on the external debt issue in emerging and countries with low income due to their dependency on foreign capital investment (see Krugman, 1988; Clements et al., 2003; Schclarek, 2004).

The research addresses the issue of the latest accumulation of public debt and its direct impact on economic conditions in the short run. The empirical evidence shows that beyond a certain threshold higher public debt lowers potential growth, which may indicate a non-linear and concave (inverted U-shape) relationship between government debt and economic growth (Kumar and Woo 2010; Reinhart and Rogoff 2010a, 2010b; Checherita and Rother, 2010; Cecchetti et al., 2011; Clements et al., 2003 etc.). This means that low levels of public debt enhance and at the same time increase economic growth. When debt reaches a certain level, an additional increase in its impact on economic growth may mean that it turns to negative. Although more developed countries are facing the problem of an excessive and unsustainable level of government debt, the empirical evidence on the transmission channels through which high debt is likely to have adverse effects on growth is relatively scarce.

Among recent studies, Clements et al. (2003) find support for a non-linear relationship between external debt and economic growth using a panel dataset of 55 low-income countries over the time period 1970–1999. The authors estimated that the critical threshold turning point in the net present value of external debt is in the range of 20%–30% of GDP (considering the nominal value of external debt, the critical value is higher at around 50%). The conclusion is associated with the debt-overhang hypothesis defined by Krugman (1988), whereby after exceeding a certain level of a threshold value debt has adverse effects on growth due to growing uncertainty to meet a country's debt servicing obligations. Altogether, this consequently has deleterious effects on investment incentives which, together with lowering the solvency of a country's repayment ability, reduces potential growth (also see Imbs and Ranciere, 2004). Similarly, Pattillo et al. (2002) confirmed a non-linear, Laffer-type relationship between the level of external debt and economic growth using a large panel dataset of 93 developing countries over the period 1969–1998. The findings suggest that the key channel through which excessive external indebtedness depresses growth is via the reduced effectiveness of investments rather than the level of investment. This is consistent with other empirical studies showing that total factor productivity explains most variations in output (Checherita and Rother, 2010; Clements et al., 2003). In addition, Partillo et al. (2004) estimated that the critical value when external debt has a deleterious effect on growth is between 35–40% of GDP for the considered panel of developing countries.

A recent influential paper by Reinhart and Rogoff (2010a) analyses the impact of different levels of government debt on the long-term real GDP growth rate by considering a sample of 20 advanced and 24 emerging countries over a period of nearly 200 years (1790–2009). They obtained similar results with simple correlation statistics as previous studies, namely that below a threshold of 90% of GDP debt has a positive but weak impact on the long-term GDP growth rate, whereas the effect of debt above 90% is negative and significant. Likewise, Kumar and Woo (2010) also confirmed a nonlinear relationship between the initial level of government debt and subsequent GDP growth behaviour based on panel data of 38 advanced and emerging economics countries over a period spanning around four decades (1970–2010). To examine the effects of debt on growth in the medium and long term, the research takes into account reliable determinants of growth as well as some methodological issues like the problem of reverse causality (i.e. the potential impact of low economic growth on higher indebtedness) and the problem of endogeneity, respectively. In particular, large public debts are likely to have detrimental effects on capital accumulation, as well as productivity, which potentially produces an adverse impact on economic growth.

Further, Checherita & Rother (2010) and Cecchetti et al. (2011) are closely related to our research by focusing on the impact of total public debt on economic growth in advanced countries. To our knowledge, Checherita & Rother (2010) is so far the only empirical study based explicitly on data for euro area countries. Like previous studies, both studies confirm a non-linear relationship between public debt and economic growth and find a debt turning point at about 85%–100% of GDP, beyond which the debt has a deleterious effects on growth. Kumar and Woo (2010) stress a variety of channels through which high debt is likely to have adverse effects on growth, including

higher long-term interest rates, higher future distortionary taxation, higher inflation, greater uncertainty and vulnerability to crises.

To summarize, the existing literature on this topic shows that the relationship between public debt and economic growth is nonlinear and concave (an inverted U-shape) (Clements et al., 2003; Reinhart & Rogoff, 2010a, 2010b; Kumar & Woo, 2010 etc.). This implies that public debt can either have a positive or negative effect on economic growth. Moreover, the literature review reveals that the academic literature on the effect of public debt on economic activity in developing countries is scarce and that there is a lack of consensus. In contrast with previous studies, the focus of our research is to examine the critical threshold for public debt and its impact on economic growth in EU and OECD countries, thereby distinguishing between developed and emerging countries.

3. METHODOLOGY AND DATA

In order to account for the impact of the level of the debt-to-GDP ratio on the real growth rate of GDP, we employ a generalized theoretical economic growth model augmented with a debt variable. Following the estimation strategy by Checherita & Rother (2010), we are particularly interested in the existence of a non-linear impact of government debt on the behaviour of GDP growth. Therefore, we use the quadratic equation in the debt-to-GDP ratio. As noted in earlier studies, the process of estimation encounters the problems of heterogeneity and endogeneity which give inconsistent and biased estimates with the pooled OLS estimator (Kumar and Woo, 2010; Partillo et al., 2002, 2004). Namely, the regression model using pooled OLS does not account for unobserved country-specific effects that vary across countries. Thus, the result may be affected by an omitted variable bias (Partillo et al., 2002, 2004). First, the solution of the heterogeneity problem could be avoided by using a fixed effects (FE) panel regression that allows us to control all time-invariant country-specific factors, whether observable or unobservable. In previous empirical studies, they corrected the problem of heterogeneity by introducing a lagged explanatory variable of the initial level of GDP per capita in a dynamic panel specification. However, the presence of a fixed effects panel estimation is likely to impose a correlation between the lagged endogenous variable and the residuals, which makes the results of the coefficient of the lagged initial level of GDP per capita negatively biased (Partillo et al. 2004).

Second, we use an instrumental variable (IV) approach to address the problem of endogeneity resulting from the issue of *reverse causality* between the economic growth and level of public debt ratios. Namely, the reverse causality problem derives from the possibility that lower economic growth may lead to higher debt build ups for reasons unrelated to debt (Kumar and Woo, 2010; Partillo et al. 2004). To account for the possibility of the endogeneity issue influencing the debt variable, among a variety of methodologies in the panel context we employ the instrumental variable (IV) estimation technique proposed by Checherita and Rother (2010). In particular, the estimator used in our research is the two-stage GMM estimator with instrumental variables. Following earlier studies, we implemented the lagged debt-to-GDP ratio and

the lagged debt-to-GDP ratio squared as instruments (Checherita and Rother, 2010; Partillo et al. 2002, 2004).

Thus, we employ two different models to empirically assess the impact public debt has on potential growth, thereby identifying the debt turning point, where the negative effect of public debt on growth prevails. First, the non-dynamic baseline fixed effects (FE) panel regression specification to control the heterogeneity is as follows:

$$g_{i,t} = \alpha_i + \beta \ln(\text{GDP per capita})_t + \gamma_1 \text{debt}_{i,t} + \gamma_2 \text{debt}_{i,t}^2 + \delta X_{i,t} + \eta_i + \varepsilon_{i,t} \quad (1)$$

Second, the instrumental variable (IV) dynamic panel regression specification to control for endogeneity is as follows:

$$g_{i,t} = \alpha_i + \beta \ln(\text{GDP per capita})_{t-1} + \gamma_1 \text{debt}_{i,t} + \gamma_2 \text{debt}_{i,t}^2 + \delta X_{i,t} + \varepsilon_{i,t} \quad (2)$$

where $g_{i,t}$ and $\text{debt}_{i,t}$ are the annual change of GDP per capita and initial government debt as a share of GDP (note that subscripts i and t denote the country and time). Against this background, we assume a non-linear relationship between government debt and growth and thus the model is augmented with the quadratic equation in debt ($\text{debt}_{i,t}^2$). Based on the theoretical assumption that the relationship is non-linear, we expect that the coefficient of the debt variable will be positive whereas the coefficient of the debt variable squared will be negative. This would imply that public debt at lower levels has a positive impact on growth, while at higher levels a negative impact prevails (concave functional form). In addition, $X_{i,t}$ represents a vector of explanatory variables to take account of the determinants of economic growth and other economic and financial factors including the initial level of GDP per capita, gross government savings as a percentage of GDP, gross fixed capital formation as a share of GDP to cover the level of investment, gross government revenues as a share of GDP, the population growth rate, the gross secondary school enrolment rate as a proxy for human capital, trade openness as a percentage of GDP as an indicator of an economy's competitiveness, initial inflation measured as a GDP deflator, general government structural balance as a fiscal indicator to examine the impact of fiscal policy on economic growth. In this regard, we will consistently follow the core determinants associated with growth in the related literature to obtain robust results (see Sala-i-Martin et al., 2004; Kumar and Woo, 2010; Checherita and Rother, 2010; Clements et al., 2003). The model (1) also includes country-fixed effects η_i to control the heterogeneity for unobserved country-specific effects and the unobservable error term $\varepsilon_{i,t}$.

The empirical analysis primarily includes a panel dataset of a total of 36 countries (25 EU member states and 11 OECD countries). Our sample is divided into subgroups distinguishing between so-called developed and emerging economies¹, respectively. The former subgroup includes a sample of 24 developed economies, namely, Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland

¹ We divided our sample according to the IMF's classification with the exception that Czech Republic, Slovenia and Slovakia were included in the group of 'emerging economies'.

Ireland, Italy, Korea, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, the United Kingdom and the United States, covering the period 1980–2010. The latter sample is composed of 12 emerging countries, including Czech Republic, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, Slovenia, Turkey, Mexico, Bulgaria and Romania², covering the period 1995–2010 since data for most of the control variables are not available before then for that subgroup of countries. Thus, the obtained results will provide us with important understanding of differences in the short-term effects of public debt on economic activity in both subgroups.

The data used for estimating both models come from various sources. Data on the levels of public debt are primarily drawn from the OECD's *Economic Outlook* database. For the purpose of the empirical research we used gross central government debt³ as a percentage of GDP (henceforth "public debt") due the data availability. Openness as a ratio of GDP is obtained from the Penn World Table (PWT) version 7.1 of Heston et al. (2012). Data on government structural balances (referring to the general government cyclically adjusted balance as a share of potential GDP) is drawn from the IMF's *World Economic Outlook* database. All other data were taken and calculated from the World Bank's *World Development Indicator (WDI)* database.

In particular, our aim is to identify the turning point beyond which the debt-to-GDP ratio has deleterious effects on growth. The available literature suggests that the critical debt-to-GDP ratio value will lie in the interval between 85–100% for developed economies and between 40–60% for emerging economies, respectively. Accordingly, these hypotheses will be applied to and tested on both sub-groups. The results will give us an important understanding of differences in the short-term effects of public debt on economic activity in both subgroups.

4. EMPIRICAL RESULTS

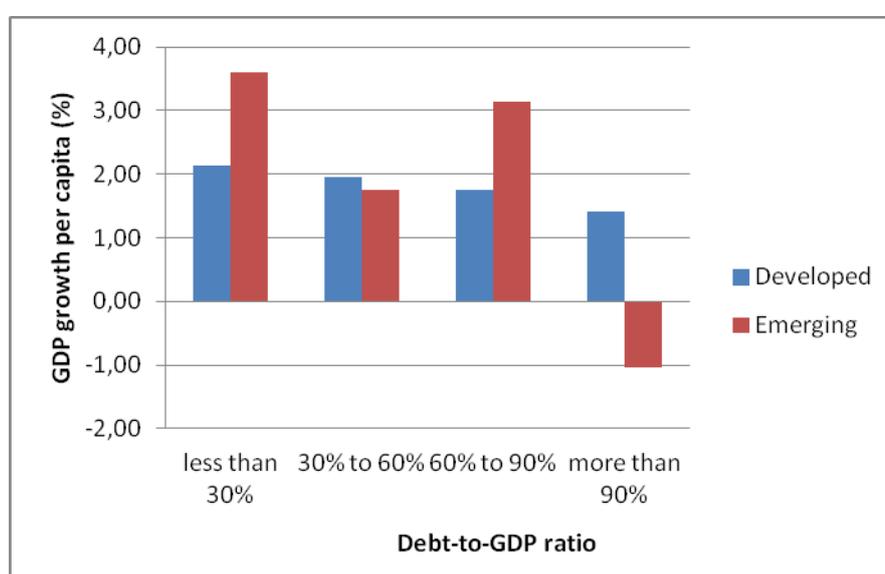
Before presenting the empirical results, we provide some stylized facts that higher levels of public debt clearly have negative effects on potential economic growth in our sample of countries. Figure 1 provides a preliminary summary of average GDP growth rates across varying levels of public debt for a particular subgroup of countries. It follows that the annual observations are classified in four categories according to the debt-to-GDP ratio during that particular year. Referring to the interpretation in the literature, the groups distinguish the years when the debt-to-GDP ratio was at low levels (below 30%), middle-low levels (between 30 and 60%), middle-high levels (between 60% and 90%) and high levels (more than 90%) (see Reinhart and Rogoff, 2010a, 2010b). The bars show the average GDP growth per capita rates for each of the four debt categories, thereby distinguishing between the developed and emerging

² We excluded Estonia and Cyprus because comparable data was unavailable.

³ The narrow concept of government debt at the central level based on the European System of Integrated Economic Accounts (ESA-95) covers the entire stock of direct government fixed-term contractual obligations to others outstanding on a particular date, excluding state and local government debt and social security funds. It includes marketable and non-marketable central government debt instruments, including domestic and foreign liabilities such as currency and money deposits, securities other than shares, and loans (OECD, 2010; Eurostat, 2011; IMF, 2011).

economies. Note that all calculations for developed economies cover the period 1980–2010, whereas for emerging economies we took the period 1995–2010. Figure 1 shows a possible negative link between public debt and growth already at a lower level of debt-to-GDP ratios, especially for the subgroup comprising the emerging economies⁴. Figure 1 implies that the threshold value for the emerging economies is lower than for the advanced ones as a group of countries. As shown below, this pattern is consistent with the results obtained using an econometric analysis.

Figure 1: Relationship between GDP growth per capita and different levels of public debt for developed and emerging economies



Sources: WDI, 2012; OECD, 2011; own calculations

As noted in the previous section, to evaluate the direct relationship between public debt and economic growth for our subgroup of countries, we estimated both panel growth regression models augmented with a debt variable. Specifically, we considered all potential explanatory variables in order to control the impact on economic growth. This allowed us to obtain statistically significant robust results on the short-term relationship between public debt and economic growth regarding both subgroups of countries. Thus, in addition to the debt and debt squared variable our final set of control variables in the economic growth models with statistically significant coefficients is the following: GDP per capita, inflation, population growth, government total expenditures, gross government revenues, gross fixed capital formation, lagged initial GDP per capita, gross government savings, openness and government structural

⁴ However, note that the negative effect of public debt on growth exceeding a 90% threshold presents just one observation at a particular point in time (Bulgaria), which enables us to draw a significant inference of the pattern.

balance. Table 1 shows which control variables are included in the panel regressions estimated with respect to the estimation procedure and sample of countries.

The empirical results for both subgroups of countries are displayed in Table 1. Columns 1 and 2 show the estimations for the FE regression model and IV model with the GMM estimators regarding the developing countries. In addition, statistically significant results for the emerging economies are presented in column 3. As shown in Table 1 by the first-stage Shea partial R-square statistics, both instruments (the lagged levels of debt and debt squared) used in the IV estimation approach in models 2 and 3 may potentially satisfy both required conditions of instrument validity, such as that the endogenous variables are highly correlated with the instrument, and exogeneity so that the instruments are not correlated with the error term (Cameron and Trivieri, 2010; Checherita and Rother, 2010). All the coefficients of explanatory variables are in line with expectations according to economic theory (Kumar and Woo, 2010; Checherita and Rother, 2010, Clements et al. 2003).

To summarize, the results across all models indicate a statistically significant non-linear impact of public debt ratios on the annual GDP per capita growth rate for the developed and emerging countries included in our sample. Namely, the coefficient of the quadratic debt-to-GDP variable is negative, indicating a concave (i.e. inverted U-shaped) relationship between economic growth and public debt. These results confirm the general theoretical assumption that at low levels of public debt the impact on growth is positive, whereas beyond a certain debt turning point a negative effect on growth prevails (Elmendorf and Mankiw, 1999). Further, the calculated debt-to-GDP turning point⁵, where the positive effect of accumulated public debt inverts into a negative effect, is roughly between 90% and 94% for developed countries when we consider both models. The results are comparable with the estimated threshold values for developed countries in previous empirical studies (Kumar and Woo, 2010; Checherita and Rother, 2010; Reinhart and Rogoff, 2010a, 2010b etc.). For emerging countries the debt-to-GDP turning point is substantially lower, namely between 44% and 45%. Therefore, we can confirm our previously stated hypothesis that the threshold value for the emerging countries is lower than for the advanced ones. Beyond the estimated turning point the possibility arises that the countries will be trapped in a so-called vicious circle of high debt accompanied by low growth and unsustainable debt dynamic projections.

⁵ Note that we obtained it as a maximum of a quadratic function.

Table 1: Panel regression on developed and emerging countries

	Developed countries		Emerging countries
	(1) FE	(2) GMM IV	(3) GMM IV
Dependent variable	GDP growth per capita	GDP growth per capita	GDP growth per capita
ln (GDP per capita)	-1.2737*** (0.1905)		
Debt	0.0935*** (0.0188)	0.0715*** (0.0143)	0.3471** (0.1096)
Debt squared	-0.0005*** (0.0001)	-0.0004*** (0.0001)	-0.0039** (0.0013)
Government total expenditures	-0.3538*** (0.0299)	-0.2780*** (0.0374)	-1.6653*** (0.2700)
Inflation	-0.1203*** (0.0233)	-0.1154*** (0.0165)	0.2415** (0.0779)
Government revenues	0.1763*** (0.0461)	0.2259*** (0.0354)	1.4788*** (0.3030)
Population growth	-1.5421*** (0.3593)		
Gross fixed capital formation	0.2388*** (0.0476)		
Lagged ln (GDP per capita)		-1.5150*** (0.1667)	-1.7992*** (0.4461)
Government savings		0.0576** (0.0219)	
Government structural balance			-1.2469*** (0.2532)
Openness			0.0161* (0.0063)
Constant	15.8401*** (2.8373)	16.3870*** (1.8802)	19.6700*** (5.4500)
Number of observations	548	533	114
R-squared	0.342	0.319	0.495
Shea partial R-squared		0.94	0.79
Turning point	93.5	89.5	44.5

Note: Standard errors are in parentheses.

Levels of significance: * p<0.05, ** p<0.01, *** p<0.001

Sources: OECD, 2011; IMF, 2012; WDI, 2012, own calculations

However, we should note that the estimated threshold values do not provide the level to be targeted to support the growth projections. In fact, those results represent an additional argument for implementing fiscal consolidation strategies to reduce public debt. In this context, it is reasonable to assume that our research provides direct evidence of nonlinearity between public debt and economic growth. The obtained

results thus imply that unstable debt dynamics may increase the risk of a detrimental effect on capital accumulation and productivity growth, which would potentially trigger an adverse effect on economic growth (Cecchetti et al. 2010). Hence, the research may contribute to a better understanding of the problem of high public debt and its effect on economic activity. As a result, the knowledge gained could be used to tackle the problem in a timely fashion so as to preserve a stable macroeconomic environment in the future.

5. CONCLUSION

Our paper empirically explores the transmission mechanism regarding the short-term impact of public debt and growth. We examined and evaluated the direct effects of higher indebtedness on economic growth for EU countries which are in the epicentre of today's sovereign debt crisis. In addition, our sample includes some OECD countries that are used to provide robustness in the estimated values. Our examination will shed light on the current debt problem by identifying a possible non-linear relationship between the level of public debt and economic growth, with an explicit focus on determining the threshold values for our sample of countries.

In order to account for the impact of the level of the debt-to-GDP ratio on the real growth rate of GDP, we employed a generalized theoretical economic growth model augmented with a debt variable. The process of estimation encounters the problems of heterogeneity and endogeneity which give inconsistent and biased estimates. First, the solution of the heterogeneity problem could be avoided by using a fixed effects (FE) panel regression that allowed us to control all time-invariant country-specific factors. Second, we used an instrumental variable (IV) approach to address the problem of endogeneity resulting from the issue of *reverse causality* (i.e. the potential impact of low economic growth on higher indebtedness) between the economic growth and level of public debt ratios.

Our results across all models indicate a statistically significant non-linear impact of public debt ratios on the annual GDP per capita growth rate for the developed and emerging countries included in our sample. Namely, the coefficient of the quadratic debt-to-GDP variable is negative, indicating a concave (i.e. inverted U-shaped) relationship between economic growth and public debt. The results confirm the general theoretical assumption that at low levels of public debt the impact on growth is positive, whereas beyond a certain debt turning point a negative effect on growth prevails. Further, we calculated that the debt-to-GDP turning point, where the positive effect of accumulated public debt inverts into a negative effect, is roughly between 90% and 94% for the developed economies. Yet for the emerging countries the debt-to-GDP turning point is lower, namely between 44% and 45%. Therefore, we can confirm our hypothesis that the threshold value for the emerging countries is lower than for the developed countries in our sample.

Nevertheless, we must point out some limitations and further avenues for research. First, our model specification was not subject to robustness tests which could confirm the validity of our results. It would also be desirable to calculate the confidence

intervals for the critical threshold values and control for other potential variables. Second, we did not take the possibility of outliers in the data into account, which may bias the results. Finally, our research could be extended to determine the channels through which the impact of public debt is indirectly transmitted to growth.

REFERENCES

- Abbas, A. S. M. & Christensen, J. E. (2007). *The Role of Domestic Debt Markets in Economic Growth: An Empirical Investigation for Low-income Countries and Emerging* (IMF Working Paper 07/127). Washington, D.C.: IMF. Retrieved February 20, 2013, from <http://www.imf.org/external/pubs/ft/wp/2007/wp07127.pdf>
- Cameron, A. C., & Trivedi, P. K. (2010). *Macroeconometrics Using Stata (Revised Edition)*. Texas: StataCorp LP College Station.
- Cecchetti, S. G., Mohanty, M. S., & Zampolli, F. (2010). *The Future of Public Debt: Prospects and Implications* (BIS Working Papers No. 300). Basel: Bank for International Settlements. Retrieved September 13, 2012, from <http://www.bis.org/publ/work300.pdf>
- Cecchetti, S. G., Mohanty, M. S., & Zampolli, F. (2011). *The Real Effects of Debt* (BIS Working Papers No. 352). Basel: Bank for International Settlements. Retrieved September 13, 2012, from <http://www.bis.org/publ/work352.pdf>
- Checherita, C. & Rother P. (2010). *The Impact of High and Growing Government Debt on Economic Growth: An Empirical Investigation for the Euro Area* (ECB Working Paper Series No. 1237). Frankfurt: ECB. Retrieved December 20, 2012, from <http://www.ecb.int/pub/pdf/scpwps/ecbwp1237.pdf>
- Clements, B., Bhattacharya, R., & Nguyen, T. Q. (2003). *External Debt, Public Investment and Growth in Low-income Countries* (IMF Working paper 03/249). Washington, D.C.: IMF. Retrieved December 12, 2012, from <http://www.imf.org/external/pubs/ft/wp/2003/wp03249.pdf>
- Elmendorf, D. W. & Mankiw G. N. (1998). *Government Debt* (NBER Working Paper 6470). Cambridge, MA: National Bureau of Economic Research. Retrieved January 20, 2013, from <http://www.nber.org/papers/w6470.pdf>
- Eurostat. (2011). Structure of Government Debt. European Commission, Eurostat, Statistics Explained. Retrieved December 20, 2012, from http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Structure_of_government_debt
- Imbs, J., & Ranciere, R. (2005). *The Overhang Hangover* (Working Paper No. 3673). World Bank Policy Research. Retrieved March 12, 2013, from <http://ideas.repec.org/p/wbk/wbrwps/3673.html>
- IMF (2011). Public Sector Debt Statistics: Guide for Compilers and Users. Washington, D.C.: IMF. Retrieved September 5, 2012, from <http://www.tffs.org/pdf/method/PSDS11fulltext.pdf>
- IMF. (2012). World Economic Outlook Database October 2012. Retrieved March 12, 2013, from <http://www.imf.org/external/ns/cs.aspx?id=28>
- Krugman, P. (1988). Financing vs. Forgiving a Debt Overhang: Some Analytical Issues (NBER Working Paper No. 2486). Cambridge, MA: National Bureau of Economic Research. Retrieved January 20, 2013, from <http://www.nber.org/papers/w2486.pdf>
- Kumar, M. S. and Woo, J. (2010). *Public Debt and Growth* (IMF Working Paper 10/174). Washington, D.C.: IMF. Retrieved September 5, 2012, from <http://www.imf.org/external/pubs/cat/longres.cfm?sk=24080.0>
- Miller, T., & Foster, J. D. (2012). Public Debt, Economic Freedom, and Growth. The Heritage Foundation. Retrieved September 5, 2012, from <http://www.heritage.org/index/book/chapter-3>
- OECD. (2010). *Central Government Debt: Statistical Yearbook 2010*. Paris: OECD Publishing.

- OECD. (2011). *Total central government debt* (Finance and Investment: Key Tables from OECD, No. 1). Paris: OECD. Retrieved April 5, 2013, from <http://www.oecd-ilibrary.org/statistics>
- Pandoan, P. C., Sila, U., & Van den Noord, P. (2012). *Avoiding Debt Traps: Financial Backstops and Structural Reforms* (Economics Department Working Paper No. 976). Paris: OECD.
- Pattillo, C., Poirson, H., & Ricci, L. (2002). *External Debt and Growth* (IMF Working Paper 02/96). Washington, D.C.: IMF. Retrieved September 5, 2012, from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=879569
- Pattillo, C., Poirson, H., & Ricci, L. (2004). *What are the Channels through Which External Debt Affects Growth?* (IMF Working Paper 04/15). Washington, D.C.: IMF. Retrieved January 20, 2013, from <http://www.imf.org/external/pubs/cat/longres.cfm?sk=17021.0>
- Heston A., Summers R. & Aten B. (2012). Penn World Table Version 7.1, Center for International Comparisons of Production, Income and Prices at the University of Pennsylvania. Retrieved January 20, 2013, from <https://pwt.sas.upenn.edu/>
- Reinhart, C. M. & Rogoff, K. S. (2010a). Growth in a Time of Debt. *American Economic Review*, 100(2), 573–578.
- Reinhart, C. M., & Rogoff, K. S. (2010b). *Debt and Growth Revisited* (MPRA Paper No. 24376). Munich: Munich University Library. Retrieved January 20, 2013, from <http://mpra.ub.uni-muenchen.de/24376>
- Sala-i-Martin, X., Doppelhofer, G. & Miller, R. (2004). Determinants of Long-Term Growth: A Bayesian Averaging of Classical Estimates (BACE) Approach. *American Economic Review*, 94(4), 813–835.
- Schclarek, A. (2004). *Debt and Economic Growth in Developing and Industrial Countries* (Working Paper No. 34). Lund, Sweden: Department of Economics, School of Economics and Management, Lund University. Retrieved January 20, 2013, from http://ideas.repec.org/p/hhs/lunewp/2005_034.html
- Tanzi, V., & Schuknecht, L. (1997). Reconsidering the Fiscal Role of Government: The International Perspective. *The Economic Review*, 87(2), 164–168.
- WDI. (2012). *World Development Indicators & Global Development Finance*. Washington, D.C.: The World Bank. Retrieved March 20, 2013, from <http://databank.worldbank.org/ddp/home.do?Step=1&id=4>

Radmila Jovančević

University of Zagreb, Faculty of Economics and Business, Zagreb, Croatia

Tomislav Globan

University of Zagreb, Faculty of Economics and Business, Zagreb, Croatia

THE IMPACT OF FDI FLOWS ON ECONOMIC CONVERGENCE IN CENTRAL AND EASTERN EUROPE

ABSTRACT

During the transition process, due to low levels of domestic savings, countries of Central and Eastern Europe (CEE) have used foreign capital flows to finance economic restructuring, intensify investment projects, finance increasing domestic demand in order to obtain high economic growth rates. By doing so, CEE countries experienced a process of quick economic convergence with EU-15 countries. However, the global financial crisis brought an abrupt end of these trends by triggering a severe economic crisis in Europe, with CEE countries taking a strong hit. An economic divergence started to take place in most CEE countries, with a sharp decline of foreign capital flows to these countries. The aim of this paper is to explore the role of foreign direct investment flows in economic convergence of European post-transitional countries with EU-15 countries. The main hypothesis is that the countries which received highest amounts of greenfield investments, achieved higher convergence rates and managed to catch-up with Western European countries faster. The paper also hypothesizes that the crisis-induced economic divergence was most evident in countries with pronounced sudden stops of foreign investment flows.

Keywords: *foreign direct investment, catching-up, transition, convergence*

JEL classification: *F21, O47*

1. INTRODUCTION

The role of foreign direct investment flows in boosting domestic GDP growth rates and stimulating the process of economic convergence of emerging and developing countries has long been a topic of scientific research, from both theoretical and empirical perspective. Economic theory distinguishes FDI from other types of capital flows, i.e. portfolio flows and foreign loans, in terms of its stability, low volatility and inability to leave the country even during financial crises. This is due to the fact that the presence of large, fixed and illiquid assets which come with direct investments significantly hinders quick disinvestment and capital flight. FDI is considered as "good cholesterol" and the type of investment that brings most benefits to the domestic economy. FDI entails the transfer of know-how, new technologies and management

skills to the company, it improves the quality of human capital and work force, and it helps create new jobs and produces a spillover effect on the economy (Blomström and Kokko, 1997; Jovančević and Šević, 2002; 2006). Potential benefits of FDI inflows could be found also in strengthening the competition in specific sectors of the economy, thus improving the efficiency of the economy as a whole.

A large number of empirical studies confirm previously stated hypotheses. It has been proven that FDI increases domestic investment in developing economies (Bosworth and Collins, 1999), thus promoting GDP growth. Borensztein, De Gregorio and Lee (1998) found a positive relationship between FDI and economic growth when the level of education (as a measure of absorption capacity of an economy) in capital receiving country is high. Blomström, Lipsey and Zejan (1992) came to the similar conclusion, only for developing countries with slightly higher incomes. It has been noted that FDI could positively affect foreign trade, employment and investment, depending on the complementarity or substitutability of imports and exports, the efficiency of administration, the level of corruption, the quality of human capital, etc. (Babić, Pufnik and Stučka, 2001). Some other authors, however, found a negative relationship between FDI and domestic economic growth (Mencinger, 2003).

Positive impact of foreign direct investment on the domestic economy was proven by World Bank (1999). They showed that the potential benefits depend not on the volume of FDI flows, but rather on the quality of domestic institutions and investment climate. They emphasize that the correlation between FDI and total factor productivity growth is higher in developing countries with higher levels of savings (a proxy variable for good domestic policies and investment climate) than in countries with lower levels of savings, where the correlation becomes negative. Similar conclusion applies for countries with more liberalized trade regimes (World Bank, 1997).

The purpose of this paper is to explore the role of foreign direct investment (FDI) flows in economic convergence of Central and Eastern European (CEE) countries⁶ with EU-15 countries⁷. The main hypothesis is that the countries which received highest amounts of greenfield investments achieved higher GDP per capita convergence rates and managed to catch-up with Western European countries faster. The paper also hypothesizes that the crisis-induced economic divergence was most evident in countries with pronounced sudden stops of foreign direct investment flows.

The rest of the paper is organized as follows. The second section gives an overview of the dynamics of capital inflows in CEE countries. The third section presents the data and methodology applied in measuring the convergence level of analysed countries. Findings of the analysis are presented in the fourth section, while the fifth concludes the paper.

⁶ In this paper, the following countries are included in the CEE group: Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia.

⁷ EU-15 countries are: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, UK.

2. DYNAMICS OF CAPITAL INFLOWS IN CEE COUNTRIES

With the beginning of the transition and liberalization processes in early 1990s, foreign direct investments have become a very important form of foreign financing for Central and Eastern European countries. Inflows of FDI in new EU member states and Croatia had continuously been rising until 2007 (Figure 1). Simultaneously, ever stronger and fiercer competition in international markets forced multinational companies and other enterprises to search for new, more profitable locations and markets, with lower labour costs vis-à-vis advanced economies (UNCTAD, 2007).

Factors in capital receiving countries and trends in the global market both had an important role in stimulating capital flows. For European emerging economies, negotiations and subsequent membership in the European Union attracted foreign capital, due to ensuing lower risk premiums, higher macroeconomic stability and credibility of economic policy, and enforcement of necessary structural reforms. Relatively high rates of interest also affected the volume of capital flows to CEE countries positively, as well as higher liquidity in the global market, large scale privatization projects of state-owned enterprises, financial deregulation, restructuring of foreign debt and access to EU funds. Capital flows had been alleviated by the presence of foreign banks in CEE countries, which had by that time taken over large parts of banking markets in most transition countries and were main facilitators of fast credit growth (Ötker-Robe et al., 2007).

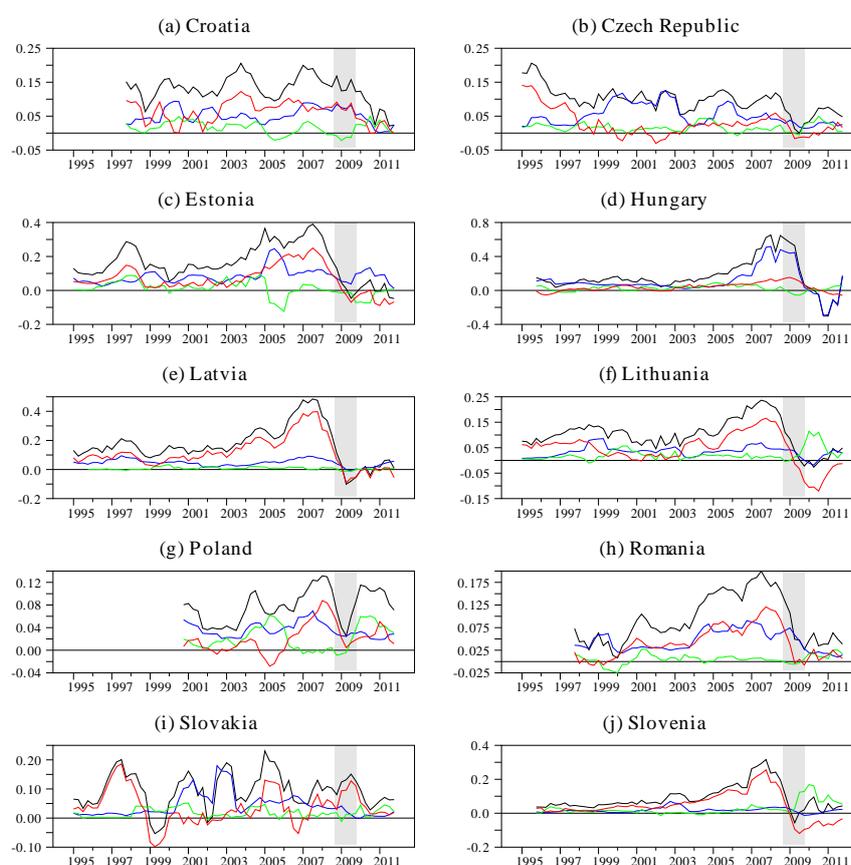
A large part of FDI flows to Central and Southeastern European countries has been directed to their banking sectors. Foreign banks have played a dominant role in financial sectors of analysed countries and FDI in the banking sector has recorded a rise since 2000, stimulated by the restructuring and privatization. In 2008, as much as 90 per cent of banking assets was in the hands of foreign banks, which have generally played a positive role during the global financial crisis (UNCTAD, 2008). However, recent experience of the Greek crisis has renewed the concern that a significant presence of foreign banks also creates potential risks.

By observing the composition of capital flows, it is evident that equity flows, e.g. foreign direct investment flows, were on relatively low levels at the beginning of the transition process. The inflow of FDI in early 1990s exceeded the threshold of 10 per cent of GDP only in Czech Republic and Estonia (Figure 1), but still was a dominant type of capital inflows at the aggregate level. Overcoming the so-called transition recession, i.e. by accelerating economic growth rates during late 1990s and early 2000s, especially after the accession to the EU, CEE countries started to attract increasing amounts of FDI.

Large share of FDI in the composition of total capital inflows in most CEE countries had several important economic implications. One of them stems from the character of FDI, given that this is a type of investment that does not yield a fixed income for an investor, since the income depends on the successfulness and the profitability of an

investment-receiving company. Thereby the risk is diverted to an investor, which is the reason why CEE countries have been able to maintain higher levels of current account deficit than they otherwise would have been able to, thus accelerating the convergence process with EU-15 countries. Furthermore, direct investment often entails a technology transfer, which can result in an increase of productivity and income in FDI receiving countries (Lane and Milesi-Ferretti, 2006).

Figure 1: FDI, portfolio, other and total capital inflows in CEE countries, 1995:Q1-2011:Q4



Note: The black line represents total capital inflows, the blue line represents FDI inflows, the green line represents portfolio investment flows, and the red line represents other investment inflows. All values are expressed as a share of GDP. Shaded areas indicate the period of the global financial crisis (2008:Q4-2009:Q4).

Source: IMF – International Financial Statistics, authors' calculations

Global financial crisis resulted in a sudden stop of all types of foreign capital inflows in all countries of Central and Eastern Europe (Figure 1). Amongst all emerging and

developing regions in the world, the crisis-induced fall of FDI was the sharpest in CEE countries (Globan, 2012). The causes of such events are both global and country-specific. Global factors comprise of an aggravated access to foreign sources of financing as a result of high risk aversion, which consequently reduced economic growth rates in CEE countries. Furthermore, the collapse of asset prices and the recession in main investment partners of CEE countries – Germany, Italy, Great Britain, Austria, etc. – have also had a very important role in the reduction of foreign investment flows to post-transition countries (UNCTAD, 2009).

The recovery of capital flows to CEE countries after 2010 is currently based primarily on portfolio investment and, to some extent, foreign loans. The recovery of FDI inflows remains sluggish, insufficient, with recorded inflows mainly resulting from the rise in reinvested earnings, rather than new investment ventures and greenfield investments (Figure 1; Table 1; UNCTAD, 2013).

Table 1: Greenfield investment inflows in CEE countries, in per cent of GDP, 2003-2011

	2003	2004	2005	2006	2007	2008	2009	2010	2011
Croatia	3.3%	1.8%	2.4%	1.2%	3.0%	4.6%	2.7%	4.0%	2.9%
Czech R.	4.1%	5.7%	3.9%	5.2%	4.2%	2.5%	2.3%	3.9%	2.3%
Estonia	8.7%	11.9%	14.6%	5.7%	3.8%	6.2%	6.6%	5.0%	4.0%
Hungary	6.8%	6.4%	7.1%	7.8%	7.0%	5.8%	3.7%	5.9%	2.3%
Latvia	29.9%	5.7%	10.2%	16.4%	2.5%	7.6%	3.2%	4.0%	2.5%
Lithuania	8.7%	2.9%	5.5%	4.3%	3.8%	3.2%	3.3%	4.3%	17.1%
Poland	5.2%	6.3%	4.7%	4.6%	5.4%	6.7%	3.4%	2.4%	2.5%
Romania	6.1%	6.2%	11.6%	15.7%	12.9%	16.0%	9.1%	4.7%	8.5%
Slovakia	8.9%	11.2%	19.0%	20.7%	7.3%	3.5%	6.2%	4.9%	5.9%
Slovenia	1.9%	5.8%	1.3%	1.7%	2.2%	1.1%	0.6%	1.6%	1.3%

Source: UNCTAD, authors' calculations

FDI has been an important source of financing of current account deficits in CEE countries. Table 2 shows that foreign direct investment flows financed significant shares of pre-crisis current account deficits in most countries, or even exceeded it, like in Czech Republic and Hungary. In Czech Republic the recovery in 2011 was driven by higher FDI flows, linked mainly to an increase in reinvested earnings. The substantial export-oriented FDIs during the past decade have helped to generate significant merchandise trade surpluses.

However, most CEE countries significantly decreased their current account deficits after the year 2007 due to the moderate growth of exports and to the large extent reduction of imports as a result of the financial crisis. Some countries have experienced current account surplus, which is visible as a negative FDI to current account deficit ratio (see Estonia, Latvia, Lithuania and Slovakia in Table 2). In Hungary external balance has improved in 2010 and 2011 as a consequence of adjustment process, driven

by falling domestic demand, reducing import growth, combined with a resilient export performance as well as higher absorption of EU funds (EU Commission, 2012).

One of common features of emerging economies is the greater volatility of their less capitalised markets. This volatility is an expression of the greater risks faced by the investors, among them currency risks, non-transparent accounting guidelines and political risks such as nationalisation or confiscation. The level of volatility of capital flows significantly rises during periods of financial crises, which was empirically confirmed on a sample of CEE countries during the recent global financial crisis (Jovančević, Globan and Arčabić, 2011).

Table 2: FDI to current account deficit ratio in CEE countries, 1995-2011

	1995	2000	2005	2006	2007	2008	2009	2010	2011
Croatia	-	2.2	0.8	1.0	1.1	0.9	1.0	0.7	2.4
Czech R.	1.9	1.9	10.1	1.8	1.4	1.4	0.6	0.8	0.9
Estonia	1.3	1.3	2.2	0.7	0.8	0.8	-2.9	-2.9	-0.6
Hungary	3.0	0.7	0.9	2.3	7.0	6.2	23.4	24.2	-12.5
Latvia	11.1	1.1	0.4	0.4	0.4	0.3	0.0	-0.5	4.8
Lithuania	0.1	0.6	0.6	0.6	0.3	0.3	0.0	-1.4	1.9
Poland	-	0.9	1.4	1.5	0.9	0.4	0.7	0.4	0.7
Romania	-	1.0	0.8	0.9	0.4	0.6	0.7	0.4	0.3
Slovakia	-0.6	2.9	0.6	0.9	0.8	0.5	0.0	0.3	-40.2
Slovenia	0.5	0.2	0.9	0.7	0.7	0.6	-1.9	1.3	-

Source: UNCTAD, IMF – World Economic Outlook (October 2012)

3. MEASURING THE CONVERGENCE LEVEL OF CEE COUNTRIES

Following Alexe and Tatomir (2011), our paper measures the level of economic convergence in CEE countries by calculating a real convergence index (*CONVERG*) comprised of three indicators: *LABOUR*, *GDPPC*, and *GROWTH*. Data covers the period from 2000:Q4 to 2011:Q4.

LABOUR is an index of a country's labour productivity and it measures the real gross domestic product per employee of a CEE country in relation to the EU-15 average. Furthermore, *GDPPC* (GDP per capita in purchasing power parities) measures the level of GDP per capita in CEE countries in relation to the EU-15 average. Values of indices higher than 100 indicate that the level of labour productivity and GDP per capita in a CEE country is higher than average in EU-15, and vice versa.

Third indicator, *GROWTH*, measures the quarterly real GDP growth rate (compared to a corresponding quarter of the previous year) of CEE countries, in relation to the EU-15 average. This indicator is calculated as follows:

$$GROWTH_{i,t} = 100 + Growth_rate_CEE_{i,t} - Growth_rate_EU_t \quad (1)$$

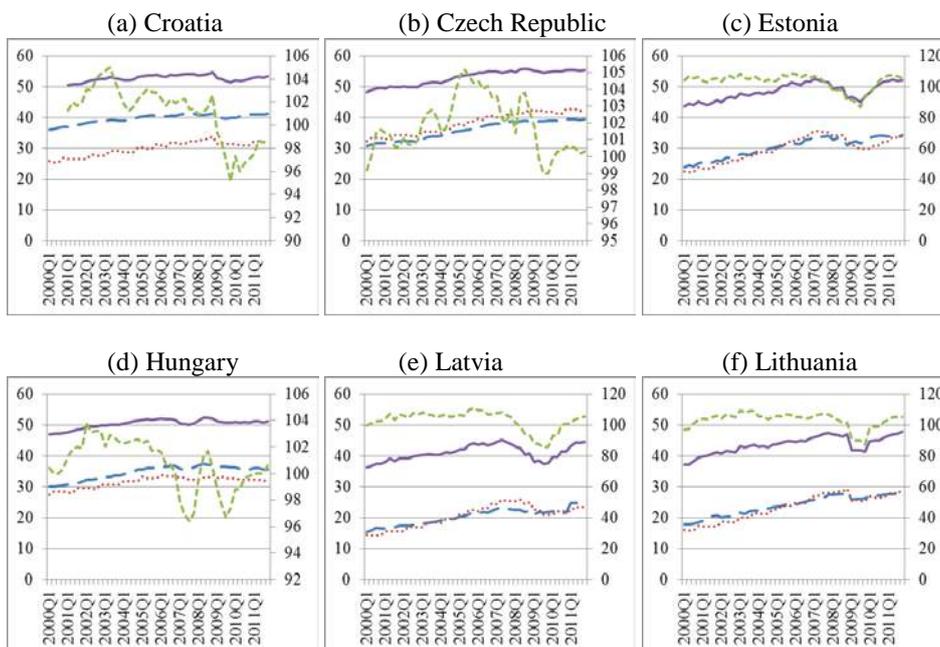
where $Growth_rate_CEE_{i,t}$ is a real GDP growth rate in CEE country i in a period t and $Growth_rate_EU_t$ is an average real GDP growth rate in EU-15 countries. Value of an index higher than 100 implies that in the period t a CEE country marked a higher GDP growth rate than EU-15 countries in average, and vice versa.

The real convergence index is then calculated as a weighted average of these three indicators, as follows:

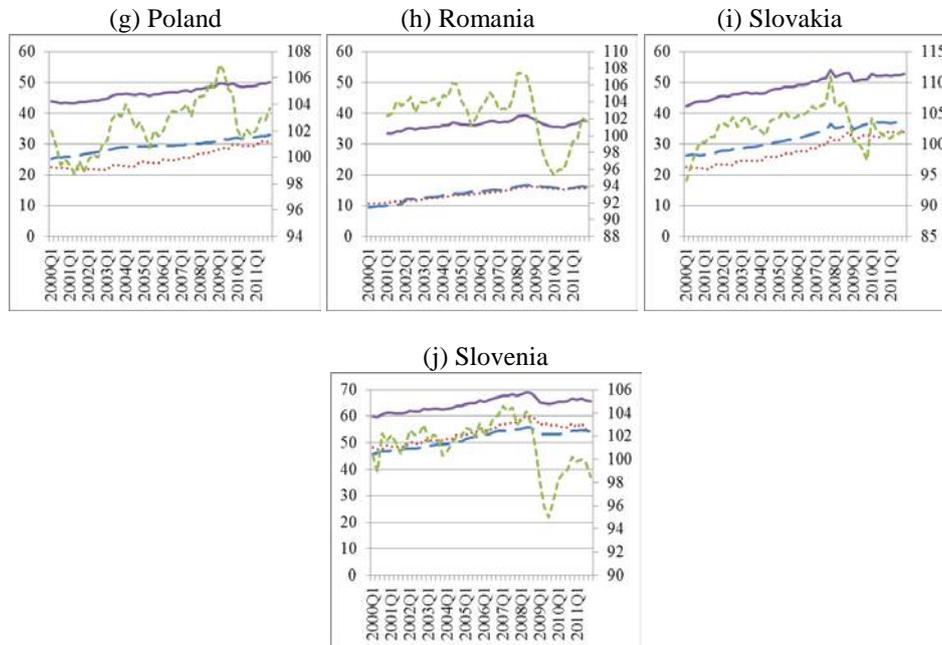
$$CONVERG_{i,t} = 0.5 * LABOUR_{i,t} + 0.25 * GDPPC_{i,t} + 0.25 * GROWTH_{i,t} \quad (2)$$

The highest weight (50 per cent) is given to the labour productivity index, while indices of GDP per capita levels and GDP growth rates are weighted equally with 25 per cent, since they indicate the level of productivity and the growth potential of a country. In order to check for the robustness of results, other weightings have been used⁸, but the results and rankings of countries regarding the convergence levels change very little. The $CONVERG$ index results in a number between 0 and 100, where 0 indicates no convergence with EU-15 countries, while 100 indicates full convergence.

Figure 2 Economic convergence indices in CEE countries, 2000:Q1-2011:Q4



⁸ For example, by increasing the respective weightings of $GDPPC$ or $GROWTH$ indices to 0.5, while holding other two indices at 0.25.



Note: The violet full line indicates the real convergence index (*CONVERG*), the blue dashed line indicates the labour productivity index (*LABOUR*), the red dotted line indicates the GDP per capita index (*GDPPC*), while the green dashed line (right axis) indicates the growth rate index (*GROWTH*).

Source: Eurostat, authors' calculations

The time series of all convergence indices are given in Figure 2. It is evident that CEE countries had been catching up with the advanced EU-15 countries throughout the 2000s until 2008. The new EU member states had benefited from their integration into the European single market, by opening up new trade and investment opportunities and by anchoring macroeconomic and institutional reforms.

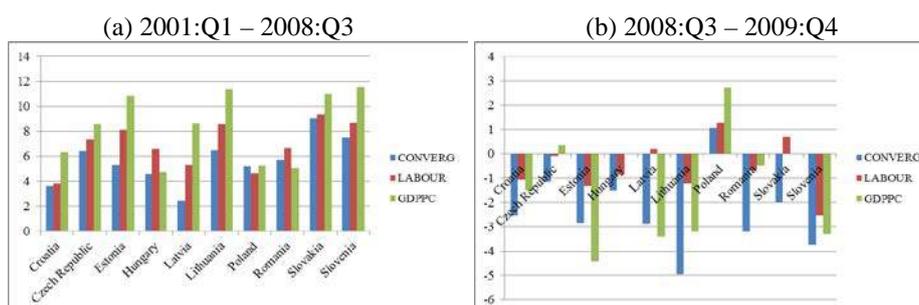
It should be noted that many authors point out that neither speed nor convergence of catching up process of new member countries are not the automatic result of membership in the EU, but are caused by other factors, i.e. structural reforms, productivity growth, capital flows, etc. (Halmai and Vasary, 2010). Convergence is measured by the size of the development, while the process of catching up measures the length and time required to achieve a certain level of progress.

Over the last decade, real GDP growth in emerging Europe exceeded the growth rate of EU-15 countries in all analysed countries. During periods of the largest economic expansion, real GDP growth rates in Baltic countries and Slovakia were higher than in EU-15 by as much as 10 percentage points (Figure 2). Relative growth of GDP was more modest in Slovenia, Croatia, Hungary, and Czech Republic. However, these four countries started from the highest levels of convergence amongst CEE countries at the beginning of 2000s, which implies that countries of Central and Eastern Europe followed the convergence hypothesis according to which countries with relatively lower levels of GDP per capita grow more rapidly.

The level of real economic convergence of CEE countries was rising until late 2008, although the pace of economic expansion decelerated in some countries in Central and Eastern Europe. Along with the aforementioned fast growing countries, the convergence in the pre-crisis period has been particularly remarkable in Slovenia and Czech Republic (Figure 3a).

Slovenia showed favourable progress due to export expansion and higher gross fixed capital formation and was the first country that has met the Maastricht criteria and joined the euro area. Baltic countries had been showing considerable improvement in the level of all convergence indices, including labour productivity, but their growth had been by large part financed by FDI inflows. Croatia had also been catching up in GDP per capita and labour productivity relative to EU-15 countries, but at a slower pace, similar to Poland and Romania. The performance of emerging economies could be attributed to their strong commitment to create an attractive business environment (including lower tax burden) and sound macroeconomic policies in the pre-crisis period (Jovančević, 2008).

Figure 3: Absolute changes in values of convergence indices related to EU-15 in the pre-crisis period and during the crisis



Source: authors' calculations

The relatively long period of constantly rising levels of economic convergence in Central and Eastern Europe ended abruptly with the occurrence of the global financial and economic crisis in late 2008. The sudden and significant decrease in foreign capital inflows in most CEE countries was accompanied by a sharp fall in domestic, external demand and asset prices, which was reflected in the decrease of 2009 gross domestic product in all CEE countries, except Poland.

The most pronounced decrease in economic activity and demand experienced Latvia, Lithuania and Estonia, all of which recorded a double-digit reduction of real GDP. On the other hand, Central European countries (Poland, Czech Republic and Slovakia) performed much better and succeeded to maintain the domestic consumption stable or even increase it, thus mitigating the fall in aggregate demand. All this reflected the differences in crisis-induced changes in levels of economic convergence, evident in Figure 3b. Remarkably, Poland increased its level of real economic convergence with EU-15 even during the crisis, while all other CEE countries diverged. The divergence process was most emphasized in Lithuania and Slovenia. However, Figure 3b reveals

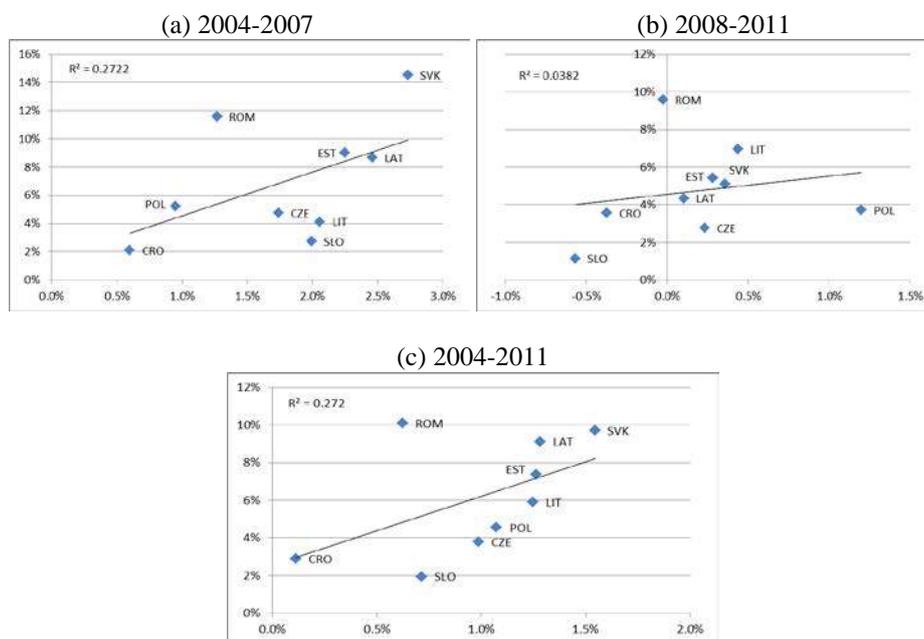
that in spite of decreasing levels of real convergence, labour productivity in Slovakia and Latvia increased during the crisis.

4. FDI AND CONVERGENCE IN CEE COUNTRIES

This section considers the role of FDI inflows, especially greenfield investment, in the convergence process of Central and Eastern European countries. Figure 4 examines the relationship between the level of greenfield investment and average percentage change in real convergence (*CONVERG* index) in CEE countries during the whole analysed period and two subperiods.

Analysis shows that the higher level of greenfield investment can be associated with more significant average increases in real convergence of CEE countries (Figure 4), which means that countries that received highest amounts of greenfield investment experienced, on average, more intensive real convergence with EU-15 countries. The conclusion stands both for the whole period (Figure 4c) and for the first subperiod, 2004-2007 (Figure 4a).

Figure 4 Relationship between greenfield investment and average percentage change in real convergence in CEE countries



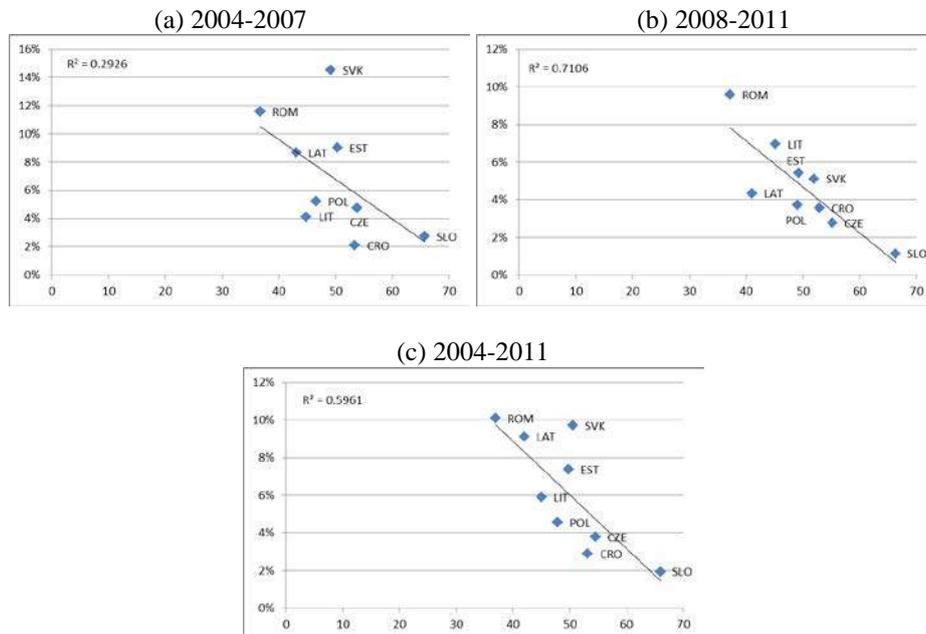
Note: The horizontal axis displays the average percentage change in the real convergence index (*CONVERG*), and the vertical axis displays the level of greenfield investment (in per cent of GDP) in CEE countries. Hungary was omitted from the sample as an outlier.

Source: Eurostat, UNCTAD, authors' calculations

However, the relationship between variables turned to be considerably weaker during the second subperiod, 2008-2011 (Figure 4b), which shows that the financial crisis had a significant impact on the reduction of FDI inflows which reflected on the divergence process of new EU member states, since the economic crisis significantly impacted ability of post-transitional countries to attract foreign investment and aggravated their economic recovery.

The next part of the analysis examines the relationship between the level of greenfield investment flows and the level of real economic convergence in CEE countries. Figure 5 reveals that the relationship has a negative sign, i.e. largest amounts of greenfield investment were, on average, attracted by least converged countries, while most converged countries, like Slovenia, Czech Republic and Croatia, recorded considerably less greenfield investment flows. This is in line with the neo-classical theory, which hypothesize that capital will move from "north" to "south", i.e. from more developed to less developed countries, due to higher marginal product of capital in the "south". In figure 5, it is evident that the relationship is relatively strong in all analysed periods for CEE countries, especially during the second subperiod. The same results hold if the level of greenfield investment is substituted by the level of total FDI flows.

Figure 5 Relationship between greenfield investment and the level of real convergence in CEE countries



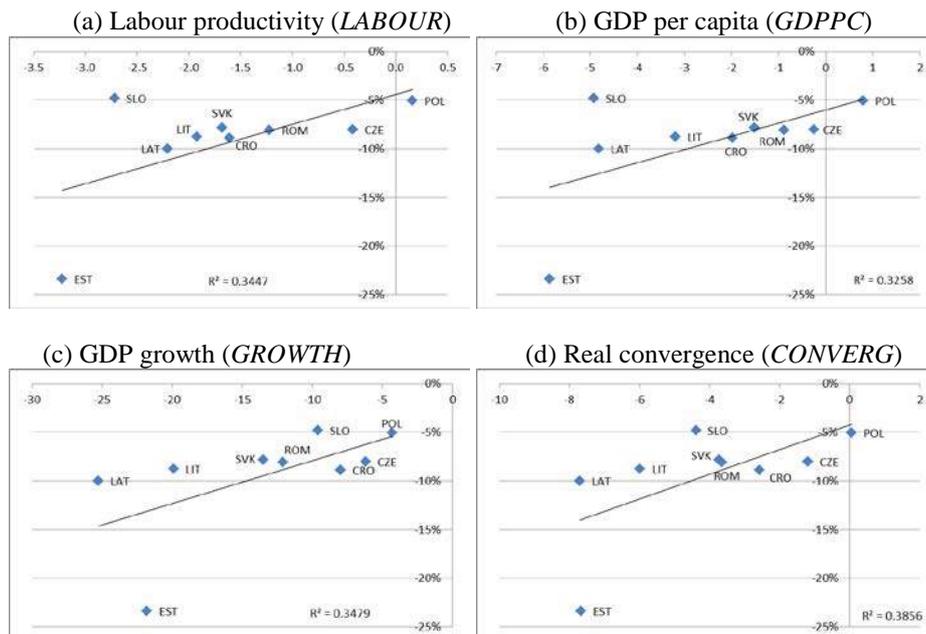
Note: The horizontal axis displays the real convergence index (*CONVERG*), and the vertical axis displays the level of greenfield investment (in per cent of GDP) in CEE countries.

Source: Eurostat, UNCTAD, authors' calculations

The final part of the analysis is concerned with the relationship between crisis-induced reversals of FDI flows and the change in convergence indices in CEE countries. The analysis shows a significantly strong positive relationship between variables. This implies that countries that experienced most intensive FDI reversals during the recent financial crisis, on average, subsequently recorded the largest decrease in the levels of their economic convergence with EU-15 countries, and vice versa (Figure 6). Results hold for all three subindices (labour productivity, GDP per capita, GDP growth) and the main real convergence index, with the coefficient of determination ranging from 0.33 to 0.39.

In order to additionally test the robustness of results, all of the above analysis was undertaken with GDP per capita as a sole indicator of the convergence level of CEE countries. However, results differ very little and all of the above-mentioned conclusions hold. These results are also available upon request.

Figure 6: Relationship between crisis-induced FDI reversals and the change in various convergence indices in CEE countries



Note: The horizontal axis displays the absolute change in convergence indices, and the vertical axis displays the absolute change in the level of FDI inflows (in per cent of GDP) in CEE countries during the global financial crisis. Absolute changes are calculated as the difference between the minimum amount of flows or convergence indices during the crisis period (2008:Q4-2009:Q4) and the maximum amount of flows and convergence indices during the pre-crisis period (2004:Q1-2008:Q3).

Source: Eurostat, UNCTAD, authors' calculations

5. CONCLUSION

The aim of this paper was to explore the role of foreign direct investment flows in economic convergence of European post-transitional countries with EU-15 countries. Countries of Central and Eastern Europe have used foreign capital flows, especially foreign direct investment, to finance economic restructuring, intensify investment projects, finance increasing domestic demand and support higher economic growth rates during the transition process. By doing so, CEE countries experienced a process of quick economic convergence with EU-15 countries until to the 2008, although by following the convergence hypothesis according to which countries with relatively lower levels of GDP per capita grow more rapidly. The new EU member states had benefited from their integration into the European single market, by opening up new trade and investment opportunities and by anchoring macroeconomic and institutional reforms.

However, the global financial crisis brought an abrupt end of these trends in the 2008 by triggering a severe economic crisis in Europe, during which CEE countries took a strong hit. Amongst all emerging and developing regions in the world, the crisis-induced fall of FDI was the sharpest in CEE countries. An economic divergence started to take place after 2008 in most CEE countries, caused by a sharp decline of foreign capital flows to these countries.

In order to measure the level of convergence of CEE countries vis-à-vis EU-15 countries and explore its relationship with FDI flows, especially greenfield investment, a real economic convergence index was constructed. The analysis showed that the higher level of greenfield investment is positively related with larger increases in real convergence of CEE countries. However, the relationship between variables was somewhat weaker during the period of the financial and economic crisis, as it significantly impacted the ability of post-transitional countries to attract foreign investment and aggravated their economic recovery.

Furthermore, the analysis showed that the largest amounts of greenfield investment were, on average, attracted by least converged countries, which concurs with the theory of neo-classical models. In addition, results of the analysis point to the conclusion that the reversals of FDI flows during the crisis have had a significantly strong connection with the economic divergence process that took place in most CEE countries. This means that the largest decrease in the levels of economic convergence with EU-15 countries was recorded in countries that experienced most intensive FDI reversals during the recent financial crisis. Results are robust for various calculation methods of convergence levels and data representations.

It should be noted that the rate of economic growth and levels of economic convergence of analysed countries cannot be explained only by the volume of FDI inflows. One could expect that the convergence process in CEE countries is influenced by the effects of their levels of productivity, employment, entrepreneurship and utilization of EU funds as well. Results stress the need of undertaking further efforts by the government to conduct a suitable economic strategic policy in post-transitional

countries to facilitate an increase of currently relatively low levels of FDI inflows, especially in terms of the ongoing recession in major investment partners in EU-15.

REFERENCES

- Alexe, I. and Tatomir, C. F. (2011), Does economic convergence with the European Union mean more FDI flows to an economy? Analysis on 5 Central and Eastern Europe countries. *MPRA Papers*, No. 36139.
- Babić, A., Pufnik, A. and Stučka, T. (2001), Teorija i stvarnost inozemnih izravnih ulaganja u svijetu i u tranzicijskim zemljama s posebnim osvrtom na Hrvatsku, *AND Hrvatska narodna banka: Pregledi*, No. 9.
- Blomström, M. and Kokko, A. (1997), The Impact of Foreign Investment on Host Countries: A Review of the Evidence, Working Paper, The World Bank.
- Blomström, M., Lipsey R.E. and M. Zejan (1994), "What Explains the Growth of Developing Countries?" in W.J. Baumol, R.R. Nelson, and E.N. Wolff (eds.), *Convergence of Productivity. Cross-National Studies and Historical Evidence*. Oxford and New York: Oxford University Press.
- Borensztein, E., De Gregorio, J. and Lee, J-W. (1998), How does foreign direct investment affect economic growth? *Journal of International Economics*, Vol. 45, pp. 115-135.
- Bosworth, B. i Collins, S. M. (1999), Capital Flows to Developing Economies: Implications for Saving and Investment. *Brookings Papers on Economic Activity*, Vol. 30, issue 1999-1, pp. 143-180.
- European Commission (2012), *Convergence Report*, No.3. 2012.
- Globan, T. (2012), Capital Flow Reversals During a Financial Crisis: Does the Pre-Crisis Composition Matter? *Ekonomski pregled*, Zagreb. Vol. 63, No. 11, pp. 587-607.
- IMF (2012), *International Financial Statistics*, <http://www.imfstatistics.org/imf/logon.aspx>.
- IMF (2012), *World Economic Outlook Database*, <http://www.imf.org/external/pubs/ft/weo/2010/02/weodata/index.aspx>.
- Halmai, P., Vasary, V. (2010), Real convergence in the new member states of the European union, *The European journal of comparative economics*, Vol.7, n.1. str. 229-253.
- Jovančević, R. (2008), Financing of Current Account Deficit in New EU Member States and Croatia. *Zbornik radova Ekonomskog fakulteta u Rijeci*. Vol. 26, No. 1; pp. 69-91.
- Jovančević, R. (2012), Izazovi kohezijske politike Europske unije 2014-2020. *Zbornik radova „Razvojna strategija malog nacionalnog gospodarstva u globaliziranom svijetu“*, HAZU, Zagreb 2012. (pp.179-207).
- Jovančević, R., Globan, T. and Arčabić, V. (2011), Volatility of Capital Inflows in EU New Member States and Croatia, in *Economics integrations, competition and cooperation Conference Proceedings* (ed. Kandžija, V.). Rijeka pp. 688-702).
- Jovančević, R. and Šević, Ž. (2002), Spill-over Effects of FDIs: Influence of the Macroeconomic Structure and Changing the National Business Culture, in *Stabilizacija-Participacija-Razvoj* (ed. Družić, I.), Zagreb: University of Zagreb, pp. 253-269.
- Jovančević, R. and Šević, Ž. (2006), Motivational Factors of Foreign Direct Investment and Public Policy Response: A Regional European Perspective, in *Foreign Direct Investment Policies in South East Europe* (ed. Jovančević, R. and Šević, Ž.), Greenwich University Press – Ekonomski fakultet Zagreb.
- Lane, P. R. and Milesi-Ferretti, G. M. (2006), Capital Flows to Central and Eastern Europe. *IHS Discussion Paper*, June, No. 161.
- Mencinger, J. (2003), Does Foreign Investment Always Enhance Economic Growth? *International Review for Social Sciences*, Vol. 56-2003, No. 4, pp. 491-508.

Ötker-Robe, I., Polański, Z., Topf, B. and Vávra, D. (2007.), Coping with Capital Inflows: Experiences of Selected European Countries. *IMF Working Papers*, WP/07/190.

UNCTAD (2007), *World Investment Report 2007*, United Nations, New York, Geneva.

UNCTAD (2008), *World Investment Report 2008*, United Nations, New York, Geneva.

UNCTAD (2009), *World Investment Report 2009*, United Nations, New York, Geneva.

UNCTAD (2013), *Investment Policy Monitor*, March, United Nations, New York, Geneva.

World Bank (1997), *Global Economic Prospects and the Developing Countries 1997*, Washington, D.C.

World Bank (1999), *Global Economic Prospects and the Developing Countries 1998/99*, Washington, D.C.

PART II

REGULATORY
ENVIRONMENT OF
THE EU; EU AND
NATIONAL
PERSPECTIVE

Nevia Čičin-Šain

University of Zagreb, Faculty of Law, Zagreb, Croatia

Sonja Cindori

University of Zagreb, Faculty of Law, Zagreb, Croatia

PROPOSED AMENDMENTS TO THE EU TAXATION SYSTEM OF INCOME DERIVING FROM INTEREST

ABSTRACT

Council Directive 2003/48/EC on taxation of savings income in the form of interest payments (the “EU Savings Directive”), came into force in the EU Member States on July 1st 2005 and was transposed into Croatian legislation by the latest General Tax Act (Public Gazette No. 147/08 and amendments in Public Gazette No. 18/11). The Directive aimed to enable savings income in the form of interest payments paid in one Member State to beneficial owners, who are individuals resident for tax purposes in another Member State, to be made subject to effective taxation in accordance with the laws of their State of residence.

However, when the Directive became applicable, it was apparent that further adjustments were necessary in order to close legal loopholes that enabled taxpayers to evade effective taxation. The goal of this paper is twofold – to reveal the most common artificial legal schemes used in order to circumvent Directive 2003/48/EC, as well as to present the Commission’s Proposal COM/2008/727 designed to redress the existing legislative loopholes and thus curb tax evasion.

Key words: *tax evasion, taxation of savings, direct tax harmonization, anti-money laundering measures*

JEL classification: *K340*

1. INTRODUCTION

The European Parliament, in its Resolution of 10 February 2010 on promoting good governance in tax matters, emphasized the problem of tax evasion and tax avoidance as one of the chief contributors to the latest economic crisis, costing the EU annually around 2,5% of its GDP in revenue losses.¹ An attempt to counter tax evasion and restore fair market competition is Council Directive 2003/48/EC on taxation of savings income in the form of interest payments (hereafter “EU Savings Directive”), which

¹ Studies conducted for the Republic of Croatia (for the year 2000) suggest it is between 5,5-7,5 of the country’s GDP (Madžarević-Sujster, 2002:138).

contains measures destined to prevent individuals from evading effective taxation of interest payments received on savings deposited in another Member State.

However, despite high expectations, in practice the Directive proved to suffer from some substantial legal loopholes and it became apparent that amendments were indispensable in order to prevent taxpayers to evade effective taxation. In this paper the authors will reveal the most common artificial legal schemes used in order to circumvent Directive 2003/48/EC and present the Commission's Proposal COM/2008/727 designed to redress the existing legislative loopholes.

In chapter two of the paper, the authors will present the development of legislative models destined to combat tax evasion concerning income deriving from interest payments. The third chapter of the paper will be dedicated to defining the territorial scope of the EU Savings Directive and the methods it provides to ensure effective taxation of interest payments made to individuals. The fourth chapter of the paper deals with definitions of the Directive's basic notions, giving a critical view of the existing legal loopholes they create and various amendments of the Directive designed to fill the existing gaps, as foreseen by Commission's Proposal COM/2008/727 final. The fifth chapter of the paper will be dedicated to the analysis of the anti-money laundering measures, as laid down in Directive 2005/60/EC, to which the EU Savings Directive makes explicit reference for the purpose of identifying the beneficial owner. In the last and concluding chapter, the authors will assess the impact of the EU Savings Directive and will recap the amendments, as formulated in the Commission's Proposal, destined to offset the shortcomings in the current directive.

2. TAXATION OF INCOME RECEIVED FROM INTEREST PAYMENTS: MODELS OF COMBATTING TAX EVASION AND ITS RELEVANT LEGISLATIVE FRAMEWORK

Extensive globalization left the States to face its negative consequences: mobility of people, capital, development of untraceable cross-border transactions and harmful tax competition, all which constitute elements aggravating the risk of tax evasion and fraud (SALVAT, 2010:103). Capital movement was liberalized within the EU by Directive 88/361/EEC and extended to relations with third States by the Treaty of Maastricht (now Article 63 of the Treaty on the functioning of the European Union, ex-Article 56 of the Treaty establishing the European Community). Initially, the States relied on an exchange of information mechanism provided for by Article 26 of the OECD Model Tax Convention, contained in a more or less developed network of bilateral conventions against double taxation (Castagnède, 2010). Since States, when concluding these bilateral conventions, could choose between various forms of exchange of information: spontaneous exchange, exchange upon request and the automatic exchange of information and could limit its material scope depending on whether the contracting States concluded a "minor information clause" (exchange of information for the sole purpose of carrying-out the Double Tax Convention) or a "major information clause" (covers also persons who are not residents of the two contracting States) (LANG, 2010:151), the effectiveness of this mechanism was hindered. In the absence of an extensive automatic exchange of information system between two

Member States, tax evasion in the matter of income in the form of cross-border interest payments, received by individuals in another EU Member State, was fairly easy. Although, the Member States were already applying Directive 77/799/EC on mutual assistance between tax authorities in the field of direct taxation, which provides for an exchange of information and coordination of investigative actions in cases of tax fraud, this exchange could be made conditional on some aspects of internal law (Commission (SEC (2008) 2767). It became apparent that a more effective legal intervention was necessary in order to combat tax evasion and distortion of the common market.

Since effective taxation of income in the form of interest payments to individuals could not be achieved properly by the Member States, the Union was entitled to act and adopt measures, according to the principle of subsidiarity, as set out in Article 5 of the Treaty on the European Union.

Various models were taken into consideration. The withholding tax model formed by the European Commission, which proposed an EC - wide withholding tax on interest at a rate of 15%, judged reasonable but not excessive, was rejected by the Council. The next model was the so-called co-existence model (offering a choice between a 20% withholding tax or exchange of information), *“but by then the winds changed, possibly under the OECD Report on Harmful Tax Competition and focus shifted from “minimum taxation in the source State” to “effective taxation in the residence State of the recipient”, and from the co-existence model to single mandatory exchange of information model.”* (Terra and Wattel, 2005:641)

Finally, as a result, the EU Savings Directive was adopted and came into force in the EU Member States on July 1st 2005. It also became part of Croatian legislation through the latest General Tax Act and its amendments (Public Gazette of the Republic of Croatia, No. 147/08 and No. 18/11).

3. TERRITORIAL SCOPE OF THE EU SAVINGS DIRECTIVE AND METHODS DESTINED TO ENSURE EFFECTIVE TAXATION OF INTEREST PAYMENTS MADE TO INDIVIDUALS

3.1. Territorial scope

Although the EU Savings Directive is a legal source belonging to the so-called secondary sources of EU Law and can thus only be applied in the Member States, its application was extended, by means of international agreements bearing equal or equivalent measures, concluded with the dependent territories of the UK (Guernsey, Jersey and the Isle of Man), UK overseas territories (Anguilla, Montserrat, British Virgin Islands, Turks and Caicos Islands and the Cayman Islands), dependent territories of the Netherlands (Netherlands Antilles and Aruba) and certain non-EU countries. The latter countries are: Switzerland, Monaco, San Marino, Andorra and Lichtenstein. Namely, the Member States agreed to start applying the EU Savings Directive only under the condition that these dependent and associated territories, as well as the aforementioned Third States start applying the similar agreements at the same date as the Directive.

Agreements with dependent and associated territories differ from Third Country Agreements in more than one aspect. Firstly, the Third Country Agreements have been concluded between the European Community and the relevant Third State, whereas agreements with dependent and associated territories were concluded separately with each Member State. Secondly, while the latter agreements ask for measures *equal* to those provided for by the EU Savings Directive, the Third Country Agreements only need to provide for *equivalent* measures. Thirdly, agreements with dependent and associated territories apply reciprocally, that is to say that the foreseen measures apply equally to inbound and outbound payments of interest savings (made from the dependent and associated territories to the EU Member State and *vice versa*) whereas the Third Country Agreements apply only to such payments made from these countries to an EU Member State.

3.2. Methods destined to ensure effective taxation of interest payments made to individuals, resident in another EU Member State

As it has been stated before, in chapter 2 of the present paper, an automatic exchange of information system was judged to be the best method to ensure effective taxation of interest payments made to individuals, resident in another EU Member State. Therefore, the EU Savings Directive obliges a paying agent to automatically report, at least a minimum amount of information, to its competent tax authority, whenever it is making interest payments to a beneficial owner who is resident of an EU Member State other than the Member State the paying agent is established in. The minimum amount of information refers to: (a) the identity and residence of the beneficial owner, (b) the name and address of the paying agent, (c) the account number of the beneficial owner or identification of the debt claim giving rise to interest and (d) the amount of interest paid or credited, or the amount of proceeds from the sale or redemption of the debt claim itself or the funds units giving rise to interest.

Subsequently, the competent tax authority in the Member State of establishment of the paying agent automatically exchanges this information with the competent tax authority in the Member State of residence of the beneficial owner, which can then tax this income according to its national tax legislation. The Directive obliges Member States to automatically exchange information at least once a year, for all interest payments made that year, within six months following the end of the tax year in the Member State of the paying agent.

A consistent application of the automatic exchange of information method would in fact result in an EC-wide abolishment of the bank secrecy. Since it became apparent that some of EU's main competitors in the financial sector (e.g. Switzerland) would not give up their cherished bank secrecy, some Member States strongly advocated the application of both the automatic exchange of information system as well as an alternative withholding tax system. Therefore, as derogation to the automatic exchange of information method, an alternative mechanism was provided for Austria, Belgium and Luxemburg. These countries are allowed to withhold a tax at a rate of 15% during the first three years of application of the EU Savings Directive, 25% for the subsequent three years and finally, since 1 July 2011, at a rate of 35%, levied on the amount of interest. The amount of tax collected is then distributed between the Member State

levying the tax (it is entitled to 25% of the revenue, as a compensation for services rendered) and the resident State (which receives 75% of the amount). All Member States levying a 35% withholding tax are obliged to enable the beneficial owner a voluntary disclosure procedure. This means that, when the beneficial owner expressly authorizes the paying agent to report information on him and the interest he received to its tax authority, which would then transfer the information to the tax authority of the State of residence of the beneficial owner, the paying agent needs to do so. The withholding tax regime was meant to be only a transitional arrangement, which should come to an end when the European Council decides that the USA, Switzerland, Lichtenstein, Andorra, San Marino and Monaco are willing to disclose requested information on beneficial owners receiving interest payments from paying agents established within their territory. Since these events, up to this date, have not yet occurred, the provisional arrangement is therefore still applicable in Austria and Luxembourg (Belgium started applying the automatic exchange of information method as of 1 January 2010).

Concerning agreements concluded with dependant and associated territories, some of them provide automatic exchange of information, whereas others withhold a tax.² Third Country Agreements provide for (a) application of a withholding tax with revenue sharing and (b) a voluntary disclosure of information upon an express request of the beneficial owner and (c) exchange of information upon request in cases of tax fraud.

4. MAIN FEATURES CONSTITUTING THE MATERIAL SCOPE OF THE SAVINGS DIRECTIVE

As stated before, the EU Savings Directive aims to enable savings income in the form of interest payments, paid in one EU Member State to beneficial owners, who are individuals resident for tax purposes in another Member State (cross-border payments), to be made subject to effective taxation, in accordance with the laws of the State of residence. Hence, the scope of following legal notions must be clearly distinguished: 1. interest payments, 2. beneficial owner, 3. paying agent.

4.1. The definition of interest payments

Four categories of income fall under the scope of the definition of interest payments, as laid down in Article 6 of the EU Savings Directive: (a) interest, paid or credited to an account, related to debt claims of every kind (etc.); (b) interest accrued or capitalized at sale, refund or redemption of these debt claims; (c) interest distributed by certain

² Four of the dependent territories (Aruba, Anguilla, the Cayman Islands and Montserrat) have provided automatic exchange of information from the date of the start of application of the relevant agreements on 1 July 2005. Since that date the following territories have also shifted to automatic exchange of information: Guernsey (as from 1 July 2011), Isle of Man (as from 1 July 2011), the British Virgin Islands (as from 1 January 2012), and Turks and Caicos Islands (as from 01 July 2012) . The dissolution of the Netherlands Antilles on 10 October 2010 resulted in two new constituent countries (Curaçao and Sint Maarten), which continue to levy a withholding tax on the same terms as Luxemburg and Austria, and three special municipalities which are part of the Netherlands (Bonaire, Sint Eustatius and Saba) and provide automatic exchange of information.

collective investment vehicles investing in debt claims, and (d) income from sale, refund or redemption of participations in such collective investment entities (Terra and Wattel, 2005). The first category corresponds to the definition of interest payments as laid down in Article 11 of the aforementioned OECD Model Tax Convention. It consists of two aspects – the positive aspect – what is to be considered interest payments and the negative aspect – what falls out of the scope of the definition. The latter group concerns penalty clauses or charges, pensions and insurance benefits (Lopes Courinha, 2006). The positive aspect of the definition encompasses all kinds of interests deriving from debt claims, concerning notably bonds, debentures, deposits and loans. Vogel for instance, defines interest “*as remuneration received for making capital available*” (Vogel, 1997:731). Category (b) refers to all interests in the form of capitalized interest or profits made at redemption or refund, the so-called capital gains. Category (c) refers to income deriving from interests received indirectly in the form of distribution from three types of investment funds – UCITS (Undertakings of Collective Investment in Transferable Securities) set up according to Directive 85/61/EEC (UCITS Directive), entities within the paying agent upon receipt concept who opted to be treated as UCITS (to be elaborated in chapter 4.3) and non-EU undertakings for collective investment.

Attention needs to be drawn to the question of asymmetrical treatment of different sorts of investment funds. The UCITS funds are investment funds that have been established in accordance with the abovementioned UCITS Directive. Once registered in one of the Member States, the units of an UCITS fund can be freely marketed across the EU. Currently, according to Article 4(2) of the EU Savings Directive, when an economic operator makes an interest payment to an entity established within the EU for the direct benefit of an individual, this entity shall be treated as a paying agent upon receipt, meaning that it will have to apply the Directive instead of the economic operator (this will be elaborated in detail within the chapter 4.3). However, if this entity proves that it is an UCITS fund or an entity which opted to be treated as such (the Member State of establishment must issue a corresponding certificate) it will not have to apply the Directive, when receiving the interest payment from an upstream economic operator. On the other hand, when an UCITS fund, an entity which opted to be treated as such or an investment fund established outside the territorial scope of the Directive, distribute income deriving from investments in debt-claims, this income falls under the definition of interest payment (Article 6 (1) (c)). The same goes for income from sale, refund or redemption of participations in such collective investment entities (Article 6 (1) (d)).

Unequal treatment may occur concerning investment funds which, although fulfilling all the necessary criteria for being treated as an UCITS fund, simply do not apply for such authorisation (non-UCITS funds). Two situations can arise. When a non-UCITS fund lacks legal personality (has not been incorporated) it can either be treated as a paying agent upon receipt (which needs to apply the Directive immediately upon receipt of the interest payment) or it can opt to be treated as a UCITS fund (in which case it needs to apply the Directive when distributing the income to individuals). On the other hand, when a non-UCITS fund has legal personality (e.g. SICAV in Belgium), the interest income it channels falls entirely out the scope of the EU Savings Directive. The income it receives from an upstream economic operator is not being distributed to an individual but a legal person, therefore the economic operator has no obligation to

report or withhold tax, nor does the incorporated non-UCITS need to apply the Directive, since legal persons are expressly excluded from the “paying agent upon receipt” concept (Article 4(2) (b)).

The second review of the EU Savings Directive, based on data provided for by EFAMA (European Fund and Asset Management Association), revealed that there has been a shift in the market towards non-UCITS funds (22% in 2002 to 25% in 2010) (Commission COM(2012) 65 final; page 11). This only encouraged the Commission to curb this unwanted asymmetry in treatment among non-UCITS funds by proposing an amendment to the current definition of interest payment, as laid down in the Article 6 of the EU Savings Directive. Rather than making a reference to the UCITS Directive, the amended Article 6(1) would include a reference to the registration of the undertaking or investment fund or scheme according with the rules of any Member State, thus submitting UCITS and non-UCITS funds alike to the same treatment. Should the Amending Proposal COM/2008/727 (final) enter into force, all income deriving from investments in debt-claims, is to be considered as interest payment, whether it is distributed directly or through an undertaking for collective investment, collective investment fund or scheme registered in accordance with the rules of any Member State or established outside the territorial scope of the Directive and in the latter case, irrespective of its legal form or whether it is an open or closed investment fund.

Based on their investment policy, there are different kinds of funds: equity funds, bond funds, money market funds and balanced funds (Adema, 2009). Whereas the answer to the question of application of the EU Savings Directive is clear in the case of the first three funds (it applies to income received through bond funds and money market funds and does not apply to income deriving from equity funds), it is less straightforward when concerning income deriving from balanced funds. The paying agent should try to ascertain the proportion of income deriving from interests as defined in category (a) and apply the Directive only to that income. If the paying agent is unable to establish this proportion, the total amount of the income shall be considered as deriving from interests.

The question of how to proceed with income gained from refund or redemption of units was solved by establishing a threshold of 25% (as of 1 January 2011) of the fund’s assets that need to be invested in/directly into debt-claims, in order for the entire proceeds from such a transaction to fall under the definition of interest payment (Larking, 2001:228). The extension of equal treatment of redemption of UCITS units and non-UCITS units is also proposed in Commission’s Proposal COM/2008/727, insofar as these funds invest at least 25% of their assets into debt-claims.

The definition of “interest”, as conceived in the current Article 6, was not intended to apply to innovative financial products, accompanied by an express statement that the issue should be re-examined during the first review of the EU Savings Directive (Weber, 2010:538). This definition follows the one used by the OECD in the Model Tax Convention, which considers that “*payments made under certain kinds of non-traditional financial instruments where there is no underlying debt do not normally fall under the definition of interest*” (see Paragraph 21.1. of the Commentary on Article 11

of the OECD Model Tax Convention). It was deemed too complicated for the paying agents to know the sophisticated features of an instrument, or the connection between its performance and the income it generates. However, the Commission, in its Proposal of Amendments to the EU Savings Directive (page 6) recognized that the extensive use of such innovative financial products, notably structured securities, which feature flexibility, a low risk and a rather safe return on invested capital provided income in a way similar to the one deriving from debt claims. Namely, data has shown that the market for structured financial products (where the current outstanding amount of sales in covered EU markets is EUR 767,3 billion) had undergone rapid development in general with an average annual increase of more than 30% (Commission, COM(2012)65 final; page 10,11).

This only supports the need to include such products into the scope of the Directive. The introduction of a general “substance over form” principle, as proposed by the cited Paragraph 21.1. Commentary on Article 11 of the OECD Model Tax Convention, although judged helpful by the Commission and the Member States, was discouraged by market operators, claiming that, without proper guidelines, disputes with clients were bound to arise. Also, the Commission considered drawing up a list of innovative financial products in each Member State, which would fall under the definition of interest payment, but this solution was deemed too rigid to keep up with market developments. Therefore, a compromise was attained by extending the scope of the Directive to securities of any kind where the investor (a) knows the conditions of the return on capital at the issuing date, and (b) at the end of the term, receives at least 95% of the capital invested.

Also, further amendments would concern some life insurance contracts where the biometric risk coverage is lower than 5% and its performance is linked to income from interest. These contracts are actually interest-generating securities concealed in life insurance contracts that are actually redeemable at a limited cost.

4.2. Beneficial owner

The beneficial owner of an interest payment is an individual who receives the payment, or for whom the payment is secured, unless this person proves that it was not received or secured for his own benefit (Article 2(1) of the EU Savings Directive). An individual receiving an interest payment will not be considered a beneficial owner if: (a) he/she acts as a paying agent for another individual or if (b) he/she is in fact an “intermediary agent”, that is if he/she acts on behalf of another individual (disclosure of identity of the beneficiary is mandatory), or (c) on behalf of a legal person (or an entity subject to tax under the general arrangements for business taxation) or (d) on behalf of an UCITS fund (or an entity that opts for being treated like an UCITS fund) (Article 2(2) of the EU Savings Directive). In the latter case, further safeguards were deemed necessary. The recipient must reveal the name and address of the entity that opted to be treated like an UCITS fund to the economic operator making the payment, who in return must communicate this information to its national tax authority.

If the paying agent suspects that the person receiving the interest payment is not the actual beneficial owner, it shall take reasonable measures to ascertain the identity of the

true beneficial owner. If it fails to do so, it shall treat the recipient as the beneficial owner. (Article 2(3) of the EU Savings Directive)

The Directive applies only to payments made *directly* to individuals. Payments made through legal persons or other legal entities fall out of the scope of the EU Savings Directive. Such a limited scope made way for various schemes of evading taxation, even though the beneficial owner of the interest payment is indeed an individual who is resident in another Member State and the Directive should apply.

In order to combat such tax evasion, the Commission proposed some substantial modifications to the current definition of the term “beneficial owner”.³

The first alteration can be found in point (b) of the proposed Article 2(1), where exemptions from the concept of beneficial owner can be found. An individual receiving an interest payment will not be considered as a beneficial owner if he/she acts on behalf of an entity or a legal arrangement and discloses the name, the legal form and the address of the place of effective management of the entity or, in the case of a legal arrangement, the name and the permanent address of the person who primarily holds legal title and primarily manages its property and income, to the economic operator making or securing the interest payment. This represents an entirely different approach from the current approach, as stated in Article 2(1) (b). In a way, the exemption is widened to the extent that it now encompasses individuals acting on the behalf of all entities or legal arrangements and not just legal persons, or entities subject to tax under the general arrangements for business taxation, or on behalf of an UCITS fund (or an entity that opts for being treated like an UCITS fund). However, in order not to be treated as the beneficial owner, the “intermediary” must disclose the name, legal form and address of effective management of this entity or legal arrangement to the economic operator making the interest payment.

Additionally, the Commission proposed the introduction of a new, third paragraph to Article 2, which directly refers to Directive 2005/60/EC on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing (hereafter: Third Anti-Money Laundering Directive): “*Where an economic operator within the scope of Article 2 of Directive 2005/60/EC makes an interest payment to, or secures such a payment for, an entity or a legal arrangement corresponding to those set out in Annex I, the definition in paragraph 1 of this Article shall include the beneficial owner, as defined in Article 3(6) of Directive 2005/60/EC, of such entity or legal arrangement*”.⁴

The concerned economic operators, under the mentioned Article 2 of the Third Anti-Money Laundering Directive, are: (1) credit institutions; (2) financial institutions; (3) some legal or natural persons acting in the exercise of their professional activities.⁵

³ COM(2008)727 (final), Explanatory Memorandum, page 3.

⁴ COM(2008)727 (final), page 15

⁵ (a) Auditors, external accountants and tax advisors; (b) notaries and other independent legal professionals, when they participate in, (i) buying and selling of real property or business entities; (ii) managing of client money, securities or other assets; (iii) opening or management of bank, savings or securities accounts; (iv) organisation of contributions necessary for the creation, operation or management of companies; (v) creation,

When these economic operators are making interest payments to certain entities or legal arrangements listed in the newly proposed Annex I to the EU Savings Directive (which will be discussed later, in the chapter 4.3) they must apply Article 3(6) of the Third Anti-Money Laundering Directive, in order to establish the true beneficial owner of the interest payment.

It is therefore indispensable to present the definition of “beneficial owner”, under the Third Anti-Money Laundering Directive. The term “beneficial owner”, means the natural person(s) who ultimately owns or controls the customer and/or the natural person on whose behalf a transaction or activity is being conducted. The beneficial owner shall at least include, in the case of corporate entities, (a) the natural person(s) who ultimately owns or controls a legal entity through direct or indirect ownership or control over a sufficient percentage of the shares or voting rights in that legal entity, including through bearer share holdings, other than a company listed on a regulated market that is subject to disclosure requirements consistent with Community legislation or subject to equivalent international standards; a percentage of 25 % plus one share shall be deemed sufficient to meet this criterion, or (b) the natural person(s) who otherwise exercises control over the management of a legal entity (Article 3(6) (a) of the Third Anti-Money Laundering Directive)

In the case of legal entities, such as foundations, and legal arrangements, such as trusts, which administer and distribute funds, one can differentiate three situations.

In a situation where the future beneficiaries have already been determined, the beneficial owner will be the natural person(s) who is the beneficiary of 25 % or more of the property of a legal arrangement or entity. In a situation where the individuals that benefit from the legal arrangement or entity have yet to be determined, the beneficial owner is the class of persons in whose main interest the legal arrangement or entity is set up or operates. Otherwise, it will be the natural person(s) who exercises control over 25 % or more of the property of a legal arrangement or entity (Article 3(6) (b) of the Third Anti-Money Laundering Directive).

The Third Anti-Money Laundering Directive, in order to set a clearer definition of the beneficial owner, sets a “25% plus one share” and a “25% of property” ownership threshold, deemed sufficient enough to meet the criterion of ultimate ownership or control. Still, when in face with complex structures featuring multiple layers of trusts, entities and companies, it is questionable who the real beneficial owner is. These types of structures of ownership designed to obfuscate the true beneficiary should definitely be treated as cases where enhanced customer due diligence should be conducted in order to pierce through a multi-layered corporate veil (see chapter 5).

4.3. Paying agent

For the purposes of the EU Savings Directive, “paying agent” means any economic operator who pays or secures interest *directly* to its *beneficial owner*, regardless of

operation or management of trusts, companies or similar structures; (c) trust or company service providers not already covered under points (a) or (b); (d) real estate agents; (e) other natural or legal persons trading in goods, only to the extent that payments are made in cash in an amount of EUR 15 000 or more, whether the transaction is executed in a single operation or in several operations which appear to be linked; (f) casinos.

whether he is also the debtor of the debt claim giving rise to the interest or solely the appointed operator. In other words, the term “paying agent” encompasses all kinds of economic operators (individuals, legal persons or entities of any kind) who are the “last link in the chain of downward payments of interest”, paying the interest directly to the beneficial owner. They have the obligation either to report information about the payment to their tax authorities or to withhold a tax, depending on which method is applied in their State of establishment (see *supra*, chapter 3).

If this definition were to be the only definition of the paying agent, it is clear that all payments made to entities established within the Community, other than individuals, would fall out of the scope of the Directive. However, some types of entities, mostly lacking legal personality, such as trusts or civil partnerships, are often regarded by the Member States as “tax transparent” entities. This means that the income they receive is generally allocated, for tax purposes, to the participants of the entity, regardless of the moment of effective distribution of this income to the participants. In some occasions, these participants might be individuals resident in another Member State. Bearing in mind that these entities may not be subject to close supervision by tax authorities of their Member State, to the extent that individuals could easily circumvent the Directive, by interposing such a tax transparent entity, between the paying agent and themselves, the EU Savings Directive set up the concept of a – “paying agent upon receipt” (Art. 4(2)).⁶

When the “initial” paying agent, or rather the upstream economic operator, pays interest to such an entity established within the EU, the Directive applies in two stages. Firstly, the upstream economic operator will convey information to its national tax authority on the name and address of the entity and the total amount of interest paid to it. The tax authority of the Member State of establishment of the economic operator will then communicate this information to the tax authorities in the State of establishment of the entity. Secondly, the entity itself will apply one of the methods stated in the Directive which applies in its State of establishment (automatic exchange of information about the beneficial owner and the amount of interest the entity will distribute to him/her or withholding tax).

It is important to note that these entities, due to the fact that they are often considered transparent for tax purposes in Member States, must apply the Directive at the moment of receipt of the interest payment and not distribution of the interest to their beneficial owners. Hence the term “paying agent upon receipt”.

The reason for this two-staged application of the Directive is the following. The upstream economic operator has no knowledge of the identity or residence of the actual beneficial owner of the interest payment, whereas the entity receiving the interest payment or rather, the “paying agent upon receipt” necessarily knows of which participants it is constituted and can therefore apply the Directive when its participants are individuals resident in a Member State other than the one the entity is established in. Member States applying the withholding tax method, may provide measures that

⁶ The five non-EU countries applying equivalent measures did not accept the concept of the paying agent upon receipt.

oblige the upstream economic operator to apply the withholding tax instead of the entity, when the entity is established in another Member State, unless this entity has formally agreed that the paying agent discloses information on the name and address of the entity and the amount of interest paid to it (Article 11 (5) of the EU Savings Directive).

Some entities are expressly excluded from the “paying agent upon receipt” concept. These are all legal persons (with the exception of certain Swedish and Finnish legal persons, which therefore are to be considered as “paying agents upon receipt”), entities whose profits are taxed under general arrangements for business taxation and UCITS investment funds. When interest payments are made to these entities, the Directive does not apply. But, when they distribute income to individual beneficial owners resident in another Member State, this payment falls under the scope of the EU Savings Directive, provided that it meets the criteria set in Article 6 of the EU Savings Directive (definition of interest payment).

Although it was expected that the definition of the “paying agent” would prevent misuse of the Directive, its scope was proven to be too narrow in practice (Commission COM(2008)727 (final), page 4). Namely, the Directive is easily circumvented by artificially channelling the interest payment through an economic operator established outside the territorial scope of the Directive or agreements with similar measures. The second review of the EU Savings Directive confirmed the widespread use of untaxed offshore structures interposed between the payer and the ultimate beneficiary in order to obscure the actual beneficial ownership: 35% of the non-bank deposits in Member States (65% for deposits held in Savings Agreements countries) are held by such structures located in offshore jurisdictions (Commission, COM (2012) 65 final; page 7).

Another way of evading tax is the case where an economic operator established within the EU distributes the interest to its branch established outside of the territorial scope of the Directive (for instance the USA) which then, in return makes the payment to the individual resident in another Member State. The initial economic operator does not have the obligation to apply the Directive, because it is not paying the interest to an individual and the second economic operator is not bound at all by the Directive, being established outside its territorial scope. The same goes for payments made to other interposed legal persons or trusts situated outside the territorial scope of the Directive.

Therefore, the Commission in its Proposal of Amendments to the EU Savings Directive intends to substantially modify Article 4 and the definition of the “paying agent”. In the case where interest payments are made to certain entities and legal arrangements, whose place of effective management is outside the territorial scope of the EU Savings Directive, the proposed amendment to Article 4(1) would impose an obligation on paying agents within the EU to apply a so-called “look-through approach”. This means that they would have to make use of information on beneficial owners, already available to them based on anti-money laundering measures they are already required to apply, as laid down in the aforementioned Third Anti-Money Laundering Directive (special attention will be paid to these measures in chapter 5 of this paper). The

Commission believes⁷ that these measures ensure identification of the beneficial owner and when there are indications that the beneficial owner is in fact an individual resident in another Member State, the paying agent should “look through” the interposed entity or legal arrangement and consider the interest payment to be made directly to the beneficial owner.

In order to limit uncertainties as to which entities should be regarded in such a way, a list of entities and legal arrangements whose place of effective management (not establishment!) is in a certain country or jurisdiction, outside the territorial scope of the EU Savings Directive or corresponding agreements, which does not ensure proper taxation of income paid to such entities, was added as Annex I.⁸

Proposed amendments to Article 4(1) would also cover situations in which an economic operator is making payments to another economic operator established outside the territorial scope of the Directive or similar agreements with Third Countries and jurisdictions, for which it has proof that they will subsequently be distributed to individuals resident in another Member State. Again, the Community paying agents would be obliged to apply a “look through approach” and consider such payments to be made for the immediate benefit of the individual and should therefore apply the Directive. This would put an end to the circumvention of the Directive through the misuse of international networks of financial institutions (Weber, 2010;527).

The “paying agent upon receipt” concept, although believed to be sufficiently resistant to misuse, in practice proves to suffer from legal loopholes and requires modifications as well. The main problem lies in exempting “entities whose profits are taxed under general arrangements for business taxation” from being treated as paying agents upon receipt. This is due to the fact that certain Member States consider some entities as being generally subject to corporate or similar tax, while not obliging them to keep records of any kind (e.g. partnerships in Austria). Such discrepancies enable some Member States to “*maintain or even increase (in relation to other participating countries) the attractiveness of their financial markets, despite the implementation of the Savings Directive*” (Gläser, Halla, 2006:38). These entities are mostly trusts and civil law partnerships.

The proposition of extending the “paying agent upon receipt” concept to all entities and legal arrangements established in other Member States was rejected as being administratively too burdensome for upstream economic operators. Instead, an approach based on a positive definition of intermediate structures obliged to act as a “paying agents upon receipt” was adopted. This meant shifting the obligation to apply the EU Savings Directive from the economic operators on to various trusts, foundations and other legal arrangements. The definition is based more on substantive elements than the legal form. Its key elements are: (a) it is an entity or legal arrangement, (b) which, under the *general rules for direct taxation applicable* in the Member State in which the entity or legal arrangement has its *place of effective management*, (c) is *not*

⁷ COM(2008)727 (final), page 3

⁸ For example: Bahamas – trust, foundations, international business company; Bahrain – Financial trust, Maldives – all the companies, partnerships and foreign trust ...

taxed on its income or on the part of its income, arising to its non-resident participants, including any interest payments.

The “paying agent upon receipt” concept underwent the following important changes. First of all, whether there is effective taxation of the income of such an agent is assessed according to the laws of the Member State where it has its place of effective management, irrespective of its place of establishment. For this purpose, a legal arrangement shall be considered to have its place of effective management in the country where the person who primarily holds legal title and primarily manages its property and income has his or her permanent address.

Additionally, in order to lighten the administrative burden lying upon economic operators, an indicative list of entities and legal structures that should in all cases be considered as “paying agents upon receipt” is joined as Annex III. If such entities or legal arrangements have the place of effective management of their movable assets in one of the Member States (determined by the residence of the main trustee or administrator responsible for movable assets), they shall be treated as “paying agents upon receipt”, irrespective of the laws under which these trusts or similar arrangements have been set. This means that a trust or foundation established in e.g. Singapore (outside the scope of the Directive), but whose place of effective management is within the EU, will be treated as “paying agent upon receipt” and its management must therefore apply the Directive, upon receipt of interest payments from an upstream economic operator.

Subsequently, “*entities whose profits are taxed under general arrangements for business taxation*” are removed from the list of exemptions from the “paying agent upon receipt” and “*non-taxation of the income, arising to its non-resident participants, including any interest payments*”, was added as a constituting part of the definition of the paying agent upon receipt. By doing so, the amended version of the definition would put a stop to discrepancies which occur in practice, where some entities are considered to be subject to general business income tax, but are not obliged to keep track of their income, thus enabling tax evasion.

Other exemptions from the concept were also changed. The following entities or legal arrangements should not be treated as “paying agents upon receipt”: (a) UCITS funds or non-UCITS funds whose income is covered by points (c) and (d) of the definition of interest payment (they apply the Directive upon distribution), (b) if they are serving management of assets of a pension fund or insurance business, (c) if they are serving exclusively charitable purposes in the Member State of residence and (d) if it is a shared beneficial ownership for which the economic operator making the payment has established identity and residence of all beneficial owners and is therefore acting as a paying agent, instead of the entity or legal arrangement.

Finally, the proposed amendment expressly defines beneficial owners within these entities or legal arrangements, as being individuals who are legally entitled to the assets or the income of the entity or legal arrangement, or, in the absence of such, individuals who have directly or indirectly contributed to the assets giving rise to the interest payment. In terms of trust law, if there is a beneficiary of the trust, he/she would be

considered as the beneficial owner. If there is no identifiable beneficiary, the principal settlor should then be considered as its beneficial owner. When neither the beneficiary, nor the principal settlor are identifiable, the paying agent upon receipt becomes a paying agent upon distribution and must apply the EU Savings Directive when an individual becomes entitled to the interest.

Again, there is a two-staged application of the Directive. First, the upstream economic operator must convey information about the name and place of effective management of the entity, or in case of a legal arrangement, the name and permanent address of the person who primarily holds legal title and manages the property and income of the legal arrangement (e.g. permanent address of a trustee) and the total amount of interest paid, to its national tax authority. In other terms, the economic operator must report on payments made to these entities or legal arrangement, irrespective of the identity of the beneficial owner or withhold 35% tax if it operates in Austria or Luxembourg (unless the entity or legal arrangement formally agree to disclose information). When the entity or legal arrangement is located in another Member State, this authority shall pass the information to its tax authorities. Secondly, this entity or legal arrangement must apply the provisions of the EU Savings Directive upon receipt of such income from an upstream economic operator. It must do so irrespective of the location of its bank account to which the payment has been made (it could be located outside of the territorial scope of the Directive, e.g. Hong Kong).

5. THE ISSUE OF IDENTIFICATION OF BENEFICIAL OWNERS AND THEIR RESIDENCES UNDER THE ANTI-MONEY LAUNDERING DIRECTIVE (2005/60/EC) AND ITS CORRELATION TO THE EU SAVINGS DIRECTIVE

It is clear that the effectiveness of the EU Savings Directive depends largely on the quality of information gathered by the paying agents which they later transmit to their competent authorities. Therefore, it is crucial to determine procedures necessary to allow paying agents to identify the beneficial owners and their residence. Minimum standards for establishing the identity and residency of the beneficial owner vary depending on the date the transaction or a contractual relation between the paying agent and the beneficial owner took place (Art. 3(2) (a) or (b) of the EU Savings Directive). Prior to 1 January 2004, the paying agent had to establish at least the name and address of the beneficial owner pursuant to the Know Your Customer principle set in Council Directive 91/308/EEC of 10 June 1991 on prevention of the use of the financial system for the purpose of money laundering.⁹ Although the latter Directive imposes the obligation on the paying agent to ascertain the identity of the beneficial owner, it does not lay down any further details. For business relations entered into after 1 January 2004, the EU Savings Directive demands the paying agent to determine, apart from name and address of the beneficial owner, also his tax identification number (TIN), or failing such number, his date and place of birth figuring on his passport or identification card. If some clients present a piece of identification issued by a Member

⁹ As amended by Directive 2001/97/EC of the European Parliament and of the Council O.J. L 344, 28 December 2001

State, but they declare themselves as residents of a third State, they must prove that, by submitting a tax residence certificate of that State.

Commission's Proposal COM/2008/727 intends to substitute the reference to Council Directive 91/308/EEC with a reference to Council Directive 2005/60/EC (the Third Anti-Money Laundering Directive). Since this Directive derogates the previous one, this proposition is only logical. Furthermore, the Third Anti-Money Laundering Directive raises the issue of identification and risk assessment to a higher level. Taking into consideration the importance of the quality of information gathered by the paying agent, we deem it necessary to further analyse regulations of the aforementioned Third Anti-Money Laundering Directive concerning identification of the beneficial owner.

Bearing in mind the complexity of business transactions, even more so when in the presence of a tax evasion scheme, identification of a beneficial owner is neither easy, nor uniform. „*The required identification evidence depends on the nature of the client and the degree of risk associated with the client or the business to be transacted*“ (Bazley; Forster, 2004). The Third Anti-Money Laundering Directive imposes on the paying agents (both from the financial and non-financial sector) a multitude of obligations but also provides them with a wide array of authorities when identification is concerned. These authorities enable the paying agent to perform a customer due diligence (according to Article 8 of the third Anti Money Laundering Directive) as a key element of the risk assessment process.

Customer due diligence does not only entail the identification of the *customer* and verification of the *customer's* identity on the basis of documents, data or information obtained from a reliable and independent source. It also imposes the obligation on the paying agent to identify the *beneficial owner* by taking adequate measures as to verify his identity, to the degree that the paying agent is satisfied that it knows who the *beneficial owner* is. Regarding legal persons, trusts and similar legal arrangements, this involves taking risk based and adequate measures to understand the ownership and control structure of the customer. It also imposes on the paying agent the obligation to obtain information on the purpose and intended nature of the business relationship and to monitor the business relationship, including scrutiny of transactions undertaken throughout the course of that relationship.

In other words, the extent of identifying the customer stands in direct correlation with the assessed risk. This process is known in both theory and practice as the „Know Your Customer (KYC)“ principle, a complex process where identification and verification of customer represent only the beginning¹⁰.

An even more enhanced customer due diligence is foreseen in situations enumerated in Article 13 of the Third Anti Money Laundering Directive, that is where the customer has not been physically present for identification purposes, or in respect of cross-frontier correspondent banking relationships with respondent institutions from third countries, or when having business relationships with politically exposed persons

¹⁰ On KYC principle and its difference from the KYB principle, see more in Hopton, D., (2005), *Money laundering: A Concise Guide for All Business*, Gower, Hampshire, pages 85, 89

residing in another Member State or in a third country or all other situations that represent a higher risk. On the other hand, in case of entering in business relations and transactions with certain credit or financial institutions covered by this Directive or beneficial owners of pooled accounts held by notaries, the Third Anti Money Laundering Directive provides for a more simplified customer due diligence, since the assessed risk for these kinds of transactions is presumably lower (Article 11).

6. CONCLUSION

Due to liberalization of capital movement, tax evasion and tax avoidance are a growing problem in the EU. In order to successfully battle against these negative consequences of globalization, Member States must work together in order to coordinate their tax legislations and install effective procedures. In a territory such as the EU, where market operators make use of barriers being brought down, but tax authorities are still confined to their jurisdictions, an automatic exchange of information is judged to be the best way to tackle tax evasion and tax avoidance.

After long negotiations, the EU Savings Directive finally saw the light of day, on 1st July 2005. On average more than 4 million records have been sent each year from source countries to residence countries representing on average 20 billion euro of savings income (Commission(COM(2012)351final; page 6). On the other hand, the reviews of the Directive showed that the Directive fell short of its aim. When the EU Savings Directive was drafted, its scope was deliberately limited. For instance, innovative financial products were expressly left out of the scope of the Directive, provided that this decision be re-assessed at the occasion of the first review of the Directive. Indeed, the review showed that market distortions did occur to an extent, as individuals started rearranging their portfolios in such a fashion as to remain out of the definition of „interest payment“ whilst still benefiting from all the features that such an investment entails. As stated before, the second review of the Directive revealed that the market for structured financial products has been increasing at more than 30% on average annually in recent years (*supra*, page 8). This wanted loophole, ought to be closed, by extending the scope of the Directive to such investment product in order to prevent further market distortions.

Other loopholes were less planned. For instance, it became apparent that the „paying agent upon receipt“ concept needs fine-tuning for, in practice, individuals made use of certain entities that are incorporated, or are subject to general rules for business taxation, but are in fact considered to be tax transparent (e.g. partnerships in Austria). Also, inconsistent treatment of non-UCITS funds, based solely on the fact whether the fund is incorporated or not, gives the result that interest channelled through an incorporated non-UCITS funds, such as the Belgian SICAV, fall entirely outside the scope of the Directive, whereas interests distributed by UCITS funds or non-incorporated non-UCITS funds are always covered. The second review also showed a shift in the market towards investments in non-UCITS (*supra*, page 6).

Apart from closing detrimental loopholes, the Commission plans to lighten the administrative burden laying upon the economic operators, mainly banks. The entire

Directive relies on the cooperation of market operators throughout the EU. These often point out the lack of clarity regarding as to which legal arrangements or entities should be treated as “paying agents upon receipt”. In order to enforce legal certainty, the Commission, in its Amending Proposal, suggests the introduction of a positive list of entities which should be regarded as such. It also suggests the introduction of a list of entities situated in non-EU jurisdictions which do not ensure effective taxation, in order to reduce uncertainties as to which entities the economic operators need to apply the „look-through“ approach. The paying agent would not need any cooperation of the selected jurisdictions outside the EU, as it would use the results of the Customer Due Diligence which it is already obliged to perform under the Third Anti-Money Laundering Directive.

Although, the Commission 's Amending Proposal of the EU Savings Directive could be considered as a mitigated solution, addressing solely the most flagrant loopholes, while leaving out further savings products, such as dividends payments, it is still not adopted. The reason for this is of purely political nature. Namely, the Member States are fearful that, by strengthening the automatic exchange of information within the EU, their financial markets will lose some of their attractiveness to other booming financial markets, such as Singapore, Hong Kong or Switzerland. Therefore, some Member States are reluctant to adopt the amendments to the EU Savings Directive, even though it would ensure better taxation of income deriving from interests. In a globalized market, where savers can move their savings around the world, wherever suits them best, the impact of such an amendment needs to be assessed on an international scale. Capital might relocate to other jurisdictions, where the banking secrecy is still a unquestionable bastion of the banking world. Although, in the short run, such taxation policy is understandable, in the long run harmful tax competition deprives the countries of their due income. The latest economic crisis emphasized budgetary strains in the Member States, caused by their will to satisfy often incongruent interest – the ones of the market operators and the ones of their citizens. It is therefore only advisable that the Council adopts the pending amendment proposal and that the EU makes use of its political influence on competing countries within the financial sector, in order to achieve reciprocal automatic exchange of information, in the form of bilateral agreements providing for measures equal to those in the EU Savings Directive.

REFERENCES

- Adema, R., (2009), UCITS and Taxation, Kluwer Law International, Great Britain
- Bazlely, S., Forster, C., (2004), Money Laundering: Business Compliance, LexisNexis, United Kingdom
- Castagnède, B., Lutte contre la fraude ou l'évasion fiscale internationale : la nouvelle donne, *Revue française de finances publiques*, Vol. 110 (April), 3 – 22
- Commentary of the OECD Model Tax Convention with respect to Taxes on Income and on Capital
- Commission Staff Working Document (SEC (2008) 2767) Accompanying the Proposal for a Council Directive amending Council Directive 2003/48/EC on taxation of savings income in the form of interest payments, Impact Assessment
- Commission (COM(2012)351final) - Communication from the Commission to the European Parliament and the Council on concrete ways to reinforce the fight against tax fraud and tax evasion including relation to third countries

Commission (COM(2012)65 final) - Report from the Commission to the Council in accordance with Article 18 of Council Directive 2003/48/EC on taxation of savings income in the form of interest payments

Council Directive 2003/48/EC on taxation of savings income in the form of interest payments, O.J. No. L 157 of 26 June 2003

Council Directive 2005/60/EC on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing, O.J. L 309/15 of 26 October 2005

Council Directive 85/61/EEC O.J. L 375/3, in the field of Undertakings of Collective Investment in Transferable Securities of 20 Dec. 1985

Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty, O. J. No. L 178, of 08 July 1988

Council Directive 91/308/EEC of 10 June 1991 on prevention of the use of the financial system for the purpose of money laundering, O.J. 166, 28 June 1991

European Parliament Resolution of 10 February 2010 on promoting good governance in tax matters

General Tax Act (Public Gazette of the Republic of Croatia, No. 147/08 and No. 18/11)

Hopton, D., (2005), Money laundering: A Concise Guide for All Business, Gower, Hampshire

Lang, M. (2010), Introduction to the Law of Double Taxation Conventions, Linde Verlag & IBFD, Vienna and Amsterdam

Larking, B. (2001), Another go at the Savings Directive – third time lucky?, EC-Tax Review, Vol. 4

Larking, B., Another Go at the Savings Directive – Third Time Luck?, EC Tax Review, 2001/4, p. 220-234

Lopes Courinha, G. (2006) in ,The Taxation of Interest Savings Income in the European Capital Market, Linde Verlag, Vienna

Madžarević-Šujster, S. (2002), Procjena porezne evazije u Hrvatskoj, Financial theory and practice, Vol. 26, 117-144

OECD Model Convention with respect to Taxes on Income and on Capital

Salvat, B. (2010), La recherche du renseignement dans la lutte contre la fraude fiscale internationale, Revue française de finances publiques, Vol. 110 (April), 103- 120

Terra, B., Wattel, P. (2005), European Tax Law, Kluwer Law International

Treaty on the European Union, O.J. C 83/13, of 30 March 2010

Treaty on the Functioning of the European Union, O.J. C 83/47, of 30 March 2010

Vogel, K. (1997) ,On Double Taxation Conventions, Kluwer Law International

Weber, D. (2010), European Direct Taxation: Case Law and Regulations, Kluwer Law International

Sanja Gongeta

University of Applied Sciences „Lavoslav Ružička“, Vukovar, Croatia

COMBATING LATE PAYMENTS IN COMMERCIAL TRANSACTIONS – THE CASE OF CROATIA

ABSTRACT

This article conducts a juridical and economic analysis of Croatian legislation on combating late payments in commercial transactions with regard to the European Commission's Directive 2011/7/EU on late payment in commercial transactions. The lack of financial discipline in payments in commercial transactions between businesses and persons of public law is a perennial problem of Croatian but also of the European economy. Late payments cause insolvency and complicate financial management of undertakings, which greatly reduces their competitiveness and profitability in the market, and the risk of these adverse effects was significantly higher in periods of economic decline.

The first step in combating late payments in commercial contracts in the Croatian legal system has been the introduction of legal provisions relating to the above problem in Article 174. in the Croatian Obligatory Relations Act in 2005, with the aim of harmonizing Croatian legislation with the legal system of the European Union - in particular with the European Commission's Directive 2000/35/EC on Combating Late Payments in Commercial Transactions of the European Parliament and the Council of the European Union.

*For the sake of further harmonization of legal system with *acquis communautaire* and subsequent to the European Commission's publication of a new Directive on combating late payments in commercial transactions 2011/7/EU, the Croatian legislator passed the Act on Financial Transactions and Pre-Bankruptcy Accommodations, which has been in effect since October 1, 2012. The act stipulates entrepreneurial financial business transactions, pecuniary obligation execution deadlines and legal consequences of a belated pecuniary obligation execution and a pre-bankruptcy accommodation procedure.*

Keywords: *commercial transactions, payments, national legislation, European Union*

JEL classification: *K000, K120*

1. INTRODUCTION

Obligatory relations are regularly directed toward their realization as quickly as possible, for a purpose thereof is an interchange of commodities and establishment of equilibrium, so an obligation discharge deadline is one of significant suppositions for a legitimate duty discharge (Gorenc, 2009:171). Growing liquidity problems caused by the fast growing number of firms not paying their invoices on time is a major problem of Croatian but also European economy. Most at risk from liquidity problems are Europe's small and medium-sized enterprises¹ which represent the most significant market share in the European Union² (Viscicka, 2010; EPI 2012). Although a lot is said, and despite EU Late Payment Directive, only few governments showed interest to help Europe's SMEs in their struggle with late payment by bringing some new national legislation for this problem³.

According to the research made by *Intrum justitia*⁴, in countries such as the Czech Republic, Greece, Italy, Spain, Portugal and Slovenia, 90% of respondents wanted greater support from national governments legislation in getting paid on time. Same research showed that when it comes to liquidity problems being suffered as a result of late payments, 96% of respondents in Greece reported difficulty, followed by 81% in Portugal, 80% in Spain, 75% in Cyprus, 72% in Slovenia and 70% in Italy. Least impacted with liquidity problems resulted by late payments were Switzerland with 38%, Finland 37%, Norway 41%, Germany 43% and Austria 44% (EPI 2012: 4). From March 2013, contractual payment periods⁵ in EU must be set at a maximum 30 / exceptionally 60 days. Some countries are ready for this, but others are far from European target⁶ (Economic Outlook, 2012).

If we divide Europe on south and north, we come to very interesting facts: it now takes an average 91 days for business-to-business transactions to be paid in the southern region compared to 33 days on average in northern Europe (EPI 2012: 2). While monitoring the occurrences on the EU market, several attempts to solve this problem were effectuated in the Republic of Croatia as well during the legal system's harmonization with *acquis communautaire*. The recent data of the Republic of Croatia's Ministry of Finances demonstrate a continuous downfall of insolvency in the

¹ SMEs

² according to the European Commission, SMEs provide two out of three jobs and serve as the driving force for growth, job creation and innovation

³ good practice example are France: LME – Loi de Modernisation de L'Economie (Modernisation of the Economy Act); United Kingdom: Late Payment of Commercial Debts (Interest) Act since 1998; Germany: Gesetz zur Bekämpfung von Zahlungsverzug im Geschäftsverkehr

⁴ *Intrum Justitia* carries out annual basis results of research in 28 countries. Results above are based on a survey which was carried out during January, February and March 2012.

⁵ contractual payment period – the time period (in days) during which payment should be made according to the provisions agreed between the client and the supplier

⁶ According to research published in presentation *Payment behaviour – wide disparities* by Euler Hermes, already in 2010 Germany and Poland were already on target for new EU directive. In Germany, payment periods dropped 21% between 2000 and 2010, reaching an average 24 days' in 2010. With 61 days' France and Belgium were halfway there. Spain, Italy and Portugal were far behind. In 2010 payment period reached the record of 79 days'. available on:

<http://www.eulerhermes.com/mediacenter/news/Lists/NewsDocuments/Presentation-Payment%20behavior-20120628-EN.pdf>

past months, so it might seem as if the latest legal stipulations harmonized with the Directive 2011/7/EU were finally achieving desired results. Later in the text, we will try to explicate possible reasons for such results.

The paper will try to pinpoint the significance of pecuniary obligations' timely and consequences of a lack of financial discipline; analyze legal regulation preventing belated payment deadlines in business transactions on the EU level, with a special emphasis on the Republic of Croatia as the youngest Member State; contractual and realistic payment deadlines in certain EU Member States and will try to respond to the question of how to ensure a payment discipline as one of fundamental conditions for an effective functioning in the European market. A general attitude is corroborated whereby a legislative intervention is more important than an improved credit or financial management in solving the late payment problem (Peel et al., 2000).

2. EUROPEAN LEGAL REGULATION ON COMBATING LATE PAYMENTS IN COMMERCIAL TRANSACTIONS

As mentioned before, a purpose of obligatory relations is an interchange of commodities and the establishment of financial equilibrium, so financial discipline is one of significant suppositions for a legitimate obligation discharge (Gorenc, 2009). Late payments cause insolvency and complicate financial management of undertakings, which greatly reduces their competitiveness and profitability in the market, and the risk of these adverse effects was significantly higher in periods of economic decline.

Research made by the European Commission showed that reasons for late payments in commercial transactions are as following: financial problems 23%, intentional late payment 35% and administrative inefficiency 17% (Vukmir, 2006). In year 2006, intentional late payment in Spain was 62 % of all payment which was 27% more than average payment period in EU. On the other hand in the same year intentional late payment in Sweden was only 26% of all payments which was 9% under average payment period in the EU (Vukmir, 2006: 3)

Member States try to find a solution to the problem causing the SMEs to effectuate payment delays for a couple of years. The adduced problem is tried to be solved while harmonizing legislation on the EU level, pertaining to irregular payments, disrespect of contractual deadlines, and compensation for a damaged inflicted thereby. Since the first attempt of solving the problem of late payment in the EU in 1995⁷, and after Directive on Combating Late Payments in Commercial Transactions 35/2000/EC came into force, payment delays in commercial transactions still remained a growing problem in European economy. In the United Kingdom, one in three payments from the public sector was late⁸, and the British Chambers of Commerce says almost one fifth of SMEs are employing a dedicated person to chase late payments.⁹

⁷ On May 1995 the Commission adopted a recommendation on payment periods in commercial transactions OJ L 127

⁸ according to a survey made in 2009 by the Federation for Small Businesses.

⁹ <http://www.euractiv.com/innovation-enterprise/governments-struggle-fulfil-prom-news-380108>

The most success in fighting late payments made France. All ready in 2009 delays in payments between companies were reduced by 10 days, and for SMEs, reduction was 11 days.¹⁰

2.1. Directive on Combating Late Payments in Commercial Transactions 2000/35/EU

The European parliament and the Council adopted Directive 2000/35/EC on combating late payment in commercial transactions on 29. June 2000. The aim of the Directive was not only to ensure that previously unreasonable legal of contractual payment becomes reasonable but also Directive sought to curtail late payments (Review of the effectiveness of European Community legislation in combating late payments, 2006)¹¹. The Directive eliminates the need for a reminder before a payment is considered late (Perales Viscasillas, 2007).

Setting the final date of the payment period on 30 days and demanding that member States should ensure that interest is payable as of the date following the payment date or period of the amount specified in the contract (Viscicka, 2010: 280) were first main protection measures for combating late payment in commercial transactions defined in the European Parliament and the Council Directive 2000/35/EC on combating late payment in commercial transactions.

The provisions of the Directive are limited to payments in commercial transactions¹² and does not apply to transactions with consumers, nor the interest rates. In the introduction it was stated that late payments¹³ as breach of contract, gives debtors a financial advantage which further supports the slow process of debt collection (Directive 2000/35/EC: 36).

The Directive left the payment deadlines to national legislatures and the very parties to a contract, stipulating only deadline overdue consequences subsequent to a deadline fixed by contractual parties or the one stipulated by the law, providing for a payment deadline in cases wherein it is unstipulated either by contractual parties or by the law. In addition to inter-commercial relations, the Directive pertained to business transactions between companies and public organs, i.e., public enterprises, as well. As SMEs are closely connected to public works and affairs with these organs, their belated payments represent an equal detrimental effect as well as a failure of payment by private debtors.

Table 1 depicts the development of public organs' payments in certain European states, expressed in days in the 2009 – 2012 period.

¹⁰ <http://www.euractiv.com/innovation-enterprise/governments-struggle-fulfil-prom-news-380108>.

¹¹ http://ec.europa.eu/enterprise/policies/single-market-goods/documents/late-payments/index_en.htm.

¹² „commercial transactions“ means transactions between undertakings or between undertakings and public authorities which lead to the delivery of goods or the provision of services for remuneration

¹³ „late payment“ means exceeding the contractual or statutory period of payment

Table 1: Payment Development in EU Countries P.U.

Payment Development	Greece	Portugal	Spain	Slovenia	Italy	UK	Switzerland	Finland	Norway	Germany	Austria
Average payment term	60	60	80	30	90	25	30	20	25	25	30
Average payment duration	174	139	160	45	180	43	42	24	34	36	44
Average delay/ 2012	114	79	80	15	90	18	12	4	9	11	14
Average delay/ 2011	108	82	66	/	90	18	14	4	8	10	19
Average delay/ 2010	65	84	65	/	86	19	15	4	5	11	14
Average delay/ 2009	70	72	51	/	52	20	16	4	8	15	11

Source: European Payment Index 2012

Table 2 depicts a development of business to business payments in certain European states, expressed in days in the 2009 – 2012 period.

Table 2: Payment Development in EU Countries B - 2 – B

Payment Development	Greece	Portugal	Spain	Slovenia	Italy	UK	Switzerland	Finland	Norway	Germany	Austria
Average payment term	40	50	70	30	65	25	30	20	25	25	25
Average payment duration	80	90	97	62	96	44	40	27	34	35	36
Average delay/ 2012	40	40	27	32	31	19	10	7	9	10	11
Average delay/ 2011	35	41	29	/	34	16	11	7	9	12	12
Average delay/ 2010	30	37	28	/	30	18	13	7	8	10	11
Average delay/ 2009	35	35	26	/	21	20	13	7	11	19	8

Source: European Payment Index 2012

2.2. Directive on Combating Late Payments in Commercial Transactions 2011/7/EU¹⁴

After adoption of Directive from year 2000, average payment period in EU has stabilized, but, as we could see from tables above, different payment periods in commercial transactions remained a major problem. On February 23, 2011, the European Parliament and Commission adopted a new Directive on Combating Late Payment in Commercial Transactions. Directive 2011/7/EC of the European Parliament and of the Council of 16 February 2011 on combating late payment in commercial transactions came into effect on 16 March 2013 year and all member states had to implement Directive into their legal system. As well as the aforementioned one, the Directive should prevent a misuse of liberty to conclude a contract on creditors' account, the objective being an assistance to the SME's on the EU's internal market.

A new Directive limits a general deadline in all transaction categories in both public and private sector to 30 days and only exclusively, if it is expressly adduced in a contract and justified by objective reasons, a payment deadline may be extended to 60 days. Implied hereby are merchandise deliveries and services to healthcare institutions and other situations justified by a specific business nature. Furthermore, the Directive introduces stricter measures among entrepreneurs being belated in payments and stipulates deadlines and payment overdue compensations irrespective of the fact whether they pertain to payments between private and public companies or between companies and institutions. Should a payment delay be effectuated, entrepreneurs will be obliged to pay a € 40 expenditure compensation minimum and a regular interest rate, increased in case of a payment overdue by at least 8%. The sanctions in latest Directive with an interest rate of the reference rate plus at least 8% and a fixed sum of 40 EUR for any reasonable recovery costs exceeding the fixed sum for both public and private entities is milder for the sanctions from Directive 2000 (Winther Bolet, 2011:1). The new Directive came into force in March 2013 and all member states had to implement it in their legal system.

3. LEGAL REGULATION IN CROATIA

As mentioned before, growing liquidity problems caused by the fast growing number of firms not paying their invoices on time is a major problem of many European countries and Croatian economy isn't exception. Legal provisions that were supposed to contribute to financial discipline excellently worked in theory, however, missed their performance in a regular business practice.

In addition to the economists, insolvency in the Republic of Croatia is also caused by the State, being one of the key non-payers. According to the Mega Drugstore Association,¹⁵ the Croatian Health Insurance Institute discharges its obligations within a 275-day deadline and hospitals within a 400- to 820-day one. Thereby, a discrepancy

¹⁴ OJ L 48

¹⁵ Cf. <http://www.novolist.hr/Vijesti/Hrvatska/Ni-30-ni-60-Zdravstvo-i-dalje-najveci-duznik-kasni-i-do-820-dana> (accessed on Mar. 17, 2013).

between the SMEs and public organ persons is repeatedly pronounced, and SMEs are literally obligated to accept the conditions of the “big ones” or stay without a business partner.

3.1. Article 174 in the Croatian Obligatory Relations Act in 2005¹⁶

With the aim of harmonizing Croatian legislation with the legal system of the European Union - in particular with the European Commission’s Directive 2000/35/EC on Combating Late Payments in Commercial Transactions of the European Parliament and the Council of the European Union, the first step in combating late payments in commercial contracts in the Croatian legal system has been the introduction of legal provisions relating to the above problem in Article 174. in the Croatian Obligatory Relations Act in 2005.

The most important elements of Art. 174 relate to the provisions on payment deadlines in commercial contracts, interest rate right in case of payment delay, and protection in case of an unequal payment deadline contracting detrimental to a creditor (Gongeta, Belaj, 2012).

A basic principle consisted in the fact that Art. 174 failed to stipulate payment deadlines but it was left to the contracting parties’ will. Thereby, contracting liberty between the parties was not limited, but if the parties failed to anticipate the deadlines by virtue of a contract applicable were the ones stipulated by Art. 174 (Vukmir, 2006:5).

That being said, each commercial contract contained a condition that a deliverer acquires his/her right to interest rates if a customer fails to pay for a commodity or service within a relative deadline, and the customer is obligated to pay the interest rates without specific call. In such cases, payment deadline without specific debtor’s call amounted to 30 days (Gorenc et al., 2005).

The aforementioned deadline began to expire according to the following: from the day whereupon a debtor received an invoice or an alternative corresponding payment request; if it was impossible to precisely establish the day of invoice reception or the reception of an alternative payment request, a payment deadline began to expire from the day whereupon a creditor fulfilled his/her obligation, and if a contract stipulated a special procedure for a delivery inspection, the deadline began to expire by the expiration of obligational subject’s inspection, with a hypothesis that a debtor has received an invoice prior to the deadline expiration.

3.2. Act on Time-limit of the Fulfilment of Financial Obligations¹⁷

As previous regulation didn’t show much success in practice, new Act came into force. Act on time-limit of the fulfilment of financial obligations in the Republic of Croatia

¹⁶ Official Gazette *Narodne Novine* 35/2005, 41/2008, 125/2011.

¹⁷ Official Gazette *Narodne Novine* 125-2501/2011 (invalid).

has been implemented since January 1, 2012. The new legislation on time-limit of the fulfilment of financial obligations as well as legal consequences provided for their delay should have back up financial discipline in payment of commercial transactions among entrepreneurs, i.e. entrepreneurs and legal entities.

According to the legislator, one of the reasons for the passage of the Act on Pecuniary Obligation Discharge Deadlines were unfavorable relations in economy caused by a payment crisis between entrepreneurs and entrepreneurs and public law persons, whose contractual obligations the newly proclaimed legal provisions are related to. This is also one of the differences with regard to the previous Art. 174 of the Obligatory Relations Act, which pertained to commercial contractual obligations between traders. The newly promulgated Act stipulated contracting a deadline for a pecuniary obligation discharge among entrepreneurs up to 60 days in Art. 2, para. 1, while a deadline to fulfill a pecuniary obligation might be contracted up to 30 days by virtue of a contract between entrepreneurs and public law persons, whereby a public law person is a pecuniary obligation debtor.

An exception to the aforementioned facts was an aberration concerning the stipulated contract rules within a legal deadline allowed if an entrepreneurial debtor was an institute performing obligatory health insurance and healthcare institutions established by the Republic of Croatia, a regional self-governmental unit, or a city, whereby a payment deadline was extended equally to the inter-entrepreneurial contract, i.e., 60 days (Gongeta, Belaj, 2012; Gorenc, 2011).

By virtue of this provision, entrepreneurs and public law persons were equalized. The aforementioned article stipulated that in case that a deadline to discharge a pecuniary obligation is not contracted by virtue of a contract between entrepreneurs or entrepreneurs and public law persons a debtor is obligated to discharge his/her pecuniary obligation up to 30 days, without a necessity to be reminded thereof by a creditor.

The provisions on the extension of legally stipulated deadlines that might cause an obvious inequality in the contractual parties' rights and obligations on part of a creditor shall be regarded as futile.¹⁸

3. 3. Act on Financial Transactions and Pre-Bankruptcy Accommodations¹⁹

Finally, for the sake of further harmonization of legal system with *acquis communautaire* and subsequent to the European Commission's publication of a new

¹⁸ According to the Croatian legal literature (cf. Gorenc, 2011), the objective of penalty interest rate is multiple: retention of debtor's financial discipline as a „punitive“ function, pressing him/her to discharge it timely, and a „protective“ function, protecting a creditor *ex lege* if a debtor fails to fulfill his/her obligation timely, influencing an inter-contractor confidence and promotion of business morale in transactions as well. It has been noted that in the countries wherein payment deadlines are short (Scandinavia and the UK) the interest rates concerning belated payments are high (18 – 24%) and therefore have a punitive function. On the other hand, in the south of Europe interest rates are not calculated and amount to only 8 to 12% when calculated. Thus, in these countries it is in debtors' interest to extend a payment deadline, not to take a credit, as to settle his/her debts.

¹⁹ *Officiele Gazette/ Narodne novine* 108/2012, 144/2012.

Directive on combating late payments in commercial transactions 2011/7/EU, the Croatian legislator passed the Act on Financial Transactions and Pre-Bankruptcy Accommodations, which has been in effect since October 1, 2012. The act stipulates entrepreneurial financial business transactions, pecuniary obligation execution deadlines and legal consequences of a belated pecuniary obligation execution and a pre-bankruptcy accommodation procedure.²⁰

While promulgating the Act, the legislator bore in mind that the Directive 2011/7/EU is the one invoking minimal harmonization, allowing for the EU Member States to retain the provisions in national legislature or to adopt the ones that could be more favorable to pecuniary obligations' creditors than the solutions anticipated by the Directive. Accordingly, amendments are suggested to achieve a higher degree of pecuniary obligation creditors' protection than those foreseen in the Directive.

Although the recent Act amendments reduced payment deadlines in the Croatian legal system to 30, i.e., 60 days, respectively, a quotidian business practice demonstrates that it is still reducible to a mere theory.²¹ Table 3 depict an increase and downfall in the number of blocked entrepreneurs in the Republic of Croatia from 2010 to 2013 and a respective insolvency amount expressed in HRKs - billions.

Table 3: Insolvency in Croatia

Year	Blocked businesses	Illiquidity
2010	69 000	35,8
2011	68 489	41,7
2012	73 853	44,5
2013	67 019	38,4

Source: FINA (Financial Agency)²²

As we can see, Legal frame was not very effective in practice so in august 2011 we had 68.336 insolvent businesses and in March 2013 67.019 insolvent businesses.

As the recent Act tried to establish discipline concerning entrepreneurs and public law persons while complying to payment deadlines and invigorating overdue or insolvent entrepreneurs, multiple dubiousness with regard to the very purpose and Act implementation have emerged in practice.

For that reason, the legislator launched the Bill on Amendments and Addenda to the Act on Financial Transactions and Pre-Bankruptcy Settlement in March 2013.

²⁰For the purpose of this paper, analyzed are only the payment deadline provisions without an analysis of conditions to launch a bankruptcy procedure.

²¹ Croatian Healths Insurance: 275 days; Hospitals: 400 – 820 days; Medica: 191 days; Altantic group: 121 days; Petrokemija: 78 days; Konzum: 189 days; Belje: 488 days; Ina: 150 days; An analysis of business transactions of the adduced companies was conducted by economic analyst of *Banka* magazine Suzana Koščak. (April, 2010): available on: <http://www.banka.hr/komentari-i-analize/dm-zar-je-to-moguće-41273>

²² available on: <http://www.fina.hr/Default.aspx?sec=1527>

As previously emphasized, the paper analyzes only the Act provisions pertaining to the obligation discharge deadlines, adducing solely the amendments pertinent thereto. The new Bill thus specifies the provisions limiting contractual payment deadlines in business transactions between entrepreneurs in more detail while limiting them to 60 days, with a condition that it does not contradict with a principle of conscientiousness and honesty. The deadline may amount to maximally 360 days, provided that a creditor has received a security instrument having a distraint document effect.

If the parties fail to contract a pecuniary obligation discharge deadline, a debtor is obligated to discharge a pecuniary obligation up to 30 days without a necessity to be reminded thereof by a creditor. Additionally, the Bill re-stipulates in more detail the existent Act provisions that in business transactions among entrepreneurs and public law persons a pecuniary obligation discharge deadline may be contracted up to maximally 60 day, with objective, justified hypotheses.

The pecuniary obligation discharge deadlines pursuant to the Bill also pertain to liberal arts, but they do not penetrate into the Act provisions stipulating an installment pay-off.

The Bill introduces a notion of "business transaction,"²³ stipulating that a creditor shall enjoy a right to all other pertinent expenditures due debtor's deferral, in addition to special compensation in a fixed amount whereto s/he has a right due to debtor's delay and legally prescribed consequences concerning obligatory relations.²⁴

4. CONCLUSION

According to the previous data cited by the Croatian Ministry of Finances in April 2013, insolvency in the Republic of Croatia amounted to HRK 37.6 billion. In September 2012, insolvency amounted to a recorded HRK 44 billion. The following are quoted as the reasons for a continuous insolvency downfall: a deletion of indebted but dysfunctional companies, initiation of pre-bankruptcy settlements of major companies, and an increase in financial discipline controlled by the Ministry of Finances, Taxation Authority, and Financial Agency. Insolvency should additionally decrease by virtue of a solution to all pre-bankruptcy settlements and especially upon Croatia's accession to the EU on July 1, 2013, when an obligation payment deadline will amount to 30 days for entrepreneurs and 60 days for the State, respectively.

Insolvency in the Republic of Croatia is caused, *inter alia*, due to a functional failure of penalty interest rates as an instrument to secure payment and contractual discipline, which has lost its sense, because the creditors failed to suit the pecuniary obligations' debtors. (Gorenc, 2011) As the public law persons are the main clients of commodities and services, there is a justified anxiety that SMEs will be unable to obtain a job from a non-payment generator, whereby contractual parties' inequality is repeatedly emphasized. Failing to contribute thereto is also a long-lasting court procedure concerning capital and penalty interest rate payments heretofore, whereby it was more

²³ A „business transaction“ denotes the one between entrepreneurs or between entrepreneurs and public law persons resulting in a monetarily compensated merchandise procurement or service rendition.

²⁴ E.g., enumerated hereby are an expenditure inflicted by a forced payment procedure and all actions s/he effectuated to vouchsafe the payment.

realistic to a creditor that s/he would experience bankruptcy than to end a lawsuit timely. (Gorenc, 2009) Due to the aforementioned facts, encouraging are recent movements forward in a legislative regulation of this problem both on the level of the Republic of Croatia and that of the EU.

Eventually, a question of what else can be done to solve this problem is being raised. With governments committing to forceful national legislation to speed payment with statutory interest rates and fees, there is much enterprises can do to avoid risk of non payment. They can start with looking for potential international opportunities; increase their international exposure; seek markets outside Europe and increase their investment in innovation (EPI 2011: 6,7). Also, they can start from closely profiling the identity of customers at the start to implementing swift reminders and remedial action when late payment occurs (EPI 2012:3).

REFERENCES

- Consultation Document On the Transposition into Irish Law, of Directive 2011/7/EU of 16 February 2011 on Combating Late Payment in Commercial Transactions (Recast), Department of Jobs, Enterprise and Innovation, (August), 2012.
- Euler Hermes Economic Research Department (2012), *Economic Outlook no. 1182: Payment periods in Europe: wide gaps*, (May)
- European Commission (1998), Proposal for a European Parliament and Council Directive Combating Late Payment in Commercial transactions (COM/1998/126), Brussels
- European Commission (2000), *Directive 2000/35/EC of European Parliament and the Council on Combating Late Payments in Commercial Transactions*, OJ L 200
- European Commission (2011), *Directive 2011/7/EC of European Parliament and the Council on Combating Late Payments in Commercial Transactions*, OJ L 48
- Gongeta, S, Belaj, I. (2012): *Rokovi ispunjenja novčanih obveza – novo zakonsko uređenje*, Zbornik radova VIII tradicionalnog naučnog skupa „Pravnički dani prof. dr. Slavko Carić“, Novi Sad,
- Gorenc, V. et al (2005), *Komentar Zakona o obveznim odnosima*, RRiF, Zagreb
- Gorenc, V. (2009), *Vrijeme ispunjenja obveze (može li se rastuća nelikvidnost ukloniti donošenjem “novih” propisa o roku plaćanja)*., Računovodstvo, revizija i financije (srpanj) 171-174
- Gorenc, V. (2011), *Rokovi ispunjenja novčanih obveza od 1. siječnja 2012.*, Računovodstvo, revizija i financije (prosinac) 140-145
- Intrum Justitia, (2011) *European Payment Index 2011*
- Intrum Justitia, (2012) *European Payment Index 2012*
- Košćak, S. (2012), *Dm, zar je to moguće?*, Banka, (studeni), available on: <http://www.banka.hr/komentari-i-analize/dm-zar-je-to-moguce-41273>
- Late payment regulations wont give SMEs power, says expert, available on: <http://www.out-law.com/>
- Payment behaviour – wide disparities, Euler Hermes (2012). available on: <http://www.eulerhermes.com/mediacenter/news/Lists/NewsDocuments/Presentation-Payment%20behavior-20120628-EN.pdf>
- Peel, M J; Wilson, N; Howorth, C. (2000) *Late Payment and Credit Management in the Small Firm Sector: Some Empirical Evidence*, International Small Business Journal 18(2) 17 - 37

Perales Viscasillas, P (2007), *Late Payment Directive 2000/35 and the CISG*, 19 Pace International Law Review, (Spring 2007/1) 125 – 142

Review of the effectiveness of European Community legislation in combating late payments (2006) available on: http://ec.europa.eu/enterprise/policies/single-market-goods/files/late_payments/doc/finalreport_en.pdf

Regulatory Impact Analysis – Ireland 2012. available on:
http://www.djei.ie/enterprise/smes/RIA_Credit_Guarantee_Scheme.pdf

Schroer, A.: Neue Regelungen zum Zahlungsverzug im geschäftsverkehr 2012, available on:
http://www.fom.de/fileadmin/fom/downloads/Forschungsprojekte/FOM_Forschung_Newsbox_020_12_0615.pdf

Šonje, V; Faulend, M; Šošić, V. (2001) *Nelikvidnost: razotkrivanje tajne*, HNB, Zagreb

Viscicka, S. (2010), *Combat late payment in commercial transactions: experience of European Union*, 6th International Scientific Conference – Business and Management, Vilnius, 278 – 285

Vukmir, B. (2006), *Novčane obveze kod trgovačkih ugovora (članak 174. ZOO-a)*, Pravo i Porezi, (travanj) 3 – 7

Winther Bolet, M. (2011), *A legal and economic analysis on the European Commission's Directive 2011/7/EU on late payment in commercial transactions*,

Zakon o finansijskom poslovanju i predstečajnoj nagodbi, Narodne Novine 108/2012, 144/2012/ (*Act on Financial Transactions and Pre-Bankruptcy Accommodations*)

Zakon o obveznim odnosima, Narodne Novine 35/05, 41/08/ (*Croatian Obligatory Relations Act*) ,

Zakon o rokovima ispunjenja novčanih obveza, Narodne Novine 125/11 / (*Act on time-limit of the fulfillment of financial obligatons*)

Barbara Mörec

University of Ljubljana, Faculty of Economics, Ljubljana, Slovenia

Lea Peterka

University of Ljubljana, Faculty of Economics, Ljubljana, Slovenia

THE MANDATORY MULTILATERAL SET-OFF OF PAYABLES AND RECEIVABLES IN SLOVENIA – A CASE STUDY

ABSTRACT

Voluntary multilateral set-off of payables and receivables is a frequent non-cash debt settlement tool used by companies worldwide. Regardless of that, corporate indebtedness and hence defaults increased in Slovenia during the current financial and economic crisis. In order to reduce overall companies' indebtedness Slovenia adopted Act on prevention of late payments (APLP) in March 2011, which introduced a mandatory multilateral set-off: once a month all Slovenian corporations are obliged to enter all due payments into multilateral set-off procedure in order to accelerate non-cash debt settlements and therefore reduce overall corporate indebtedness. The paper assesses the impact of the APLP's adoption in the case of large Slovenian wholesale trading company, well integrated in Slovenian economy. By using their full monthly payments data for the period between 2006 (long before current financial and economic crisis) and 2012 (deeply into the current financial and economic crisis) we calculated several liquidity indicators before and after APLP's adoption. Although mandatory multilateral set-off of payables and receivables turned out to be more effective for selected company compared to an average Slovenian company, by its application overall company's indebtedness hasn't decreased, as mandatory multilateral set-off merely replaced other non-cash debt settlement tools.

Keywords: *multilateral set-off, liquidity, Slovenia*

JEL classification: *G30, K22, L20*

1. INTRODUCTION

High scarcity of external financial resources during current financial crisis is a major problem for companies worldwide. Slovenia, according to the World Economic Forum (2013) an innovation-driven EU economy and a member of European monetary unit, has been hit even worse by the liquidity aspect of the current crisis due to high instability of its banking system. Compared to other countries worldwide Slovenian companies experience extremely limited access to loans. On the top of it other external sources of funding like venture capital and financing through local equity market are severely limited, too. According to the UMAR (2010) all this is reflected in the lack of

payment discipline and extended payment terms, which creates additional pressure on companies' liquidity. Consequently, corporate indebtedness and hence defaults caused merely by company's illiquidity increased in Slovenia during the current financial and economic crisis.

In order to reduce overall companies' indebtedness despite the severely limited liquidity the Slovenian National Assembly adopted Act on prevention of late payments (hereinafter APLP) in March 2011. APLP introduced a mandatory multilateral set-off: once a month all Slovenian corporations are obliged to enter all due payments into multilateral set-off procedure in order to accelerate non-cash debt settlements and therefore reduce overall corporate indebtedness. Soon after APLP's adoption public divided on the question whether the mandatory set-off of payables and receivables really enhanced companies' financial strength or – on the contrary – due to the introduction of APLP corporate liquidity even deteriorated.

The aim of this paper is therefore to explore whether the mandatory multilateral set-off truly improved corporations' liquidity. The impact of the APLP's adoption is assessed on the case of large Slovenian wholesale trading company, well integrated in Slovenian economy with over 4.000 buyers and over 2.000 suppliers per month. By using their full monthly payments data for the period between 2006 (long before current financial and economic crisis) and 2012 (deeply into the current financial and economic crisis) we calculated several liquidity indicators before and after APLP's adoption. Therefore the main contribution of this paper is a quantitative estimation of the mandatory multilateral set-off introduction on the companies' liquidity in a small economy in the case of well integrated company, which has access to other tools of claims settlement, too.

The reminder of this paper is organized as follows. Section 2 provides a statutory definition of set-off. Section 3 explains the requirements of the APLP and its advantages and disadvantages. Section 4 estimates the efficiency of mandatory multilateral set-off in the case of a well integrated large Slovenian retail company. Section 5 summarizes the overall findings and points out the problems that might occur by implementation of mandatory multilateral set-off in environment similar to Slovenian economy.

2. THE STATUTORY DEFINITION OF SET-OFF IN SLOVENIA

In Slovenia set-off of payables and receivables is regulated as a cessation of dues by Articles 311 thru 318 of Slovenian Code of Obligations (slv. *Obligacijski zakonik*). According to Article 311 of this Code, debtor can settle his/her obligations toward creditor with the outstanding claims that debtor has against creditor simultaneously. Both obligations and claims have to be of the same quality, type and both have to be overdue. If the amounts (value) of obligations and claims are not equal, they are set-off in the amount that is smaller of the two. The rest of obligation or claim does not cease to exist and has to be settled in a different manner (Kovač, 2011).

Djokić (2011) distinguishes between:

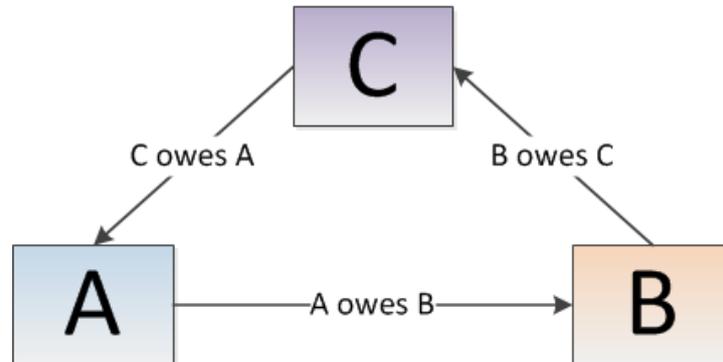
- unilateral or compulsory set-off;
- voluntary or contractual set-off;
- multilateral set-off of payables and receivables.

Unilateral or compulsory set-off of payables and receivables is regulated by Articles 311 thru 318 of Slovenian Code of Obligations. According to Article 312 the set-off does not take place automatically as soon as all conditions for set-off are met. The law requires one of the parties involved in the set-off has to present the other party with a set-off statement; whichever party does it being not important. Set-off statement is a statement of true will of the party to make a set-off of its obligations. Although form and content of the statement are not prescribed, true will is best expressed by specifying the obligations to be set-off, for example by stating the invoice number, its date of issue, and due date. There are exceptions to the set-off statement for companies in litigation, debt restructuring or bankruptcy. If there is a bankruptcy proceeding in place for the debtor, the creditor does not have to present a set-off statement as the claim of creditor towards the bankruptcy debtor and counterclaim of bankruptcy debtor towards the creditor at the start of the bankruptcy proceedings are considered to be automatically settled according to the Slovenian Compulsory Composition, Bankruptcy and Liquidation Act. The same applies for the companies undergoing debt restructuring (Juhart et al., 2003).

Voluntary or contractual set-off of payables and receivables is by Cigoj (in Djokić, 2011) defined as an agreement between two parties to consider their mutual obligations as settled. This set-off takes place at the moment defined by both parties and not as soon as all conditions of set-off are met. If the moment is not defined, set-off is considered to be complete at the date the agreement is valid.

Both unilateral and contractual set-off of payables and receivables are regulated by Slovenian Code of Obligations, whereas multilateral set-off does not meet all conditions required to be treated as set-off according to Articles 311 thru 318 of Code of Obligations (doesn't satisfy the condition of mutuality) and is therefore in Slovenia regulated by Act on prevention of late payments only. Namely as illustrated in Figure 1 multilateral set-off is defined as a set-off between three or more parties that are not directly in a mutual debtor-creditor relationship (Djokić, 2011). In Slovenia there are voluntary and mandatory multilateral set-off of payables and receivables (AJPES, 2012).

Figure 1: Multilateral set-off



According to the Ruling III Ips 59/2000 of the Supreme Court of Republic of Slovenia multilateral set-off is considered as an agreement of cessation of debt between all included parties. It does not exist if there are not at least three companies involved. The chain or circle of set-off goes on in such a way, that Company A owes Company B, Company B owes Company C and Company C owes Company A (see Figure 1). Every company in a set-off chain is in a debtor-creditor relationship with preceding and succeeding company in a chain, but the relationship is not mutual, as the company has no claims to the company it has dues to. All participants of the chain agree on the amount of debt being settled or ceased. Such a settlement is considered as a cessation of debt as every company can cease a debt of its debtor.

3. ACT ON PREVENTION OF LATE PAYMENTS IN SLOVENIA

3.1 The introduction and implementation of the multilateral set-off in Slovenia

Current financial and economic crisis severely deteriorated companies' liquidity, which resulted in poorer payment discipline and extended payment terms. Since this further aggravated corporate indebtedness and hence increased the number of companies' defaults the European Parliament adopted the "Directive 2011/7/EU of the European Parliament and of the Council of 16 February 2011 on combating late payments in commercial transactions". The directive highlighted the problem of late payments¹ in commercial transactions between companies: many companies are late with the payments and not settling their dues on time, impacting negatively liquidity, profitability and competitiveness of companies and the economy as a whole (Official Journal of the European Union, L 48).

In March 2011 the Directive was introduced in the Slovenian law by the Act on prevention of late payments (from now on APLP). Multilateral set-off of payables and receivables is defined in Articles 12 thru 18 of APLP as a method of cessation of direct

¹ The Directive defines late payment as a payment not made within the contractual or statutory period of payment (Article 2, L 48)

and indirect mutual monetary obligations. With the introduction of mandatory multilateral set-off APLP establishes a measure of reducing the payment lateness. According to the Article 1 APLP is applied as soon as creditor delivers goods or performs a service for a customer, who is a legal entity, and as a result the customer has to settle a monetary obligation towards the creditor.

APLP stipulates that the debtor has to submit his/hers overdue monetary obligation to the first round of mandatory multilateral set-off following the due date. Mandatory multilateral set-off takes place once a month according to schedule set at the beginning of the calendar year and is conducted by AJPES – the manager of the mandatory multilateral set-off system. Debtor submits his/hers past due obligations to the ePobot web application. Result of the set-off is made available by AJPES the next business day. Sign-up and submissions to the ePobot web applications are free of charge whereas the amounts set-off are subject to 0.1 % commission. The remaining amount of obligations submitted or the submissions that are not set-off can be resubmitted if they are not settled otherwise.

Monetary obligations that are part of an ongoing litigation or default and obligations secured by other legal instruments except for the ones based on bill of exchange are exempt from mandatory multilateral set-off. If mutually agreed by both parties, non-past due monetary obligations can also be submitted to the ePobot web application since AJPES also conducts a voluntary multilateral set-off, where a company can submit its obligations that are not overdue. These submissions are included in the mandatory multilateral set-off system, as this increases the set-off success rate (AJPES, 2013).

3.2 Reasons for implementation of the mandatory multilateral set-off in Slovenia

Although high scarcity of external financial resources and the resulting lack of liquidity is a major problem for companies worldwide during the current financial and economic crisis, Slovenia has been hit even worse due to high instability of its banking system and subsequently extremely limited access to loans.

According to the Glogovšek (1996) company's liquidity can be assessed in a variety of ways. It could be done on the basis of company's balance sheet date, company's business policy, on the basis of risk analysis, length of market presence etc. However, it is generally understood that a company is liquid if it has enough cash to settle its debts on the due date or that it is able to procure credit to settle the debts (Graham & Coyle, 2000). Companies that are not able to get a bank loan or some other funding source on financial market can improve their liquidity by using trade credit (Glogovšek, 1996). Trade credit is a short-term credit that creditor gives to the debtor by allowing a delay of the payment for goods or services.

When presenting of the APLP the Government of the Republic of Slovenia pointed out liquidity problems of Slovenian companies are the a main reason for adopting the mandatory multilateral set-off of payables and receivables (see Proposal of APLP, EVA: 2011/1611/0043). In the proposal Government deems the proposed measure as necessary since company's liquidity problems may negatively impact its business

partners. As such, the mandatory multilateral set-off was seen as crucial measure in reducing the lateness of payments in entire economy.

3.3. Advantages and disadvantages of Slovenian mandatory multilateral set-off system

The adoption of mandatory multilateral set-off as a measure of combating payment lateness has spurred opposing views on its effectiveness. Additionally, many misgivings and ambiguities exist regarding the process of set-off itself.

On one hand AJPES – the manager of the mandatory multilateral set-off system – highlights the following advantages of the mandatory set-off of payables and receivables (AJPES, 2011):

- decreases indebtedness of companies,
- enhances structure of companies' liabilities,
- enhances the quality of companies' assets.

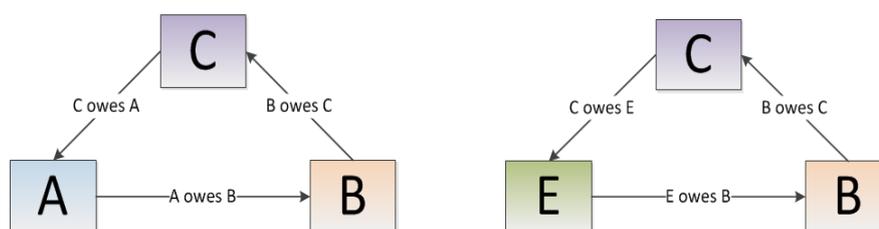
Mandatory set-off is designed primarily for companies with weaker payment capabilities (poorer liquidity) in order to reduce their indebtedness. The claim settled in the process of set-off is usually deemed hard (or even impossible) to be fully repaid and would be written off otherwise. As the debt is reduced, company's debt-equity ratio (indebtedness indicator) improves. At the same time the quality of assets is improved also, as the claim, which would otherwise be unsettled or would even have to be written off partly or fully, is settled. Improved liabilities' structure and assets' quality consequently improves company's credit rating, making it easier to obtain bank loans.

According to Črčinovič Krofič (1995) set-off of payables and receivables speeds up the payment process also as such cashless payments are more efficient than conventional payment process. It can even save an illiquid company from bankruptcy as it allows creditors to settle their claims regardless of the fact that debtor has a blocked bank account since it doesn't require the use of monetary means (Črčinovič Krofič & Bukovnik, 2009).

However the introduction of the mandatory multilateral set-off raised some criticism, mostly related to lack of regulation and ambiguous diction of the APLP. Thus APLP does not prescribe the precise method by which the debts and claims are settled in situations where participants in the set-off compete in the process of settlement. The competition arises where e.g. Company A owes Company B, Company B owes Company C and Company C owes the Company A. In this chain the claims are connected and can be set-off. If there is a Company E that owes Company B and Company C owes Company E (see Figure 2), the new chain of claims emerges that competes with the previous one (Dežman, 2011). AJPES claims that the system is designed to optimize the results: in case of two or more competing set-off chains only the chain with higher amount of set-off is actually settled. If the amount of competing set-offs are identical, system chooses the chain to be settled randomly. Since the amount of set-off settled is not divided among several competing set-off chains some participants are therefore worse off as they are members of chain not selected for set-off.

Furthermore, the obligations in litigation are exempt from the mandatory multilateral set-off according to Article 16 of APLP. The problem arises when the debt is disputed by the debtor and consequently he/she doesn't submit this obligation to the mandatory multilateral set-off, however the creditor has not yet started the litigation. According to the Article 25 of APLP the debtor is in violation of the APLP and is subject to fines in the range of 100-10.000 € for the company and 505.000 € for the person responsible in the company.

Figure 2: Competing set-off chains in multilateral set-off



On the other hand non-debt can be set-off: this will be the case when debtor submits an obligation that is later found in litigation to be void. Namely, set-off cannot be revoked. A company with void debt has contributed to a successful set-off that would not be completed otherwise, but is now worse off since its claims have been settled also, and the creditor that had a claim toward such a company profited from such non-debt, as its debts toward other companies have been settled too (Dežman, 2011). In addition, creditor has a right to assign its claim to another company without consent of the debtor, when this does not worsen debtor's position. The problem lies in a fiduciary or quiet cessation where the debtor is not notified about the change of the creditor and conversely submits erroneous information about its obligation (Šlamberger, 2011).

Doing business with foreign partners further complicates APLP application. To be exact, business partners have to agree on the applicable law, otherwise the applicable law is determined upon the domicile of the supplier of the goods or services (Grah Whatmough, 2011). If the supplier is a Slovenian company and the customer (debtor) is a foreign company with overdue obligations, the foreign company is required to submit such obligations to the mandatory multilateral set-off according to Article 16 of APLP. In most cases this would not be the case, as the foreign companies are generally unaware of those requirements. Moreover, in order to submit overdue obligations foreign companies would have to apply for Slovenian VAT ID (as this is required by Article 17 of APLP to complete the submission) which further complicates the issue. Companies with foreign suppliers (creditors) are worse off when their claims to Slovenian business partners get settled in the mandatory multilateral set-off while their foreign suppliers, which usually don't participate in the set-off, still demand cash payments for the goods or services rendered. In such a case a mandatory multilateral set-off would be deemed inappropriate as it does not bring much needed cash to the companies. Not surprisingly, companies with mostly foreign business partners are expressing doubt in the mandatory multilateral set-off as an effective tool for reducing payment lateness and are stressing the set-off is unjust for them (Chamber of Commerce and Industry of Slovenia, 2011).

Chamber of Commerce and Industry of Slovenia further maintains that the mandatory multilateral set-off of payables and receivables doesn't improve liquidity of a company that has more obligations than claims (Šubic, 2011), since the lateness of payment is not intentional but merely a result of the fact, that in the past years bank loans were inexpensive and easily accessible source to working capital financing, which led to current deficit of liquidity. Such deficit cannot be easily remedied by statutory regulation of payment deadline and/or mandatory set-off since liquid companies that were using monetary means to pay for goods and services rendered are entering the mandatory multilateral set-off too, further reducing money in circulation. Chamber of Commerce and Industry of Slovenia therefore argues mandatory multilateral set-off of payables and receivables could be successful in retail chain only.

AJPES responds to those criticism that mandatory multilateral set-off did not reduce the liquidity of the Slovenian economy, substantiating this statement with the data showing that the total cash flow has not diminished since the start of mandatory multilateral set-offs in April 2011 (Fidermuc, 2011). AJPES further states companies still have the choice of settling their debts on or before due date and consequently not submitting it to the mandatory multilateral set-off. According to AJPES data, submissions to the mandatory multilateral set-off are made by companies with lower credit rankings, thus leading to a conclusion that the mandatory multilateral set-off is being used by the companies having liquidity problems that were already late with their payments even before the enforcement of APLP (AJPES, 2013).

4. PERFORMANCE OF MANDATORY MULTILATERAL SET-OFF: THE CASE OF A SLOVENIAN RETAIL COMPANY

4.1. The aim and methodology of the analysis

The aim of the analysis is to find out if the enforcement of the mandatory multilateral set-off of payables and receivables by APLP implementation improved (as AJPES claims) or even worsened (as on the other hand argues Chamber of Commerce and Industry of Slovenia) the payment discipline in Slovenia and to pinpoint the advantages and disadvantages of the mandatory multilateral set-off the companies face since its coming in effect on March, 2011.

The APLP effectiveness is determined in the case of well-integrated Slovenian retail company, as Chamber of Commerce and Industry of Slovenia claims mandatory multilateral set-off of payables and receivables could be successful in retail chain only.

Using the data for years 2006 and 2010, when the mandatory multilateral set-off was not in force, and years 2011 and 2012, with the mandatory multilateral set-off in force, we first examined the company's obligations settlement pattern in order to find out, if the amount of claims settled increased or not, since many critics argued with the APLP's implementation even companies, which paid on time, started being late with the payments. Further on the ratio of settled versus all submitted obligations was examined for individual rounds of set-offs to check the efficiency of mandatory multilateral set-off of payables and receivables. In order to find out whether mandatory

multilateral set-off improved the total amount settled or merely replaced other payment types, time series of the ratios of various set-off types against all set-offs was analyzed. Finally, we examined days payable outstanding, days sales outstanding and liquidity ratios in order to establish whether the liquidity of the company increased or decreased with the enforcement of the mandatory mutual set-off.

4.2. Company description

For the purpose of this study we examined claims and obligations' settlement pattern of a large Slovenian retail company with 120 employees, well integrated within Slovenian economy, since The Chamber of Commerce and Industry of Slovenia claims mandatory multilateral set-off of payables and receivables could be successful in retail chain only. Company has over 4.000 commercial buyers and over 2.000 commercial suppliers per month of different sizes and from various industries. Main business partners come from construction, retail and IT and communications industry. The company uses various payment types (see Figure 3), for more than a decade even voluntary set-off as it was forced to do so due to increasing number of overdue claims.

Studied company uses both cash and noncash payments. For already a decade on a monthly basis company uses voluntary multilateral set-off services of company *E Kompenzacije Ltd.* – private company, whose main activity is the organization of voluntary multilateral set-off. Currently, studied company makes voluntary and mandatory multilateral set-off with AJPES, too. AJPES was conducting the voluntary multilateral set-off well before the advent of mandatory multilateral set-off and nowadays performs both services concurrently. Furthermore, on a monthly basis company's employees prepare proposals for multilateral set-offs by inquiring company's customers (debtors) and suppliers (creditors) to submit their lists of claims and obligations. Once the employees complete the chain an official proposal for set-off is prepared and sent to all participants for confirmation. After confirmation the set-off is complete and obligations settled.

4.3. Results of the analysis

Figure 4 shows the dynamic of set-off payments compared to other payment types. Amounts that have been set-off are quite high in years 2007 and 2008, then dropped in 2009 and held more or less constant until 2012. There is no noticeable increase of amount being set-off due to enforcement of mandatory multilateral set-off in March 2011.

Figure 3: Settlement procedures in studied company

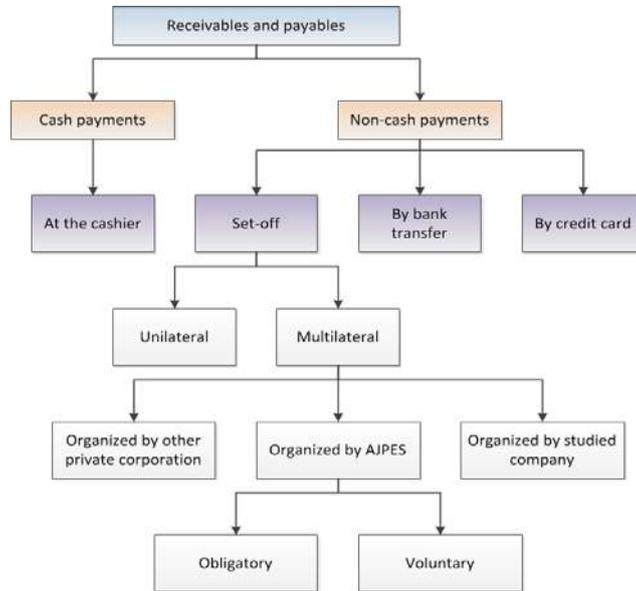
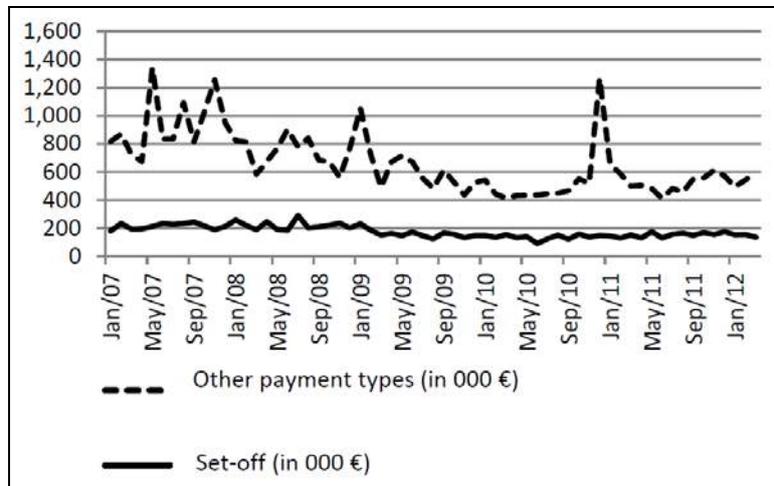


Figure 4: Payment dynamic in studied company

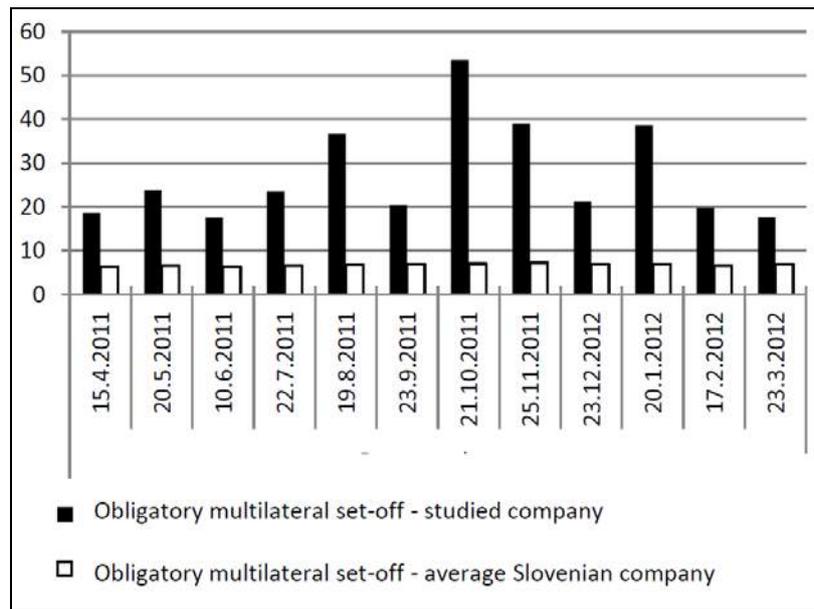


Source: company's data.

The single most successful mandatory multilateral set-off for the selected company was held on October 21st 2011 with more than half of all obligations submitted being settled. The least successful mandatory multilateral set-off was held on June 10th 2011 with approximately 17% of all obligations submitted being settled. The success rate of the mandatory multilateral set-off for the selected company is quite fluctuating whereas

the success rate for the entire round for average Slovenian company, who submitted its obligations to AJPES web application, being pretty much constant (see Figure 5). Fluctuations can be directly attributed to fluctuation of the sales – in April 2011 the sales decreased, which led to decrease of June’s 2011 set-off success rate, while large increase of sales in September 2011 contributed to the success of mandatory multilateral set-off round of October 2011.

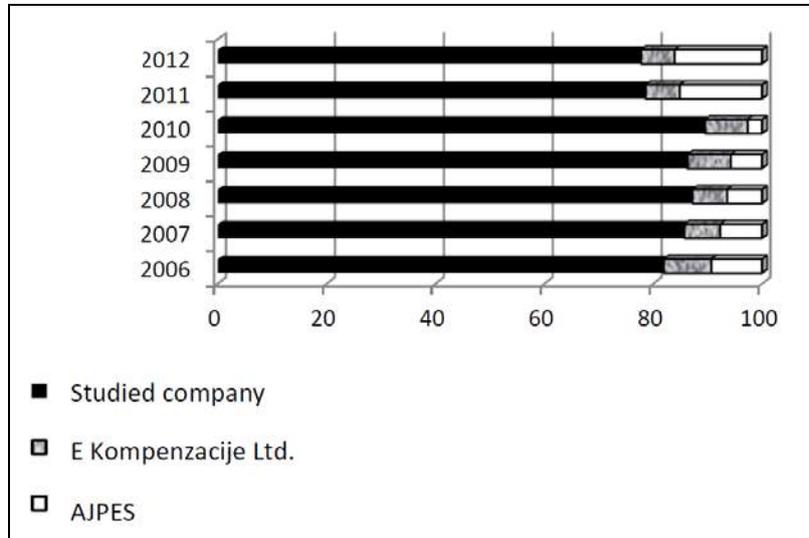
Figure 5: Mandatory offset obligations (as a % of all submitted obligations)



Source: company’s data.

The percentage of unilateral and multilateral set-offs prepared by the studied company has steadily increased from 2006 till 2010 and decreased since year 2011, as shown in Figure 6. Percentage of voluntary multilateral set-offs conducted by company E Kompenzacije Ltd. has been on the rise from 2006 till 2010, while the voluntary multilateral set-offs conducted by AJPES were on the decline in the same time period. Since the enforcement of the mandatory multilateral set-off in 2011 the percentage of obligations settled thru company E Kompenzacije Ltd. declined while the percentage of obligations settled thru AJPES voluntary and mandatory multilateral set-offs is on the rise with the latter having replaced other methods of set-offs in the studied company.

Figure 6: Set-off structure by organizer by year (as a % of all offset obligations)



Source: company's data.

Number of days sales outstanding and days payable outstanding is shown in Figure 7. Although the number of days payable outstanding (days before company's obligations are settled) highest for the first ever mandatory multilateral set-off round on April 15th 2011 and has further on steadily declined, the number of days sales outstanding (number of days before company's claims are settled) is fairly constant and not influenced by mandatory multilateral set-offs.

Finally, the introduction of mandatory multilateral set-off truly didn't improve company's liquidity is confirmed by liquidity indicators, too. Most widely used indicators of company liquidity are:

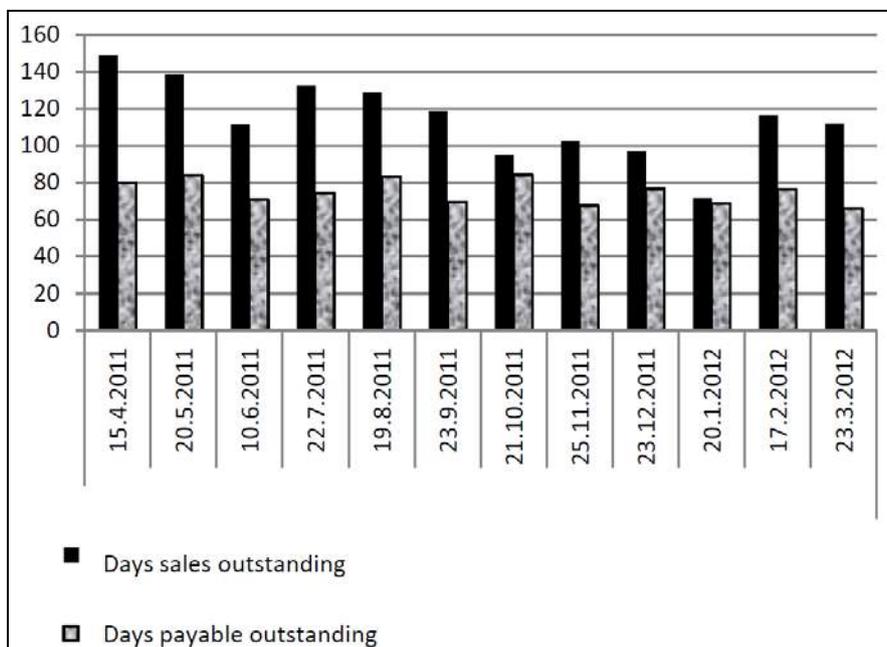
- Short-term coefficient, defined as:

$$\text{Short-term coefficient} = \frac{\text{Short-term assets}}{\text{Short-term liabilities}} \quad (1)$$

- Accelerated coefficient, defined as:

$$\text{Accelerated coefficient} = \frac{\text{Short-term assets} - \text{stock}}{\text{Short-term liabilities}} \quad (2)$$

Figure 7: Days sales outstanding and days payable outstanding on each set-off round



Source: company's data.

With the possibility of an inventory sales delay or difficulties by recovering claims, short-term coefficient is not a very good liquidity indicator. Furthermore, if the company manages to sell off the entire inventory, there is a high probability that they are giving huge discounts: they are selling inventories below their value in the company's balance sheet (Singhvi & Bodhanwala, 2006).

The short-term coefficient's weaknesses are rectified in the accelerated coefficient as the inventories are taken out of the equation.

Table 1: Liquidity of the selected company for the period of 2009 till 2011

Year	2009	2010	2011
Short-term coefficient	2,49	2,26	2,04
Accelerated coefficient	2,06	1,88	1,67

Source: company's data.

Table 1 shows studied company's liquidity decreased in the period from 2009 till 2011, but not to the extent of making the company illiquid.

5. CONCLUSION

The paper analyses the impact of mandatory multilateral set-off, implemented by Act on prevention of late payments in March 2011 by the National Assembly of Republic of Slovenia due to the increasing lateness of payments. The aim of the Act has been to decrease mutual indebtedness of businesses and to increase their liquidity.

The impact of the APLP's adoption was assessed on the case of large Slovenian wholesale trading company, well integrated in Slovenian economy with over 4.000 buyers and over 2.000 suppliers per month. Our analysis has shown that the amount of obligations settled by multilateral set-offs in the selected company has neither increased nor decreased. Therefore, complains of the opponents of the mandatory multilateral set-off that companies that used to pay on time will start being late does not hold for the studied company. On the other hand, mandatory multilateral set off didn't facilitate company's claims settlement either, despite the fact company's success rate of mandatory multilateral set-off is well above average compared to the average Slovenian company. Even more, although studied company set-offs most of its obligations in unilateral and multilateral set-offs that are proposed by the company itself, with the enforcement of the mandatory multilateral set-offs, share of settlements – either voluntary or obligatory – organized by AJPES increased significantly at the expense of other forms of settlement. Finally, while the lateness of the settlements of the studied company's obligations towards its suppliers gradually declined, there is no impact on the lateness of the settlements of the studied company's claims towards its customers (creditors). In is no surprise, mandatory multilateral set-off of payables and receivables didn't improve liquidity indicators, too.

Although mandatory multilateral set-off of payables and receivables could be an effective tool for reducing company's indebtedness, improving company's liabilities' structure and assets' quality, its effectiveness heavily depends on company's strong business interconnection and comprehensive encompass of all current liabilities in one system. As we have shown on the case of well integrated large Slovenian retail company, Slovenian economy is too small and too export oriented in order that mandatory multilateral set-off would be effective. In such an environment, mandatory multilateral set-off merely replaces other forms of payment.

REFERENCES

- Act on prevention of late payments (= Zakon o preprečevanju zamud pri plačilih). *Uradni list RS* no. 18/2011.
- AJPES (2013). *Splošni opis modela S.BON AJPES in slovenskih bonitetnih ocen (SB)*. Available on <http://www.ajpes.si/dokument.asp?id=994&print=yes> .
- AJPES (2012). *Večstranski pobot*. Available on
- AJPES. (2011). *Izvajanje obveznega večstranskega pobota po Zakonu o preprečevanju zamud pri plačilih*. Available on http://www.ajpes.si/doc/Bonitete/Pobot/Informacija_pobot_apr-jun2011.pdf .
- Chamber of Commerce and Industry of Slovenia. (2011). *Zapis omizja Interventna plačilna in insolvenčna zakonodaja – zagon ali nova zavora?*. Available on http://www.gzs.si/slo/skupne_naloge/53733 .

- Code of obligations (= Obligacijski zakonik). *Uradni list RS* no. 97/2007-UPB1, 30/2010 Odl. US: U-I-207/08-10, Up-2168/08-12.
- Compulsory Composition, Bankruptcy and Liquidation Act (= Zakon o prisilni poravnavi, stečaju in likvidaciji). *Uradni list RS* no. 67/1993, no. 74/1994 Odl. US: U-I-17/94, 8/1996 Odl. US: U-I-114/95, 25/1997-ZJSRS, 39/1997, 1/1999-ZNIDC, 52/1999, 101/2001 Odl. US: Up-148/01, 42/2002-ZDR, 58/2003-ZZK-1, 10/2006 Odl. US: U-I-253/04-11, 126/2007-ZFPPIPP no. 10/2006; Odl. US: U-I-253/04-11, 126/2007-ZFPPIPP.
- Črčinovič Krofič, V. (1995). Kompenzacija – čas izpolnitve obveznosti. *Pravna praksa*, (338), 11.
- Črčinovič Krofič, V., & Leva Bukovnik, M. (2009). *Osnove poslovnih financ*. Ljubljana: Zavod IRC.
- Dežman, A. (2011). Obvezni večstranski pobot po ZPreZP in njegove praktične posledice. *Pravna praksa*, (23), 6–7.
- Dežman, A. (2011). Obvezni večstranski pobot po ZPreZP in njegove praktične posledice. *Pravna praksa*, (23), 6–7.
- Directive 2011/7/EU of the European Parliament and of the Council of the 16 February 2011 on combating late payments in commercial transactions. *Official Journal of the European Union* L 48.
- Djokić, D. (2011). Verižno pobotanje. *Podjetje in delo*, 37(6/7), 1124–1134.
- Fidermuc, K. (2011, 26. julij). Ajpes v analizi učinkov obveznega pobota: Ni škodljiv za likvidnost podjetij. *Delo*. Najdeno 4. marca 2012 na spletnem naslovu <http://www.delo.si/gospodarstvo/makromonitor/ajpes-v-analizi-ucinkov-obveznega-pobota-ni-skodljiv-za-likvidnost-podjetij.html>
- Glogovšek, J. (1996). *Denar, denarni sistem z osnovami denarne teorije*. Maribor: Ekonomsko-poslovna fakulteta Maribor.
- Grah Whatmough, A. (2011). Predlagane spremembe ZPreZP dobrodošle, a največja napaka ostaja. *Pravna praksa* (35), 15–17.
- Graham, A., & Coyle, B. (2000). Cash Flow Forecasting Liquidity. http://www.ajpes.si/Bonitetne_storitve/Vecstranski_pobot/Vrste .
- http://www.umar.gov.si/en/public_information/press_releases/release/zapisi/okrogla_miza_ob_izidu_ekonomskih_izzivov_povzetki_in_prezentacije/
- Juhart, M., Plavšak, N., & Jadek-Pensa, D. (2003). *Obligacijski zakonik (OZ): s komentarjem*. Ljubljana: GV založba.
- Kovač, M. (2011). *Plačilni sistem in plačilna disciplina* (1. izdaja). Maribor: De VESTA.
- Proposal of the Act on prevention of late payments. EVA: 2011-1611-0043.
- Ruling III Ips 59/2000*. Najdeno 05. avgusta 2012 na spletnem naslovu http://www.sodisce.si/znanje/sodna_praksa/vrhovno_sodisce_rs/31311/.
- Singhvi, N. M., & Bodhanwala, R. J. (2006). *Management Accounting Text and Cases*. New Delhi: PHI Learning Pvt. Ltd.
- Šlamberger, M. (2011). Kritična predstavitev zakona o preprečevanju zamud pri plačilih. *Revizor* (4/11), 61–62
- Šubic, P. (2011, 7. september). Obvezni večstranski pobot podjetnikom bolj škodi kot koristi. *Finance*, str. 27.
- UMAR (2010): Economic Issues: The economic crisis interrupted Slovenia's efforts in achieving the strategic objectives and revealed structural maladjustment of its economy. Available on
- World Economic Forum. (2013): Global Competitiveness Report 2012-2013. Geneva, Switzerland.

Renata Perić

"Josip Juraj Strossmayer" University of Osijek, Faculty of Law, Osijek, Croatia

Emina Jerković

"Josip Juraj Strossmayer" University of Osijek, Faculty of Law, Osijek, Croatia

PERSONAL INCOME TAX SYSTEM: PROVISIONS REGARDING FAIRNESS AND EQUALITY

ABSTRACT

Any tax that achieves the desired and anticipated economic impact may be considered fair. Croatian positive tax system is justified by the Constitution which states that everyone must participate in the settlement of public expenses in accordance with their capabilities. Accordingly, the tax system is based on the principles of fairness and equality, therefore taxation should be the least property limitation. The notion of fairness is difficult to define due to its abstract nature. Therefore it is impossible to determine the general definition of the term that has been elusive. Regarding tax law, fairness is that the tax burdens are located fairly with regard to tax capacity. The most important problem of the perception of fairness is that individuals, in most cases, do not get any direct countervalue in return to their tax payments. Tax practitioners, however, whether they are lawyers or economists, do not attach any special meaning to the concept of fairness.

Tax on personal income is the instrument of tax policy that with its inevitable fiscal objective has a much more important objective of a social nature-alleviate regressivity of VAT. Most financial scholars, lawyers or economists, agree that the principle of fairness is tried to be put into practice just by applying progressive tax rates on income. This paper analyses personal income tax system in the Republic of Croatia, by focusing on principle of fairness regarding tax base, tax credits and tax rates, and also comparing that to the EU approach.

Keywords: *fairness, personal income tax, EU, Republic of Croatia, tax system*

JEL classification: *H24*

1. INTRODUCTION

Croatian positive tax system is justified by Article 51 of the Constitution which states that everyone must participate in the settlement of public expenses in accordance with their capabilities and that the tax system is based on the principles of fairness and equality. The notion of fairness is difficult to define due to its abstract nature. History has shown us that the concept of fairness extremely changes with passing of time and

that each historical period has its own vision of fairness. Therefore it is impossible to determine the general definition of the term that has been elusive. So to the question whether a tax is fair or unfair we have no correct answer that would be based on some generally accepted principles. Tax practitioners, however, whether they are lawyers or economists, do not attach any special meaning to the concept of fairness.

In fact, any tax that achieves the desired and anticipated economic impact they consider fair. (Lončarić-Horvat, 2010:182) However, most financial scholars, whether they are lawyers or economists, agree that the principle of fairness is tried to be put into practise just by applying progressive tax rates on income.

One of the most important and most present division of taxes is the one that separates direct and indirect taxes. When it comes to direct taxes redistribution role is possible because the concept of progressivity is not applicable when it comes to indirect taxes. One of the most important direct taxes is personal income tax which is in most developed countries one of the most fiscally abundant tax and the tax by which progressive taxation is introduced in tax systems. Tax on personal income is the instrument of tax policy that with its inevitable fiscal objective has a much more important objective of a social nature-alleviate regressivity of VAT.

2. CONCEPT OF FAIRNESS

Financial theory has concept of fairness interpreted in accordance with two principles: principle of usefulness and principle of tax power. These principles are used by economists in their attempt of justification and realisation of rational tax system. Proportional lay out of tax burden (in accordance with individual tax power) derives from complete tax system. Certainly, the most important role goes to taxation of employment income, which also encloses other types of income, as well as an answer which part of income is to be spent and which part is to be spared.

Contemporary thesis on tax fairness show that the public interest for these types of questions is declining. The classical term of tax fairness is shifted from the sphere of allocation of tax burden to the care of how will tax revenue be spend. The decrease of interest for the principle of fairness is understandable, because citizens perceive tax system as unclear, tax payments are abstract, and awareness of public consumption (how the revenue will be spend) becomes more important area of public interest.

Question of fairness is not related to any specific structural principle that would apply only to taxes. First and primary goal of taxation, that is achieved by actually paying taxes, is to secure the state financial means for coverage of public expenditure. However, it has often been accented, that this fiscal goal should cede its place to another, equally important goal- just allocation of tax burden. (Lončarić-Horvat, 2010:187)

Fairness does not mean that income is taken away from the rich and given to the poor; it rather means that it should not create inequalities and additional problems in society. Accordingly, justice and fairness mean at least that the government determines the tax

levels with self-restraint and limiting itself to the necessary minimum and distributes them equally to the sections of society, while putting them into an ethical, transparent, and efficient use with the help of the principles public finance. (Wagner, 2007:200) This would be the full-value definition of fairness-accuracy.

Most financial scholars, lawyers or economists, agree that the principle of fairness is tried to be put into practice just by applying progressive tax rates on income. Recently, however there have been rapid swerve when it comes to progressive taxation of personal income. A great number of countries, primarily countries of Eastern Europe and Central Asia, have implemented flat rate income tax into their tax systems.

Within the flat tax system, all the groups and taxpayers of the society take part the same rate in contributing to public funds irrespectively of their amount of income. Obviously their nominal contribution differs, and the rich pay more, but the same proportion, which might sound fairer than taking more proportion of their income. This could lead to a more balanced and proportionate tax payment system: the taxpayers of higher amount of income pay more anyway, taking part in contributing to public funds according to their ability to pay.

The flat tax provides a stronger motive for the taxpayers to realize higher amount of income, since they can achieve a higher amount after tax in case they work more and make higher revenue. Thus despite their tax due is higher, still a higher amount can be used as per their sole decision.

In the progressive structure it is not worth for the taxpayer to invest more energy in obtaining a higher amount of income, since the amount taken as tax is proportionally higher as well. In other words, it establishes a psychological limit to the activities out of which income is derived. For instance, the taxpayers do not take an additional job, or apply for other grants or subsidies if they get to a higher tax bracket accordingly, and by paying higher amount of tax due to the applicable higher tax rate, and therefore they take less money home. The higher tax rate increases the level of redistribution, but decreases the employment rate. As John Stuart Mill stated in 1848: the progressive tax levies a higher rate of tax on the higher income, therefore it definitely punishes the hard working taxpayers.

3. INCOME TAX

Whether a tax regime of a country is fair or effective, depends on the applicability of the principles, proportionality, progressivity, and the exemptions provided. (Deak, 1997:317) Based on the ability to pay principle, thus higher tax is levied on the taxpayers realizing higher income, and the same amount shall be paid by the taxpayers of similar payment abilities.

In modern state every tax and its elements are brought into the system by means of law. Accordingly, fairness of any tax system is determined by legislator.

The most important headquarters of taxation according to economic strength is income, which taxpayer actualizes on market for certain work or provided services. (Lončarić-Horvat, 2010:188). Income tax is the type of tax by which we want to achieve fiscal, political, social and economic goals. Most developed countries consider income tax as most significant and most prominent source of public revenue which implies at its role in realization of fiscal policy.

3.1. Revenue belonging¹

Revenue from income tax is divided between:

- municipality/city – 56,5%
- county – 16%
- part for decentralized functions – 12%
- part for position for aid of accommodation for decentralized functions – 15,5%.

4. TYPES OF INCOME IN THE REPUBLIC OF CROATIA²

In the Republic of Croatia there are 6 types of income:

- Employment income
- Independent personal services income
- Income from property and property rights
- Investment income,
- Income from insurance
- category of other income.

In this paper we are going to elaborate two most important types: employment income and independent personal services income.

4.1. Employment income

Share of the employment income tax in the entire income tax system is of great value. Depending of the year in question it can exceed 80% and it should not surprise us because overwhelming number of tax payers are employees. Dependent personal services represent relation between employer and employee in which the employee is obliged to work by the instructions of the employer. Retirees are being taxes as employees.

Employment income is contrast between receipts obtained in one taxable period and expenditures originated in same taxable period.

¹ Law on Financing of Local and Regional Self-Government Units, Official Gazette 117/93, 33/00, 73/00, 59/01, 107/01, 117/01-correction 150/02, 147/03, 132/06, 73/08, 25/12

² Income Tax Law, Official Gazette, 177/04, 73/08, 80/10, 114/11, 22/12, 144/12

Receipts based on dependent personal services are:

- salaries
- retirements
- receipts based on consideration, support, award and other, which are paid by the employer or which are given to the employees above prescribed amount
- salary which is to employee paid by another person instead of the employer
- assurance premium which employers pay for their employees dealing with life assurance, extra and private health assurance, voluntary social security contributions above prescribed amount and assurance of their assets
- all other revenue that employer pays or gives to employee for services that had been done based on employment contract or any other act that regulates employment
- entrepreneurial salary that is defined as an expenditure while establishing corporate income tax
- salary of natural persons that work in the Republic of Croatia in domestic corporation by mandate of foreign employer
- salary of members that work for representative and executive departments of state authority and departments of local and regional authority
- salaries for persons that help and care for military invalids of Homeland War according to special regulation.

4.2. Independent personal services income

Independent personal services income is considered to be:

- Income derived from trade and with trade equalled services
- Income derived from independent profession such as:
 - independent profession of health care employees, veterinarians, lawyers, public notaries, engineers, auditors, bankruptcy managers, architects, tax consultants, interpreters, translators, tourist employees and etc.,
 - independent profession of scientists, inventors, authors and other similar profession
 - independent profession of lecturers and educators and other similar profession
 - independent profession of journalists, artists and athletes.
- Income derived from agriculture, fishery and forestry
- Income of other independent services which are not main service of tax payer, but are occasionally performed for gaining income

There is one significant regulation, Article 26 by which all tax payers referred to above can upon their request pay corporate income tax instead of personal income tax.

5. TAX RATE

Progressive taxation rests on fact, that person who has bigger income should pay bigger tax. On the other hand, person who earns smaller income should pay smaller tax. That means that persons with different economic strenght should pay different amounts of tax – vertical tax fairness. (Lončarić-Horvat, 2010:192)

By most recent changes in the system of income taxation, number of tax brackets has been changed from 4 to 3. That automatically changes range of receiving which is related to each tax rate and its heights. Contrary to that concept, we have flat tax, where everybody is taxed with the same tax rate with no regard to tax payers income size. (socially most unjust) (Perić, 2010: 302)

The tax base on income for the taxation of income tax from employment and income from self-employment is divided into three tax brackets. Income tax is paid at a rate of 12% on taxable income over single of the basic personal deduction. Income tax is paid at a rate of 25% of the difference between the tax basis of single and quadruple of the basic personal deduction. Income tax is paid at a rate of 40% on taxable income over four times the amount of the basic personal deduction.

This essentially means that after the decline of the gross salary required to contribute to the basic personal allowance taxable income on a monthly basis is taxed as follows:

- up to 2.200,00 HRK pay tax at a rate of 12%
- above 2.200,00 HRK to 8.800,00 HRK (ie further 6.600,00 HRK) pay tax at a rate of 25%
- above the total amount of 8.800,00 HRK pay tax at the rate of 40%.

Table 1: Tax rates

Tax rate	Monthly basis (HRK)	Yearly basis (HRK)
12%	- 2.200,00	- 26.400,00
25%	2.200,01-10.800,00	26.400,01-105.600,00
40%	8.800,01 -	105.600,01 -

The essential issue is how business players react on taxes. High and progressive taxes cut back performance and will not stimulate production. (Streissler, 90:79) Beyond not making the pursuing of activities appealing, high tax rates encourage taxpayers to search for legal and illegal ways of tax evasion (the back door methods, such as the permanent investment account³, the calculation of cost invoices for individual entrepreneurs, or when real estate or other property is sold⁴). Tax planning performed by the taxpayer in such ways is by no means harmful, but its wide option much rather promotes that taxpayers accept tax law, because the taxpayer is happy to pay less tax feeling that implicitly he/she received more money or actually more stayed in his/her pocket. This will mean more revenue for the state or eventually in terms of the personal income tax for the budget of local municipalities than as if with regard to the high tax payment obligation or by some tax fraud techniques, such as black or grey employment, no revenue would flow in or the tax base would be significantly lower due to hidden incomes.

³ See Section 67/B. of the Act on Personal Income Tax.

⁴ The effective regulation has retained taxpayers' opportunity to deduct three types of cost: the amount of income shall be established by deducting the expenditure related to the acquisition, the costs of value-added investments, and the costs in connection with the transfer can be deducted from the revenue.

6. NON-TAXABLE PART OF INCOME

When it comes to defining economic strength, both jurists and economists, although by different means, come to same conclusions. In fact, they both accent that tax basis of income tax must be decreased for expenditure necessary for assurance of minimal existential costs. (Lončarić-Horvat, 2010:189)

Excluded from taxation is part of income that is necessary for taxpayer to fulfil his existential needs. This part of income is usually called existential minimum. Term non-taxable part of income is used in tax terminology, and in Croatian Income Tax Law term personal allowance is used. Article 36 of Income Tax Law prescribes that the full amount of realised income should be reduced for personal allowance in the amount of 1.800,00 HRK for each month of taxable period. This amount of personal allowance is enlarged for dependent members of family and children. Income Tax Law presumes that the amount of 1.800,00 HRK is enough for taxpayer to cover his basic existential needs. (Sindičić, 2010)⁵

Table 2: Personal allowance in the Republic of Croatia

Personal Allowance	Factor of Personal Allowance	Monthly Amount of Personal Allowance (HRK)
Basic personal deduction	1,00	2.200,00
Dependent member (spouses, parents of spouses, grandchildren, grandparents)	0,50	1.100,00
First child	0,50	1.100,00
Second child	0,70	1.540,00
Third child	1,00	2.200,00
Fourth child	1,40	3080,00
Fifth child	1,90	4180,00
Sixth child	2,50	5.500,00
Seventh child	3,20	7.040,00
For each additional child factor increases 0,8; 0,9, etc.		
For partial disability	0,30	660,00
For 100% disability	1,00	2.200,00
Retirees		The amount of pension income, and most 3.400,00 (least 2.200,00)

7. COMPARISON TO EUROPEAN TRENDS

When analyzing tax systems of Eastern European countries (e.g. Slovakia, Estonia, Latvia, Romania), it should be emphasized that these countries are in fact in the process

⁵ Basic personal deduction has since changed from 1.800,00 HRK to 2.200,00 HRK.

of transition just like the Republic of Croatia. That is the reason why these flat rate tax reforms should be carefully studied, especially taking into consideration the fact that in the Republic of Croatia personal income derived from employment income and income derived from independent personal services is taxed via progressive tax rate. One of the countries that have undergone the flat tax reform is Hungary.

The Hungarian tax system including the personal income tax system was characterized by progressivity and complexity. The first signs of the introduction of the flat tax rate were already marked by the trends of reducing the upper rates and the extension of the tax base. The legislator, observing the examples of other Eastern and Central European countries (e.g. Slovakia, Estonia, Latvia, Romania) believed that the goal of tax payment is easier to reach by defining a wider tax base and lower tax rates, because more people will be willing or at least become readier to pay tax, thus not only the constitutional principle of tax payment, but also the basic principle of the personal income tax law will be applicable at a much higher level and government revenues may also increase significantly. (Ercsey and Jerković, 2012)

The Hungarian government believes that the flat tax personal income tax regime shall stay in force and, in order to establish a system that is stable and calculable, shall remain protected by being related to two-third majority vote of the Hungarian Parliament. They stated that the new regulation achieved its goal; it provided higher budgetary income (a sum of extra 60 billion HUF together with the social security contribution), stimulated the economy, and promoted employment.

Hungary used to operate a progressive personal income tax system, and recently introduced the flat individual income tax regime of a unified tax rate of 16 percent, effective from 1 January, 2011, in order to make the system more righteous, and to promote employment by the reduction of the marginal tax rate. The flat tax rate system indeed favours the taxpayers of society who earn more, and this is the fundamental critic thereof. Considering that in comparison with the previous 17 per cent lower rate the current tax rate is no real decline, furthermore the tax burden of those whose income is low became higher due to the provisions of supplementary tax base, though the tax rate of 16 per cent is a significant change against the previous 32 per cent upper level rate, this statement seems to be justified. This decline produced serious tax revenue cut on the government budget side, but this was not balanced by the reduction of allowances, additionally, as the current study later states in detail, these allowances have even been extended, although the basic tax allowance for subsistence needs has been eliminated, so 'people pay taxes from the first forint they earn'⁶.

The amount of personal income tax paid by Hungarians in the same economic position may greatly differ. The tax base of contracted revenues must be defined by tax base extension (by adding 27 per cent of the revenue to it, i.e. creating a gross revenue or as people say in Hungary a "supergross" revenue for the annual income exceeding the sum of HUF 2,424,000). Thus, the real tax payment level is 20.32 per cent for revenues in the consolidated tax base, not respecting whether those arise from independent or

⁶ IMF Survey online January 25, 2012 <http://www.imf.org/external/pubs/ft/survey/so/2012/NEW012512A.htm> (30.01.2012.)

non-independent activities or other sources. Revenues taxed separately, but are not taxed under this tax base extension; the real calculated tax of such revenues is 16 per cent of the income. Based on the above mentioned, the difference is not only the accessibility of reductions or the 4.32 per cent in figures, but also the opportunity to deduct allowances and the non-identical status of other contributions. The lawmaker taxes certain revenue types differently depending on the actual business activity and taxpayers have different chances above these to optimize tax payment.

It is a fact that the reduction of the tax rate of individual income tax, as it can be seen from the recent experiences, does not result in a serious consumption increase (neither in 2011, when the VAT rate did not change and the wealthier taxpayers earned significantly more, since the tax burden dropped mostly for those who earned most, nor in 2012 and not due to the higher VAT rate), because income owners will save some of the money that stays with them. It is of course likely that they would spend and consume more, but their total surplus will not be spent in its entirety. The recent results show that consumption has in fact even radically decreased in the first quarter of 2012, according to Gfk Hungaria, the technical consumer goods market index fell radically. In accordance with these, the system effective of January 1, 2011 resulted in rather promoting savings and mostly low risk small or medium range investments, but did not increase the level of consumption extensively. (Ercsey and Jerković., 2012)

Also, we have to mention allowances provided in Hungary. Those with higher revenue can apply more allowances and get greater advantage to use the subsidy opportunities offered by laws. The family allowance – depending on the number of children in the family – will be HUF 62,500 per child and month, if the family has one or two children and HUF 206,250, if it has three or more children.

Unlike the previous progressive personal income tax system, this solution, i.e. the decline of tax rates and competitive taxation and tax amounts is on the one hand in harmony with the connecting international trends, albeit the introduction of flat tax rate is preferably used by East-Central European states, and hardly used in Western countries.

The parliamentary opposition emphasizes that the flat individual income tax is harmful for the fiscal growth and federalism, generates huge budgetary deficit, furthermore made the existence of millions of the lower classes much harder and decreased the employment rate, and basically this has been established by the International Monetary Fund as well: Hungary's design 'added to bureaucracy, and overly burdened the most vulnerable'. (Ercsey and Jerković, 2012)

8. CONCLUSION

According to P. Bejaković tax system should be simple, foreseeable and with less changes. In the Republic of Croatia politicians like to explain these income tax changes as means to introduce elements of fairness into the tax system.

Income tax is one of the basic tax forms which is relatively easy to adjust to economic strength of citizens so that the wealthier ones pay relatively more tax, and poorer ones pay less, and by which it can be influenced on just and fair splitting of income so it can be said that income tax has attributes of progression. With income tax we try to fix «injustice» that is brought by consumption tax (VAT and excise duties) that relatively more burden poorer citizens. Also, income tax has distinct and automated ability of adjusting to current economic state of any country (built-in flexibility). (Lončarić-Horvat, 2010:295)

It should be emphasised that there is no optimal fairness, and not all of societies have the same concept of fairness. However, moral aspect of taxation should equally apply both to state and taxpayer. That means that duty of every state is to develop fair splitting of tax burden, i.e. taxpayers should pay taxes in accordance to their economic strength and the state should rationally spend collected means. On the other hand, duty of every taxpayer is to bare fair amount of public expenditure in accordance to his or her economic abilities.

Table 3: Salary accounting example

1	Gross income (HRK)	8.399,79
2	Social security contributions 20%	1.679,96
3 (1-2)	Income	6.719,83
4	Personal allowance	2.200,00
5 (3-4)	Tax basis	4.519,83
6	Payed tax and surtax	
	Tax rate 12%	264,00
	Tax rate 25%	579,96
	Surtax ⁷ 13%	109,71
	Whole tax	953,68
7 (3-6)	Net income	5.766,15

REFERENCES

Deák, D. (1997), Igazságos-e a magyar adórendszer? (Egy törvényhozási csapdahelyzet elemzése) [Justice in Hungarian tax system: A case study of a legislative pitfall], 51 Jogtudományi Közlöny, 7-8

⁷ The taxpayer of surtax is obliged to pay income tax if domiciled or habitual resident in the municipality or city that prescribed the obligation for surtax.

Tax basis is the amount of income tax.

Tax rate

Municipality or city can prescribe that tax payers in their territory have to pay surtax to income tax as follows:

- municipality at a rate of up to 10%
- city under 30,000 inhabitants at a rate of up to 12%
- city above 30,000 inhabitants at a rate of up to 15%
- City of Zagreb at a rate of up to 30%.

- Ercsey, Z.; Jerković, E. (2012), Porez na dohodak: odredbe o pravičnosti, Suvremeni pravni izazovi: EU-Mađarska-Hrvatska; Pečuh-Osijek, Sunicop
- European Tax Handbook, 2012 (Editors: Ola van Boeijen-Ostaszewska and Marnix Schellekens)
- IMF Survey online January 25, 2012 <http://www.imf.org/external/pubs/ft/survey/so/2012/NEW012512A.htm> (30.01.2012.)
- Income Tax Law, Official Gazette, 177/04, 73/08, 80/10, 114/11, 22/12, 144/12
- Law on Financing of Local and Regional Self-Government Units, Official Gazette 117/93, 33/00, 73/00, 59/01, 107/01, 117/01-correction 150/02, 147/03, 132/06, 73/08, 25/12
- Lončarić-Horvat, O. (2010), Pravedna i socijalna porezna država?, Znanstveni skup Uloga države u socio-ekonomskom razvoju nacionalnog gospodarstva, Zbornik radova u povodu 80. godišnjice života prof. emeritusa Božidara Jelčića, Visoka poslovna škola Libertas Zagreb, Zagreb
- Mill, J. S. (1848), Principles of Political Economy, London, Longmans, Green and Co.
- Perić, Z. (2010), Osvrt na najnovije izmjene i dopune Zakona o porezu na dohodak: raspodjela poreznog tereta, Znanstveni skup Uloga države u socio-ekonomskom razvoju nacionalnog gospodarstva, Zbornik radova u povodu 80. godišnjice života prof. emeritusa Božidara Jelčića, Visoka poslovna škola Libertas Zagreb, Zagreb
- Sindičić, P. (2010), Načelo pravednosti u poreznom sustavu RH, Znanstveni skup Uloga države u socio-ekonomskom razvoju nacionalnog gospodarstva, Zbornik radova u povodu 80. godišnjice života prof. emeritusa Božidara Jelčića, Visoka poslovna škola Libertas Zagreb, Zagreb
- Streissler, E. (1990), Gazdaságméleti kétségek a progresszív jövedelemadó ésszerűségét illetően [Theoretical economic doubts regarding the rationality of progressive income tax] / Közgazdasági Szemle
- Wagner, R. E. (2007), Fiscal Sociology and the Theory of Public Finance (Cheltenham Edward Elgar Publishing Limited)

Antonija Zubović

University of Rijeka, Faculty of Law, Rijeka, Croatia

Mihaela Braut Filipović

University of Rijeka, Faculty of Law, Rijeka, Croatia

SIGNIFICANCE OF THE CISG FOR FRANCHISING AND DISTRIBUTION AGREEMENTS IN THE EU MARKET

ABSTRACT

Authors' aim is to answer whether UN Convention on Contracts for the International Sale of Goods (further: CISG) can be applied to contracts such as franchising and distribution. Primarily, it shall be explored if the CISG can be applicable to sale of goods part solely, and secondly, if its application can be stretched to the entire franchise/distribution contracts, when disputes arise as to formation, termination of these contracts or other issues generally covered by the CISG. Franchise/distribution contracts are considered as framework agreements, where the main element is almost regularly a sale of goods "part". However, there is no set of rules which deal with contractual aspects of franchise/distribution contracts on the EU level, except of, for now, a fruitless attempt in Part E of the Book IV of the Draft Common Frame of Reference (further: DCFR). Ultimate goal, in the opinion of the authors is to preserve international character of franchise/distribution contracts and through intensified application of the CISG, as a legal instrument widely adopted and shyly marked as the EU sales law, to achieve a better economic and legal integration of the EU market in the field of franchise/distribution business, including Croatia as a newcomer.

Keywords: CISG, franchising, distribution, sale of goods, EU sales law

JEL classification: K120

1. INTRODUCTION

International trade on which the entire global economy is based usually consists of at least one sale of goods contract. Franchise and distribution agreements are also heavily used for international deliveries of goods and services, thus posing a serious task upon legislators to rather enhance than to pose obstacles for these agreements as are choice of law issues, differing regulation and ignorance of already existing international legal sources. Although contractual aspects of franchise and distribution agreements are not harmonized on international or EU level, authors aim to explore whether the application of some other already existing international legal instrument could significantly enhance the unification process of these agreements. The suggested legal source is the CISG which presents the highest success of unification regarding sales of

goods contract not only on regional, but on the international level as well. Application of the CISG is intended to the sale of goods contract, including certain mixed contracts as well as instalment contracts, though it is clear that framework agreements as are franchising and distribution generally fall outside its scope. Authors shall explore the legal nature of franchise/distribution agreements with the emphasis on the sales of goods contract concluded within or based upon them. Accordingly, it shall be elaborated on the possibility whether CISG can be applicable to the entire franchise/distribution agreement or solely to individual sale of goods contract based on them. Equally, authors shall explore position of the EU legislator in the light of the newest legislative movements as are DCFR and proposed CESL, and whether their adoption could enhance or rather complicate already existing legal environment for international trade where franchise and distribution agreements take an important place. Croatian practitioners should be more aware of international legal instruments, and in that light, authors shall elaborate on the issue that by more frequent application of the CISG, even the disputes arising from franchise/distribution agreements could be resolved on an international level. It shall be discussed whether further unification on EU level with effect in Croatia could, thus, be achieved not solely through new set of rules on international franchise/distribution agreements, but also by using already adopted and more familiar legal sources as is the CISG.

2. LEGAL NATURE OF FRANCHISE AND DISTRIBUTION AGREEMENTS

Franchise and distribution agreements were imported in the EU countries under the strong influence of the USA. While these types of commercial transactions were recognized in the USA already in 1880s, in the EU countries their significance grew since 1950s onward. They owe their popularity to flexible construction of mutual rights and obligations for international traders and enhanced access to foreign markets under lower cost (Horak, 2005; Gemet-Pol, 1997). Authors shall not elaborate on the numerous types of franchise and distribution agreements which appear in the practice, but shall focus on their legal nature and subsequently, legal sources applying on them. Franchising and distribution agreements are forms of business that touch upon a great many different areas of law. In some literature they are marked as “agreements”, while in others as “contracts”. Authors use both terms, aiming always at a legally binding consensus between the parties.

The legal nature of franchise/distribution contracts is blurred by the elements of agency, sales of goods, intellectual property, competition, joint ventures, transfer of technology, license, services and many others (Horak, 2005; Gemet-Pol, 1997), thus imposing to be a starting point in discussion of whether CISG can be applied on these agreements.

In theory, there are different and even diametrically opposed views on the legal nature of franchise and distribution agreements (Singapore-WIPO Regional Workshop, 2007). We shall emphasis four basic approaches. Under the first, the very existence of these agreements is denied, and rather described as a phenomenon of “Americanization of integrated trade” (Savatier et.al 1967). Under the second approach, they should be regarded as unnamed typical contracts developed in the practice but not regulated by

law (Goldštajn, 1991). According to the third, both franchise and distribution contain elements of different contracts, thus falling under the category of so-called mixed contracts (*mixti iuris, gemischte Verträge*) (Milenković, 1997; Vukmir, 2000; Mlikotin-Tomić, 1986). Finally, these agreements could fall under the category of *sui generis* contracts (Milenković, 1997; Pražetina, 2006; Čuveljak, 1998; Čuveljak, 2001; Horak, 2005).

Authors' note that regardless of the differing views, none of it contests that franchise and distribution agreements can contain elements of sale of goods contract. If they have a sales part, then it is open to discuss whether the sales part can be of such importance to render the entire agreement as a sale of goods contract. In that light, authors shall further discuss possibility and scope of the application of the CISG on them.

3. FRANCHISE AND DISTRIBUTION AGREEMENTS UNDER EU LAW

Trading through franchise and distribution channels was not introduced in EU market by a legislative effort, but through a commercial practice. In fact, although they first appeared in commercial practice in 1950s, and in Croatia in 1970s it was not until 1983 that EU legislator was concerned with issues regarding distribution, and in 1988 with franchising agreement (Alon et.al 2007; Gemet-Pol, 1997). Interestingly, both of them were regulated as an exemption from prohibited agreements in competition law (Regulation No 1983/83, Regulation No 4087/88), where no additional provisions for contractual regulation of franchise/distribution agreements were imposed upon EU Member States (Gemet-Pol, 1997; Ferrier, 2001).

Consequently, franchise and distribution agreements are not harmonized on the EU level, except in the context of competition law. It must be emphasized that most EU Member States, although free to construe their own national rules for franchise and distribution, regulated these agreements solely in the area of competition law (Bueno Diaz, 2008; Hesselink *et al.*, 2006). In other words, they mostly remain a part of autonomous commercial law, thus leaving parties to freely negotiate terms of these agreements to the extent they do not infringe national mandatory provisions which include competition law rules introduced by the EU.

Croatian legislature took the same position. Although Croatian Trade Act from 1996 (further: CTA) by revision in 1999 (Official Gazette no. 75/99) set a definition for both franchising and distribution agreements, definitions were under the clear influence of EU regulation in the area of competition law. Since it contained sole definitions, authors find that there was no legislative incentive to regulate contractual aspects of franchise and distribution agreements. Later on, legislator put aside the CTA from 1996 and brought a new CTA in 2008, currently in force, which no longer contains these definitions. In accordance with the trend of EU countries, franchising and distribution agreements are mentioned solely in Croatian Competition Act as exemptions from prohibited agreements in competition law, and further defined in its implementing regulations of 2011 (Regulation on block exemption granted to certain categories of vertical agreements; Regulation on block exemption granted to agreements on

distribution and servicing motor vehicles). Thus, franchise/distribution agreements fall under the autonomous commercial law in Croatia as well.

The path of putting franchise/distribution agreements under the EU legislative cap was attached with many difficulties, beginning from the very definition of these agreements. The fact that the content of these agreements depends on the will of the contracting parties and its continued development, creates difficulties of putting each of these agreements under one definition that would encompass complexity and diversity of relationship that appear during their execution (Mlikotin-Tomić, 1986; Draškić, 1983). However, EU legislator was obliged to provide a definition in order to make an exemption rules for these agreements in competition law. It did so for distribution firstly in Regulation No 1983/83 and for franchising in Regulation No 4087/88 after the key *Pronuptia* case, though in later stages it transposed definitions to accompanying guidelines (Regulation No 330/2010/EC and Guidelines on Vertical Restraints, 2010). Nevertheless, definitions set in these two regulations had the greatest influence on both international and EU legal and soft law sources that followed after (Regulation No 2790/1999 on selective distribution, UNIDROIT Model Franchise Disclosure Law; European Code of Ethics of European Franchise Federation), as well as on national legislations of EU Member States.

The fruitless attempt, at least for now, to harmonize contractual aspects of franchising and distribution agreements on the EU level was made in the frame of DCFR. Proposal for regulation of franchise and distribution contracts was set out in 2006 by The Principles of European Law on Commercial Agency, Franchise and Distribution Contracts (PEL CAFDC) as a part E of the Book IV of the DCFR. It equally calls for the application of general rules of contract law set in DCFR (Cashin, 2007.). Thus, if parties opt-in for the application of the DCFR, any dispute arising out of sale of goods contract concluded within or based on franchise/distribution agreements shall equally fall within the scope of DCFR, thus rendering any national or international legal sources as superfluous, except in the case of legal gap. However, since the DCFR is an optional instrument its application shall depend on the parties' choice, and for that sole reason, it is already intertwined with great difficulties in practice.

4. CISG AS EU SALES LAW

Undisputed goal of the CISG is to unify international sales law, and it is designed to be applied on contracts of sale of goods, with proclaimed exceptions for sale of shares, ships, electricity and other goods specified in article 2 of the CISG (Schlechtriem, 2001). Today, even 79 countries adopted the CISG (UNCITRAL database), and it is anticipated that potentially 80% of world sales of goods contracts could fall within its scope (Schlechtriem and Schwenger, 2010). Croatia as an independent country became a contracting state of CISG in 1991 (UNCITRAL database). Within EU, from its 27 Member States, only four did not adopt it: Great Britain, Portugal, Ireland and Malta (UNCITRAL database). Non-adoption by Great Britain is considered to be the greatest obstacle in achieving that CISG is closer to unifying international and EU commercial sales law, since it is a major trading partner within EU and has an important impact on common law jurisdictions (Hofmann, 2010). Recently, there are opinions that

traditional reasons for its non-adoption are no longer prevailing, and that, although until now no legislative initiatives are commenced, it is only a matter of time when the CISG shall be adopted in Great Britain as well (Nikolova, 2012; Hofmann, 2010; Moss, 2005).

Role of the CISG on the EU level and on national laws of EU Member States can be examined from two main standpoints. First, CISG as a role-model for EU sales law, and to a certain extent, even for entire EU contract law. Second, influence of the CISG on recently changed sales laws of EU Member States.

Role of the CISG as a model and basis for EU contract law is explicitly declared by EU legislator (European Parliament resolution, 2001). Also, a clear influence of the CISG on already existing EU law is visible for example in Consumer Sales Directive, Directive of Late Payments, Package Travel Directive and others (Schroeter, 2009). EU soft law on contracts is not an exception, providing the Principles of European Contract Law (further: PECL) as the most important example of the CISG influence. Even future EU law is developing under the strong influence of the CISG, where in the field of contract law the most important are the DCFR and CESL (Bonell, 2008; DiMatteo, 2012).

CISG significantly influenced some of the recent changes in domestic sales law of EU Member States, as are Germany and France (Zimmermann, 2005; De Ly, 2005). Also, new Croatian Obligations Act (further: COA), which is in force since 1st January 2006 is argued to be under influence of both PECL and CISG (Crnić, 2005; Ćesić et.al 2005). In fact, it is considered that because COA contains mostly same solutions as the CISG it encouraged Croatian practitioners to use CISG only occasionally, since the same decisions and outcomes were achieved by using familiar national instead of international provisions on sales of goods as is the CISG (Baretić and Nikšić, 2008).

In cases when CISG and EU regional sources of law overlap and contradict, interesting question arises which shall prevail. The answer is rather simple. Since the CISG is a convention, and an implemented EU directive in national law is not, CISG shall always prevail over the EU directives, unless a country made a reservation of a kind when signing the CISG or the parties agreed to exclude a part or the entire CISG (Schroeter, 2009; Ferrari, 2004). In that light, it is necessary to emphasize that Croatia gave no reservation on the CISG.

An exception from the rule that CISG as a convention prevails, is a proposed CESL on the EU level, which provides in its recital 25 that when parties opt-in for CESL it should be considered that they derogated, i.e. opted-out from the CISG. Although CISG can be derogated by parties' choice even implicitly, such a solution endures heavy criticism because the prevailing scholars' opinion is that derogation of the CISG can be considered only according to the rules of CISG and not by any other regulation (Kornet, 2012; Hesselink, 2012; Mišćenić, 2012). It is yet to be seen whether this proposal shall be adopted by EU legislator.

In practice, however, CISG is confronted with the problem that parties often exclude its application, where the recent research shows that approximately 50% of lawyers in

most developed EU countries continuously opt-out from the CISG (Spagnolo, 2009). Unfamiliarity with the CISG and the fact that CISG is incomplete, as it does not refer to issues as are validity of the contract, property of the sold goods and other issues, are considered to be the main reasons why parties and lawyers opt-out from the CISG (Kornet, 2012; Spagnolo, 2009). To compare with the currently proposed CESL, the fact that CESL shall be applicable only if parties choose it, i.e. if they opt-in, leads to the conclusion that its application is even more questionable than the application of the CISG from which the parties must opt-out if they want to avoid it (Magnus, 2012).

CISG is seriously understated in Croatian practice as well. Although there are many scholarly writings on the CISG in Croatia, until now, Croatian lawyers and practitioners demonstrated great unawareness of it (Baretić and Nikšić, 2008). Court practice beginning from 2003 witnessed an important recognition of applying CISG when conditions for its application are met, although far from desirable degree of recognizing its international character and influencing the style of interpretation and making decision (Baretić and Nikšić, 2008). Besides the unfamiliarity issue, additional reason could be that until now Croatian practitioners, particularly lawyers and their clients had little experience with international trade (Baretić and Nikšić, 2008). Further, when trading on international level, instead of using CISG, they rather relied on a developed practice of using standard terms in contracts, thus impliedly opting-out of those parts covered by the CISG (Baretić and Nikšić, 2008). Undoubtedly, when Croatia becomes a full EU Member State, it shall further open its market, and consequently, the need that Croatian practitioners become aware of the CISG in context of the international sales of goods is becoming obligatory and unavoidable.

At last, the issue arises whether there is any need on the EU level for making a uniform contract law. Although there are certain differences in national laws of Member States, there are recent surveys (Orgalime, 2011; American Chamber of Commerce, 2011; Eurobarometer, 2011), indicating that businesses find no serious obstacles for conducting business in current state of national laws, thus threatening to conclude that current EU legislative incentives as are DCFR and CESL rather complicate than enhance the commercial trade in EU (Kornet, 2012). One must note that EU legislator until now primarily focused on the harmonization of contract law in area of consumers' protection, while commercial law is affected solely by few EU directives, as is for example Directive of Late Payments and Commercial Agency Directive. Since proposed CESL invokes for almost the same degree of protection for both consumers and traders which form SMEs, there is a criticism that consumer and commercial sales contracts cannot be dealt with on the same way (Kornet, 2012). Further, it is considered that CESL has the same defects as the CISG. In particular, it is argued that EU Member States which did not adopt the CISG shall have even greater reasons for not supporting CESL (Kornet, 2012). Example for it would be the scope of good faith principle which is one of the main obstacles for adopting the CISG in Great Britain (Hofmann, 2010), and which is heavily emphasized and used in CESL (DiMatteo, 2012; Hofmann, 2010). Further, if one claims that CISG is incomplete since it does not solve all issues connected with sales contracts, the same can be said for CESL as well (Kornet, 2012; Mišćenić, 2012).

For all it has been said, it is to conclude that CISG in spite of all its deficiencies presents the highest success in unifying not only EU, but rather international commercial sales law. Besides its international character, its main advantages are that its application solves the issue of applicable law on the dispute arising from the sales contract and that it already has a rather developed practice before national and arbitral courts, thus loudly promoting its further application by offering an insight in how certain provisions were interpreted in practice of courts (Bonell, 2008). In the light of global economy, China's accession to the CISG and the fact that Chinese lawyers often contract its application (Spagnolo, 2009), together with the impact of proclaimed inclination of the Great Britain towards adopting the CISG on common law jurisdictions (Hofmann, 2010), importance of the CISG for commercial contracts is all but diminishing. Thus, CISG presents the most relevant set of rules for international commercial contracts, clearly dominating over current proposals for EU common sales law, which impact and importance should be also more recognized by Croatian practitioners.

5. APPLICATION OF THE CISG ON FRANCHISE AND DISTRIBUTION AGREEMENTS

Generally, franchise and distribution agreement fall outside of the scope of the CISG (Schlechtriem and Schwenger, 2010; Honnold and Flechtner, 2009; Lookofsky, 2008). However, the issue arises whether CISG should be applied on an individual sale of goods contract concluded based upon franchise/distribution agreements. Further, authors shall explore whether CISG can be applied even on the entire franchise/distribution agreement, and if it can, then under which circumstances.

First step towards bringing in relation the CISG with framework contracts, as are franchise and distribution, is recognizing the distinction between the framework contract and the individual sale of goods contract concluded on its basis. The case Benetton II of 1997 is of great importance due to the court's elaborations where the German Federal Supreme Court went so far in order to make this distinction that it ruled that individual sale of goods contract can be valid even if the framework contract itself is void. In that case, the parties concluded a franchise agreement with the application of the German law, which since they failed to exclude it, determined the applicability of the CISG as well. The issue in dispute concerned the validity of both franchise agreement and individual sales contract based on it. Since the issue of the validity of the contract is not covered by the CISG, the answer was provided by German national law. The court decided that the framework franchise agreement is void because it infringed competition law rules. However, it held that the individual sale of goods contract concluded based on it are valid due to the fact that they are independent contracts and do not form a unified legal transaction (Schlechtriem, 2001). These individual sales of goods contract were considered to fall under the application of the CISG.

Accordingly, prevailing scholarly opinion is that CISG should be applied on the individual sales of goods contract concluded based on framework contracts which itself are not covered by the CISG (Djordjevic, 2011; Honnold and Flechtner, 2009;

Lookofsky, 2008; Schlechtriem, 2001). It is also heavily supported in court practice (Leather Goods case of 1997; Fitness Equipment case of 1997; Blood Infusion Devices case of 1997; Lawn Mower Engines case of 1996; Computer Chip case of 1993). Thus, CISG should be applicable to individual sale of goods contract concluded on the basis of franchise/distribution agreement if the conditions for its application are met.

Further step is to investigate whether parties can expressly choose that their franchise or distribution agreement is governed by the CISG. Parties' autonomy is one of the main principles in commercial law. It includes the right of the parties to choose applicable law or set of rules to be applied on their contract to the extent that these rules are in accordance with the applicable national mandatory rules. In that light, parties are free to choose CISG as the applicable set of rules for their contract, even if the contract itself is not the sale of goods contract (Lookofsky, 2008). Accordingly, ICC court in case no. 11849 of 2003 concluded that CISG is applicable on an exclusive distributorship agreement due to the express parties' will. ICC court started from the wording of the parties' agreement, where it was stated that the CISG shall be applicable "[...] for what is not expressly or implicitly provided for under the contract." Disputed issues in that case was the breach of the duties and consequent right on termination of the distributorship agreement. ICC court admitted that CISG is regularly applicable to sales of goods contract, but it correctly argued that parties' will in the agreement at hand clearly determined the CISG to govern all issues arising from it, and not solely the sales part. Further, it is understood that CISG can be applied only on issues covered by it, while issues not covered by the CISG should be governed in accordance with the gap-filling rules of the CISG provided in its article 7(2), with emphasis on preserving the international character of the dispute. Since the CISG contains provisions on breach and termination of the contract, ICC court concluded that termination of exclusive distributorship agreement should be solved by application of the CISG due to the expressly stated parties' will. Thus, parties can choose the CISG to be applicable to their agreements as are franchise and distribution.

At the end, the hardest question that should be answered is whether the CISG could be applied to the entire franchise/distribution agreement even in cases when parties did not expressly agree on its application. The answer lies in determining the legal nature of the franchise/distribution agreements, where in this light it should be answered whether these agreements could be determined as a sale of goods contracts. Naturally, framework contracts, as are franchise and distribution, are not sale of goods contracts by their legal nature. However, if for example, they oblige one party to deliver or buy certain amount of goods in a defined time-frame, it could be argued that the agreement itself already forms a sale of goods contract. This standpoint is supported among scholars (Schlechtriem and Butler, 2009; Newhouse and Tsuneyoshi, 2012; Bridge, 2007).

Possible application of the CISG to franchise/distribution agreements has also been discussed in court practice. In the ICC arbitration case no. 8817 of 1997, parties concluded an exclusive distribution agreement, and the issue concerned before the court was whether conditions for termination of the contract were fulfilled. As to the applicable law, parties did not expressly agree on the applicability of the CISG. However, it was questionable whether CISG can be applied to distributorship

agreement when not expressly chosen by the parties. ICC court did not dismiss its application solely because of the general notion of non-applicability of the CISG to distribution agreements, but it rather investigated whether the sales part of the agreement forms a preponderant part of the agreement in accordance with the article 3 (2) of the CISG.

The fact is that general standpoint which excludes franchise/distribution agreement from the application of the CISG is based on the argument that these agreements are mainly focused on providing the services as are the organization of distribution channels (Djordjevic, 2011) or organization of working schemes in franchise agreements and other services, instead of selling the goods. However, each agreement should be analyzed for itself, and depending on each particular case, courts should investigate whether framework contracts have a preponderant sales part, and consequently, whether CISG should be applied. In the mentioned ICC arbitration case no. 8817 of 1997, ICC court established that sales of goods forms a preponderant part of distributorship agreement, and thus, it ruled that issue of its termination shall be resolved under the application of the CISG. The same reasoning was applied before other courts as well (Metallurgical sand case of 2006; Manufactured goods case of 1999; Forklifts case of 1995).

Worthy of mentioning is yet another standpoint which offers more neutral solution. Namely, defining franchise/distribution agreements as sale of goods contracts by their legal nature is the greatest obstacle in discussing the application of the CISG on them. A sort of compromise would be determining franchise/distribution agreements as pre-contracts by which the parties are obliged to conclude individual sale of goods contracts as the main contract. Pre-contract is well recognized in Croatian law as well (article 268 of COA), and it is easy to argue that franchise/distribution agreements already contain sufficiently defined obligations for the parties in order to be determined as pre-contracts to a contract of sale of goods. Naturally, it always depends on each particular case. Pre-contracts as such are not expressly covered by the CISG, and they are not mentioned as a part of the formation of the sale of goods contract. However, pre-contract, as known in Croatia, is undoubtedly a contract, with main obligations for the parties to conclude the main contract on its basis (article 268 (1) of COA). If franchise/distribution agreements are considered to be pre-contracts for the sale of goods contract, then it should be answered whether CISG should be applied on them. Firstly, it is clear that the CISG shall be applicable if the agreement contains a general provision which call for the application of the CISG on the entire agreement. If such an express choice is lacking, and the CISG is applicable as a part of national law, then we argue that the courts should again apply the preponderant test in order to determine whether pre-contract has a preponderant sales part. If it has, then it is clear that the CISG should be applicable to franchise/distribution agreement as a pre-contract of sale of goods contract (Schlechtriem and Butler, 2009; Bridge, 2007). Thus, although coming to the same conclusion that the CISG should be applied to franchise/distribution agreement, this standpoint offers a middle solution by which it does not determine these agreements as a sale of goods contract, but it rather gives them a probably more acceptable neutral pre-contract legal nature.

6. CONCLUSION

Eliminating obstacles in unification of the EU market is one of the fundamental goals of the EU. Unification of legal aspects concerning commercial transactions seems as a desirable path for EU legislator. However, commercial law traditionally prefers autonomous sources over strict legal rules which rather limit than enhance trade and development of specific commercial transactions, such as franchise and distribution. Recently, there are legal incentives on the EU level to put commercial transactions under a regulatory cap, as are DCFR for wide range of contracts and CESL for sales transactions. Both of these instruments are intended to be optional, and even if adopted, shall be applicable only if chosen by the parties. On the contrast, CISG stands as a part of national law which must be excluded for its non-application. Equally, CISG represents the highest success in achieving unification of sales goods transactions not only on the EU level, but on the international as well. However, CISG itself is flawed. To begin with, it does not cover all the issues arising from the sale of goods contract, as it also does not cover all types of sales contract. Further, although even 79 countries adopted the CISG, there is still a significant resilience towards its full application, shown primarily by lack of knowledge by practitioners and their preference of standard terms contracts already tested in international trade. In this article, authors elaborated whether CISG can be applied on framework contracts as are franchise and distribution, and whether its intensified application can achieve better unification of these transactions than burdensome process of creating new rules. The application of the CISG depends on determination of the legal nature of franchise/distribution agreements. While it was easily deducted that CISG should be applicable on the individual sales of goods contracts concluded based on franchise/distribution agreement, the hardest issue was to answer whether CISG should be applied on the entire franchise/distribution transaction. In that regard, authors found court practice which went so far as to determine the entire franchise/distribution contract as a sale of goods contract in its legal nature in order to positively answer on the applicability of the CISG on these transactions. Equally, CISG was applicable on all issues arising from franchise/distribution agreements if parties chose the CISG as applicable set of rules on their agreement, always under the condition that disputed issue was covered by the CISG as for example can be considered the termination of franchise/distribution transactions. Thus, to conclude, applicability of the CISG is not necessarily limited to sales transactions. In fact, authors demonstrated that its application can be stretched even to framework contracts which traditionally fall outside of the scope of the CISG. Although intertwined with many difficulties, CISG can still be regarded as a primary source in international trade which is gradually being accepted by international traders who generally rely on self-construed standard terms contracts. In that light, authors consider it is worth of proclaiming that instead of creating new set of rules, full application of the CISG to both sale of goods contracts and certain franchise/distribution contracts, naturally depending on each particular case and wording of these agreements, could, from the legal aspect, most effectively put Croatia in the sphere of recognized international and EU franchising and distribution market.

REFERENCES

- Alon, I. et.al (2007), *Opportunities and threats regarding the development of the franchising business model in Croatia, Seventh International Conference on "Enterprise in Transition"*, available at: <http://www.fransiza.hr/Opporurtunities%20and%20threats%20regarding%20the%20development%20d%20the%20franchising%20business%20model%20in%20Croatia.pdf>
- American Chamber of Commerce to the EU's position on the Green Paper on policy options for progress towards a European contract law for consumers and businesses, 28 February 2011, available at: http://ec.europa.eu/justice/news/consulting_public/0052/contributions/8_en.pdf.
- Baretić, M. and Nikšić, S. (2008), *Croatia*, in Ferrari, F. (ed.), *The CISG and its Impact on National Legal Systems*, Sellier, München.
- Benetton II case, CISG case no. 276, Bundesgerichtshof (German Federal Supreme Court), 23 July 1997, available at: <http://cisgw3.law.pace.edu/cases/970723g2.html>.
- Blood Infusion Devices case, CISG case no. 228, *Obergericht des Kantons Luzern* (Switzerland), 8 January 1997, available at: <http://cisgw3.law.pace.edu/cases/970108s1.html>.
- Bonell, M. J. (2008), *The CISG, European contract law and the development of a world contract law*, American Journal of Comparative Law, Vol. 56, 1-27.
- Bridge, M. (2007), *The International Sale of Goods, Law and Practice*, Oxford University Press, London.
- Bueno Diaz, O. (2008), *Franchising in European Contract Law: A comparison between the main obligations of the contracting parties in the Principles of European Law on Commercial Agency, Franchise and Distribution Contracts (PEL CAFDC), French and Spanish law*, Sellier, München
- Cashin, R. E. (2007), *The Common Frame of Reference (CFR) and the Principles of European Law on Commercial Agency, Franchise and Distribution Contracts*, available at: http://www.lalive.ch/data/publications/Article__ERA_19.10.07.pdf
- CISG database, available at: <http://www.cisg.law.pace.edu>.
- Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices (Text with EEA relevance), OJ EC L 336/21 of 29 December 1999.
- Commission Regulation (EEC) No 1983/83 of 22 June 1983 on the application of Article 85 (3) of the Treaty to categories of exclusive distribution agreements, OJ L 173, 30.6.1983., p. 1–4.
- Commission Regulation (EEC) No 3577/82 of 23 December 1982 amending Regulation No 67/67/EEC on the application of Article 85 (3) of the Treaty to certain categories of exclusive distribution agreements, OJ L 373, 31.12.1982, p. 58–58.
- Commission Regulation (EEC) No 4087/88 of 30 November 1988 on the application of Article 85(3) of the Treaty to categories of franchise agreements, OJ EEC L 359/46 of 28 December 1988.
- Commission Regulation 330/2010/EC of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices, OJ L102, 23. 4. 2010., p. 1-7.
- Computer Chip case, CISG case no. 91, Appellate Court Koblenz *Koblenz* (Germany), 17 September 1993, available at: <http://cisgw3.law.pace.edu/cases/930917g1.html>.
- Council Directive 86/653/EEC of 18 December 1986 on the coordination of the laws of the Member States relating to self-employed commercial agents, OJ L 382, 31.12.1986., p. 17–21.
- Council Directive 90/314/EEC of 13 June 1990 on package travel, package holidays and package tours, OJ L 158, 23.6.1990., p. 59–64.
- Crnić, I. (2005), *Zakon o obveznim odnosima*, Organizator, Zagreb.
- Croatian Competition Act, Official Gazette of the Republic of Croatia, No. 79/09.
- Croatian Obligations Act, Official Gazette of the Republic of Croatia, No. 35/05, 41/08, 125/11.

- Croatian Trade Act, Official Gazette of the Republic of Croatia, No. 11/96, 101/98, 30/99, 75/99, 76/99, 62/01, 109/01, 49/03, 96/03, 103/03, 170/03, 55/04 (not in force).
- Croatian Trade Act, Official Gazette of the Republic of Croatia, No. 87/08, 96/08, 116/08, 76/09 and 114/11 (in force).
- Čuveljak, J. (1998), *Ugovor o franchisingu*, Računovodstvo, revizija i financije, No. 8, 95-100.
- Čuveljak, J. (2001), *Franchising*, Hrvatska pravna revija, No. 9, 49-59.
- Ćesić, Z. et.al (2005), *Komentar Zakona o obveznim odnosima*, RRIF, Zagreb.
- De Ly, F. (2005), *Sources of International Sales Law: an Eclectic Model*, Journal of Law and Commerce, Vol. 25, 1-12.
- DiMatteo, L. A. (2012), *Common European Sales Law: a critique of its rationales, functions, and unanswered questions*, Journal of International Trade Law & Policy, Vol. 11, 222-240.
- Directive 1999/44/EC of the European Parliament and of the Council of 25 May 1999 on certain aspects of the sale of consumer goods and associated guarantees, OJ L 171, 7.7.1999., p. 12–16.
- Directive 2011/7/EU of the European Parliament and of the Council of 16 February 2011 on combating late payment in commercial transactions, OJ L 48, 23.2.2011., p. 1–10.
- Djordjevic, M. (2011) in Kröll, S., Mistelis, L. and Viscasillas, P. P. (eds.), *UN Convention on Contracts for the International Sale of Goods (CISG)*, C. H. Beck/Hart/Nomos, München.
- Draškić, M. (1983), *Ugovor o franšizingu*, Institut društvenih nauka, Centar za pravna i politološka istraživanja, Beograd
- Eurobarometer survey on European contract law in business-to-business transactions (2011), Flash EB # 320, available at: http://ec.europa.eu/public_opinion/flash/fl_320_en.pdf.
- European Code of Ethics for Franchising, available at: <http://www.eff-franchise.com/spip.php?rubrique13>
- European Parliament resolution on the approximation of the civil and commercial law of the Member States of 15 November 2001, OJ No. C 140 E of 13 June 2002, p. 538.
- Ferrari, F. (2004), *Unification of sales law: do regions matter?*, International Business Law Journal, Vol. 4, 445-459.
- Ferrier, D. (2001), *La politique d'harmonisation des contrats de distribution en Europe*, in *L'harmonisation du droit des contrats en Europe*, Economica, 83-95.
- Fitness Equipment case, CISG case no. 281, Oberlandesgericht (Provincial Court of Appeal) München, 9 July 1997, available at: <http://cisgw3.law.pace.edu/cases/970709g2.html>.
- Forklifts case, CISG case online no. 208, OLG München, 22 September 1995, available at: <http://cisgw3.law.pace.edu/cases/950922g1.html>.
- Gemet-Pol, F.J. (1997), *Franchise agreements within the European Community*, Transnational Publishers, New York.
- Goldštajn, A. (1991), *Trgovačko ugovorno pravo – Međunarodno i komparativno*, Narodne novine, Zagreb
- Guidelines on Vertical Restraints, OJ C 130, 19.5.2010., p. 1.
- Hesselink, M. W. (2012), *How to Opt into the Common European Sales Law? Brief Comments on the Commissions Proposal for a Regulation*, European review of Private Law, Vol. 1, 195-212.
- Hesselink, M. W. et.al (2006), *Commercial Agency, Franchise and Distribution Contracts (PEL CAFDC)*, Sellier/Bruylant/Staempfli
- Hofmann, N. (2010), *Interpretation rules and good faith as obstacles to the UK's ratification of the CISG and to the harmonization of contract law in Europe*, Pace International Law Review, Vol. 22, 145-181.
- Honnold, J. O. and Flechtner, H.M. (ed.) (2009), *Uniform Law of International Sales under the 1980 United Nations Convention*, Kluwer Law International, Alphen aan den Rijn.

- Horak, H. (2005), *Ugovori o distribuciji u pravu i poslovnoj praksi Hrvatske i EU*, Sinergija, Zagreb
- ICC Arbitration Case no. 11849 of 2003, available at: <http://cisgw3.law.pace.edu/cases/031849i1.html>.
- ICC Arbitration Case no. 8817 of 1997, available at: <http://cisgw3.law.pace.edu/cases/978817i1.html>.
- Kornet, N. (2012), *The Common European Sales Law and the CISG – Complicating or simplifying the Legal Environment*, Maastricht European Private Law Institute Working Paper 2012/4. available at SSRN: <http://ssrn.com/abstract=2012310> or <http://dx.doi.org/10.2139/ssrn.2012310>.
- Lawn Mower Engines case, CISG case online no. 201, *Oberlandesgericht Düsseldorf* (Germany), 11 July 1996, available at: <http://cisgw3.law.pace.edu/cases/960711g1.html>.
- Leather Goods case, CISG case online no. 282, *Oberlandesgericht* (Provincial Court of Appeal) München, 9 July 1997, available at: <http://cisgw3.law.pace.edu/cases/970709g1.html>.
- Lookofsky, J. M. (2008), *Understanding the CISG in the USA: A compact Guide to the 1980 United Nations Convention on the Contracts for the International Sale of Goods*, Kluwer Law International, Alphen aan den Rijn.
- Magnus, U. (ed.) (2012), *CISG vs. Regional Sales Law Unification, With a Focus on the New Common European Sales Law*, Sellier European Law Publishers, Munich
- Magnus, U. (2012), *CISG and CESL*, Max Planck Private Law Research Paper No. 12/27, available at: <http://ssrn.com/abstract=2165758>.
- Manufactured goods case, CISG case online no. 1314, *Corte Suprema di Cassazione* (Italy), 14 December 1999, available at: <http://www.unilex.info/case.cfm?pid=1&do=case&id=390&step=FullText>.
- Metallurgical sand case, CISG case online no. 1399, *Supreme Court Poland*, 27 January 2006, available at: <http://www.unilex.info/case.cfm?pid=1&do=case&id=1129&step=FullText>.
- Milenković, T. (1997), *Pravna priroda ugovora o franšizingu*, *Pravni život*, Vol. 46, No. 11, 271-280.
- Mišćenić, E. (2012), *Europsko ugovorno pravo na putu od soft prema hard law, Osvrt na opcionalno zajedničko europsko pravo prodaje (CESL)*, *Zbornik Pravnog fakulteta Sveučilišta u Rijeci*, Vol. 33, No. 2, 695-745
- Mlikotin-Tomić, D. (1986), *Ugovor o franchisingu*, *Informator*, Zagreb
- Moss, S. (2005), *Why the United Kingdom Has Not Ratified the CISG*, *Journal of Law and Commerce*, Vol. 25, 483-485.
- Newhouse, A. and Tsuneyoshi, T. (2012), *CISG- A Tool for Globalization (1): American and Japanese Perspectives*, *Ritsumeikan Law Review*, No. 29, 1-41.
- Nikolova, S. (2012), *UK's Ratification of the CISG – An Old Debate or a New Hope for the Economy of the UK on Its Way Out of the Recession: The Potential Impact of the CISG on the UK's SME*, Vol. 3, 70-110.
- Orgalime comments on the Commission Green paper on policy options for progressing towards a European Contract Law – Comm (2010) 348, Brussels, 31 January 2011, available at: http://ec.europa.eu/justice/news/consulting_public/0052/contributions/270_en.pdf.
- Pražetina, R. (2006), *Ugovor o franchisingu*, *Računovodstvo i financije*, No. 5, 115-120.
- Principles, Definitions and Model Rules of European Private Law, Draft Common Frame of Reference, Outline Edition, prepared by Study Group on a European Civil Code and The Research Group on EC Private Law (Acquis Group), http://ec.europa.eu/justice/contract/files/european-private-law_en.pdf, last visited 11 July 2012.
- Pronuptia de Paris v. Schillgallis (Case 161/84, decided 29 January 1986) [1986] ECR 353
- Proposal for a Regulation of the European Parliament and of the Council on a Common European Sales Law, COM(2011) 635 final, Brussels, 11. 10. 2011.
- Regulation on block exemption granted to agreements on distribution and servicing motor vehicles, Official Gazette of the Republic of Croatia, No. 37/11

- Regulation on block exemption granted to certain categories of vertical agreements, Official Gazette of the Republic of Croatia, No. 37/11
- Savatier, R. et.al (1967), *Droit des affaires*, Paris
- Schlechtriem, P. (2001), *Uniform Sales Law in the Decisions of the Bundesgerichtshof, 50 years of the Bundesgerichtshof, A Celebration anthology from the Academic Community*, translated on English by Fox, T. J., available at: <http://www.cisg.law.pace.edu/cisg/biblio/schlechtriem3.html>.
- Schlechtriem, P. and Butler, P. (2009), *UN Law on International Sales: The UN Convention on the International Sale of Goods*, Springer, Heidelberg.
- Schlechtriem, P. and Schwenzler, I. (2010), *Commentary on the UN Convention on the International Sale of Goods (CISG)*, Oxford University Press, London.
- Schroeter, U. G. (2009), *Global Uniform Sales Law-With a European Twist? CISG Interaction with EU Law*, *Vindobona Journal of International Commercial Law & Arbitration*, Vol. 13, 179-195.
- „Singapore – WIPO Regional Workshop on the Role of Intellectual Property in enhancing competitiveness and growth of small and medium-sized enterprises in the franchising sector“, Singapore, September 18-21, 2007.
- Spagnolo, L. (2009), *A Glimpse through the Kaleidoscope: Choices of Law and the CISG (Kaleidoscope Part I)*, *Vindobona Journal of International Commercial Law & Arbitration*, Vol. 13, 135-156.
- UNCITRAL database, <http://www.uncitral.org>.
- UNIDROIT Model Franchise Disclosure Law, 2002, available at: <http://www.unidroit.org/english/modellaws/2002franchise/2002modellaw-e.pdf>
- United Nations Convention on Contracts for the International Sale of Goods (CISG), 1980.
- Vukmir, B. (2000), *Franchising*, *Pravo i porezi*, No. 5, 10-18.
- Zimmermann, R. (2005), *The New German Law of Obligations, Historical and Comparative Perspective*, Oxford University Press, London.

Edita Čulinović Herc

University of Rijeka, Faculty of Law, Rijeka, Croatia

Nikolina Grković

University of Rijeka, Faculty of Law, Rijeka, Croatia

IMPACT OF THE MADOFF SCANDAL ON THE FORTHCOMING UCITS V DIRECTIVE

Bernard Madoff's Ponzi scheme began to unravel in December 2008 when the general market downturn accelerated. Since then, investors of so-called "Madoff feeder funds" have brought large number of legal actions against funds and their custodians in various jurisdictions. Managers of these funds, as well as their depositaries delegated their duties to Madoff's BLMIS which has, contrary to European rules (the UCITS Directive), led to the accumulation of their functions. None of that was mentioned in the fund's prospectus nor reported to the competent authorities. The scandal has had a huge impact on the EU mutual fund market. Namely diverging regulatory approaches in national laws of EU member states and have opened political debates, especially between Luxembourg and France. This article presents an analysis of pre-Madoff UCITS regulatory framework and efforts of investors of Luxalpha SICAV and Thema fund in pursuing their claims before Luxembourg, French, Italian and Irish courts focusing on liability of depositary. As a result, new proposal (UCITS V Directive) has been made and its solutions are also addressed in this article.

Keywords: *Madoff, UCITS funds, investor protection, liability of depositary, compensation of damages, UCITS V*

JEL classification: *G15, G18*

1. INTRODUCTION

Although the UCITS acronym (Undertakings for collective investment in transferable securities) has developed into a strong brand recognized not only in Europe, but also in Asia and South America, recent Madoff investment scandal has seriously threatened to jeopardise investor's confidence in the UCITS label. Namely, the Madoff affair has not just claimed its victims among banks and few wealthy "high-net-worth" individuals, but has also damaged small retail investors which invested in order to accumulate savings or retirement benefits. Their investment decision was mostly based on confidence in UCITS legislation which proclaims high level of protection for retail investors recognizing them as a much more vulnerable group than professional investors. Nevertheless, it appeared not to be flexible enough to recent trends in mutual market sector. Since the emergence of scandal, investors in so-called "Madoff feeder funds" have brought large number of legal actions against funds and their custodians in

various jurisdictions including (among others) Luxembourg, France, Ireland and Italy. Those proceedings have pointed out disparate regulatory approaches in national laws of EU member states and the weaknesses of UCITS legislation, namely a lack of clarity in defining depositary duties, uncertainty regarding the depositary liability regime and silence in relation to risks associated with the delegation of depositary duties. Although approximately same areas were previously identified as areas where improvements should be made, significant effort in that regard was made in 2009 in direct response to Madoff scandal when the Commission launched a first public consultation on these issues. In 2011 AIFM Directive (which covers investments products mainly structured for professional investors) included detailed provisions on depositary duties and liability, creating a situation where retail investors had lower level of protection than the professional investors. Finally, in July 2012 the European Commission adopted a proposal for a 'UCITS V' Directive (UCITS V Proposal) amending provisions on depositary functions.

2. PRE-MADOFF UCITS FRAMEWORK

UCITS funds were introduced in 1985 when first UCITS Directive was adopted, followed by subsequent reforms in 2001 (UCITS III – Management Directive and Product Directive) and 2009 (UCITS IV). As opposed to alternative investment funds, UCITS funds are collective investments schemes aimed at retail investors and therefore have several specific characteristics introduced by UCITS Directives in order to ensure higher level of investor protection. UCITS fund raises capital from the public, operates on the principle of risk spreading and may invest only in transferable securities or other liquid financial assets (art. 1.2.a UCITS IV). What is more important, its units are redeemable at the request of the unit-holders (art. 1.2.b UCITS IV).

The fund itself may take different legal forms as it may be established in contractual form (common fund) or as an investment company (usually SICAV, i.e. a company with variable capital) (art. 2.b UCITS IV). As to prevent possible fraud or conflicts of interest, a clear distinction is made between **management and custody functions**. On the one hand, management company is in charge of managing the fund and making investment decisions, while custodian's core task is to safe-keep the assets of fund (art. 22.1 UCITS IV) though it also acts as a 'legal conscience' of the fund (monitoring duties) in relation to funds transactions, calculating the net asset value of the units, etc (art. 22.3 UCITS IV). Both management company and depositary are independent of the fund. In addition, a typical UCITS fund uses several other service providers such as: brokers (to execute the trades), a fund administrator (to calculate the value of the fund's investments) and other entities which act as a promoter and a distributor of the units. Although all those subjects are (due to the nature of investment business) obliged to work together, it is recognized that they should be independent of each other and their functions should be strictly separated. Specifically, no company can at the same time act as management company and depositary (art. 25.1 UCITS IV). Also, both the management company and the depositary are obliged to 'act independently and solely in the interest of the unit-holders' (art. 25.2. UCITS IV). Although depositary is not in a contractual relationship with the investors (but with management company), it still has

a fiduciary duty to act in the interest of the investors. Also, UCITS's assets are segregated from the assets of both depositary and manager.

Although a role of **independent depositary** seems to be one of the essential cornerstones of investor protection, UCITS depositary rules mostly have not been changed since 1985 (Impact assessment, 2012:61), while financial market and other UCITS rules did change. Namely, UCITS III Product Directive expanded the assets eligible for inclusion in the UCITS portfolio and UCITS IV extended management company's activities cross border, adjusting UCITS fund to the global nature of the financial market. Due to those changes, depositaries often rely on a network of local **sub-custodians** (their subsidiary or independent entity) in order to settle a fund's transactions. Not only that the necessity to appoint sub-custodians increases, but sometimes recourse to a local custodian becomes mandatory since local rules mandate local custody (Impact assessment, 2012:17). Of course, **delegation** of functions additionally complicates the issue of liability in the case of loss of financial instruments.

3. MADOFF SCANDAL AND EUROPEAN MUTUAL FUND INDUSTRY

In 2008 general market downturn accelerated and one scandal in particular affected mutual fund industry. Successful American financier and former president of NASDAQ Bernard Madoff was arrested, prosecuted for 11 federal felonies (securities fraud, money laundering, false statements, investment adviser fraud...) and finally sentenced to 150 years in prison (USA v. Bernard L. Madoff). The news came as a surprise since Madoff was a high-repute market maker, broker dealer and investment adviser whose Wall Street firm Bernard L. Madoff Investment Securities LLC (BLMIS) had remarkable results even during the collapse of mortgage market. He claimed high returns for investors (Clauss et.al, 2009:4) explaining it as a result of three-part "split strike conversion" investment strategy, but has never shared his calculations for determining when to buy or sell considering it proprietary (USA v. Bernard L. Madoff). What at first seemed as professional financial success was later revealed as a giant Ponzi scheme. Madoff had actually never invested client's money, but has rather deposited it on the bank account and used new investments to pay the previous clients requests. The scheme was supported by computer operations and ex post analysis of market (USA v. Frank DiPascali).

In order to keep the scheme alive, Madoff needed a constant flow of 'fresh money'. In that regard, he used so called **feeder funds** i.e. investment funds that make almost all of its investments to master fund (master-feeder relationship) allowing asset managers (of master funds) to capture the efficiencies of larger pools of assets. At first he focused on large hedge funds which were less regulated, charged higher management, performance and withdrawal fees and were available only to professional investors. Nevertheless, he expanded his business to European UCITS funds (Luxembourg based Luxalpha SICAV, Thema fund domiciled in Ireland, etc.) influencing European retail investors as well. Some authors are of opinion that the main contributor to the Madoff's default is entering in UCITS format (Clauss et.al, 2009:12). Custodians of these funds (which at the same time acted as fund's promoters and distributors) were large

international banks (UBS, HSBC, etc.) which delegated their custody of funds' asset to BLMIS. At the same time, fund's managers also delegated their duties to BLMIS (Assignment Luxalpha, 2009:14, Clauss et.al, 2009:6) creating a situation where independence rule is seriously endangered which usually raises serious concerns in the due diligence process. BLMIS consequently acted as a broker, a fund manager and the custodian of the abovementioned funds. None of that was reported to national authorities (CSSF Press Release, 2009) nor disclosed in funds' prospectus (Luxalpha prospectus, 2008).

Following the revelation of Ponzi scheme and Madoff's arrest, (European) investors suffered high losses of their investments and some funds were liquidated. The US District Court in New York appointed Attorney Irving Picard (Trustee) (SEC vs. Bernard Madoff and BLMIS) to marshal assets of Madoff and BLMIS and to assemble the largest customer fund and general estate possible in order to compensate BLMIS customers and creditors. As BLMIS was SEC (Securities and Exchange Commission) registered broker-dealer and investment adviser (from the beginning of 2006), according to the Securities Investor Protection Act of 1970, it was a member of SIPC. Nevertheless, only direct investors (those who had an account with BLMIS) could claim such compensation, while European investors in 'Madoff feeder funds' were considered **indirect investors** and were therefore deprived of such compensation and any direct payouts from the Madoff estate (Kruse et al. v. SIPC et al.). At the same time Trustee filed lawsuits before court of New York against feeder funds and their depositaries to recover the transfers that could (pursuant to Bankruptcy Code) be declared avoidable (claw back actions) also seeking compensation and punitive damages (common law claims) alleging those entities have assisted the fraud by lending its name to the feeder funds in order to attract the investors and by delegating its functions to BLMIS (In re Optimal Securities Litigation, etc.). Consequently, European investors have taken numerous legal actions against fund and their depositaries before American and European courts. Following the example of one bank which have settled with investors, certain Thema fund investors have tried to settle with depositary bank (HSBC) before the New York Court but were refused by Court on *forum non conveniens* grounds (Herald, Primeo and Thema Securities Litigation). Simultaneously, fund liquidators filed actions against depositary banks. After the decision of New York Southern District Court in July 2011¹ (Picard v. HSBC Bank Plc, et al.) the bank's liability (both in a role of depositary and promoter), UCITS legal framework and its implementation in EU member states were put under the magnifying glass and provoked serious debates.

4. DIVERGING IMPLEMENTATION OF UCITS FRAMEWORK

A discussion on the obligations and liability of depositary focused mainly on Luxembourg and French regimes since those countries represent a major part of the EU UCITS industry (EFAMA report 2010). In this context, objections were made that Luxembourg is building its leading position in the EU mutual fund industry by

¹ The Court found that Trustee does not have a legal standing to pursue common-law claims against HSBC entities.

unloosing the regulatory framework. On the other hand, strict French approach was also object of numerous critics implying that the rules on depositary are interpreted too extensively what differentiate France from other EU member states and consequently reduces its the competitive position (Maffei, 2011:48,52). This eventually led to the French finance minister's inquiry to EU Commission on the uncertainties of depositary's liability regime (in particular in the case of delegation) arising from the UCITS reference to the national law of the UCITS home member state (AMF Newsletter:2009).

4.1. French rules on depositary

In France UCITS Directives were implemented by provisions of the Monetary and Financial Code (MFC) and General regulation of AMF² (AMF RG). Depositary is responsible for safekeeping of fund's assets (art. L214-26 MFC) and has to return "the financial instruments entered into his books" (art. 322-4, 3 AMF RG). There is also a possibility of delegation of such a task to a third person by concluding a contract which should enable depositary to exercise control upon subcustodian (art. L323-14 AMF RG). Nevertheless, the same as provided in UCITS Directive, depositary's liability is not affected by the fact of delegation (art. 22.2 UCITS IV, art. L214-26 MFC). Additionally, depositary has also an obligation of permanent control of management company's actions which includes only control of legality (art. 323-5 AMF RG), but not 'contrôle d'opportunité'.

In case if one would assume that the combination of those provisions still leaves room for interpretation, recent decisions of the Commercial Division of the Supreme Court (rendered in 2010) on case concerning Lehman Brothers scandal (Société Générale decision, RBC Dexia Delta decision, RBC Dexia Laffite decision) have certainly confirmed **strict liability regime**.³ It is recognised that depositary has *even in the case of delegation of its custody duty*, an *absolute and immediate obligation to return the assets*. The court also referred to *public order* which 'aims to protect savings invested in financial instruments as well as all other investments rising from public offering and good functioning of the financial market.' In the same case, Court of Appeal has even came to conclusion that in the absence of contractual derogation of this restitution obligation in the MFC, any such contract derogation would not permitted (Société Générale decision).

4.2. Luxembourg rules on depositary

Luxembourg legislator has adopted UCITS Directives by implementing the Law of 20 December 2002 relating to Undertakings for Collective Investment (LUCI) and the Circular IML 91/75 amended by Circulars IML 03/188 and 05/177 of CSSF⁴. While LUCI simply reflects the provisions of UCITS Directives, Circular CSSF 91/75 specifies the role of depositary. It is noted that custody duty, as a general obligation of

² Autorité des Marchés Financiers is a French regulatory authority in the area of financial market.

³ UK Lehman Brothers was entrusted as a sub-custodian with assets of some alternative investment funds.

Although non-UCITS funds, the regulatory model was, in terms of depositary rules, similar to that of UCITS.

⁴ Commission de Surveillance du Sector Financier is Luxembourg national authority which regulates financial market.

a depositary "*should not be understood as conservation, but in the meaning of monitoring, which implies that depositary should at all time know how the assets of the fund have been invested and where and how these assets are available (fr. comment ces actifs sont disponibles)*" (Circular 91/75, 1991:24). This provision in fact transforms safe-keeping duty into a surveillance obligation while UCITS Directive considers monitoring duty as different and complementary to the duty of custody.

In case where safe-keeping duty was delegated, the responsibility of depositary remains ('should not be affected') (art. 17(4), 34(2) LUCI). It is considered that depositary has satisfied his obligation if the third person is *honourable, competent and possesses sufficient means* (Circular 91/75, 1991:29). Also, in the context of delegation, the one who suffers any damage should prove unjustifiable failure to perform this surveillance duty (or its improper performance) and causal connection (Circular 91/75, 1991: 28). This solution was strongly criticized since, contrary to the idea of investor protection, puts the burden of proof to investor. The concept of UCITS funds is much closer to other two solutions: first one being retaining the obligation of means but shifting the burden of proof to depositary and second implies obligation of result (French model) (Riassetto, 2009:12).

Following the Madoff scandal, CSSF in its press release (27 May 2009) found that obligation of depositary to return the assets arises from the principles of civil law. Some authors have analysed custody duty in a sense of Civil Code dispositions relating to deposit, but came to the conclusion that even in that case there is no strict liability and is certainly not applicable to non materialized securities or terms contracts (Riassetto, 2009:3,4).

5. ACTIONS OF EU INVESTORS BEFORE NATIONAL COURTS

French and Luxembourg approaches have pointed out a fundamental difference between strict liability and negligence standard. As explained in CESR paper, *obligation of means* is 'obligation of depositary to devote appropriate resources and carry out appropriate due diligence so as to ensure safe-keeping of assets', while *obligation of result* is 'an obligation on the depositary to safe-keep assets and to reconstitute them in the case of loss' (CESAR's Mapping of duties, 2010:1). According to figures released by AMF, French investors have €500m of assets invested with Madoff, mainly through Luxembourg-based Luxalpha fund (whose depositary is UBS SA) and Ireland-based Thema fund (whose depositary is HSBC). Therefore, those French investors were faced with a liability standard less protective than the one in France.

Certain investor of Luxalpha filed an action before Luxembourg District Court against different fund's service providers (depositary UBS S.A., management company UBS Third Party Management Co., S.A., administrator UBS Fund Services S.A., and promoter UBS AG). This lawsuit specifically raised issue of **redress against the depositary**. UCITS Directive provides that "liability to unit-holders may be invoked directly or indirectly through the management company, *depending on the legal nature of the relationship between the depositary, the management company and the unit-holders*" (art. 24 UCITS IV). This provision applies in the case where fund has been

established as a common fund, while in relation to investment company (as Luxalpha SICAV) Directive refers to the national law of its home member state (art. 34 UCITS IV). Those provisions have been implemented in Luxembourg LUCI in art. 19 and 36. First one refers to common UCITS funds and provides indirect redress against the depositary. Namely, if management company does not act notwithstanding written summation of investor after a delay of three months, unit holder may directly question the liability of depositary. Second one only refers to Luxemburg law and is silent on possible direct or indirect redress against the depositary. The Court considered that art. 36 LUCI refers to the principles of the law of corporations and that the unitholders do not have the capacity to bring an action where the corporation has the sole right and title to that action. The only scenario where unitholders would have that capacity is a situation where they would prove to have suffered distinct harm in relation to the harm of SICAV. The higher court confirmed this decision in 2011.

After this decision the strategy of investors in pursuing their claims has changed. This can be seen from another two cases held before Luxembourg District Court related to alternative Madoff feeder fund (Rafaele, registered in the British Virgin Islands) for which bank acted as a depositary and **distributor**. Investors brought claims against bank, but in its role of a distributor of units. Investors argued that they would never opt for such risky investment and that *information given by the bank was misleading and contradictory*. The court ruled that investors should be compensated on the basis of loss opportunity and ordered bank to pay each client 30% of the amount their investment in the fund (Case No 126.443: 2011).

Since French investors in Luxalpha were discouraged by Luxembourg court ruling on the issue of redress against the depositary, one of them (Compagnie Lebon) brought an action against UBS AG before French Commercial Court. They argued that UBS AG engaged its quasi-delict liability by not informing the investors that BLIMS assured double delegation. In this case, **the issue of jurisdiction** of French Court emerged. Plaintiff alleged that French Court should have the jurisdiction in the present case on the basis of art. 5 para 3 of Lugano Convention which establishes special jurisdiction in matters relating to tort, delict or quasi-delict – in the courts for the place where the harmful event occurred or may occur. The latter term (the place where the harmful event occurred) is defined in accordance with *principle of ubiquity* and is to be understood as the place where the harmful event giving rise to the damage occurred and as the place where the damage occurred. In principle the choice between those two is on the plaintiff (Magnus, Malnikowski, 2007:191). French Court of Cassation found that *subscription of units* is, as the plaintiff supportively argued, 'original cause of this case'. Since it was made in Luxembourg, Court has ruled that there is no jurisdiction of French courts in this matter (Case No 10-24006:2011).

Similar case arose in 2011 before Italian courts in relation to Thema (SICAV) fond. Italian investor brought an action against Irish-based fund, Swiss-based promoter, and others Irish and Austrian-based fund's service providers claiming their liability on false fund's prospectus (Case No. 8034:2011). Since Italian law considers liability on false prospectus as part of delict liability, plaintiff has focused on proving numerous unlawful acts allegedly perpetrated by defendants. Italian Supreme Court ruled that according to art. 5 para 3 of Brussels Regulation (equivalent to art. 5 para 3 of Lugano

Convention) Italian courts have jurisdiction in the present case. It recognised that the place where the damage occurred is the account where financial instruments in non materialised form have been allocated. Since the account was opened in Italian bank, Court found that the damage occurred in Italy.

The aforementioned case is still before the Milan Court which has to ascertain the respective liabilities of defendants. While Italian Supreme Court was deciding on jurisdiction, more than 50 Thema fund investors sued Thema fund and HSBC entities before Irish High Court in Dublin. Court consolidated these proceedings (Kalix procedure, UBI Banca procedure, Thema procedure, AAprocedure) (Kalix Fund case). All plaintiffs alleged that in appointing BLMIS as sub-custodian, HSBC failed to carry out any or any adequate or appropriate check or due diligence or monitoring or supervision of the performance of BLMIS as sub-custodian of Thema Fund. There are also some issues specific for each proceeding which Court noted it will be important to discuss: what rights a non registered shareholder may assert issue of redress of shareholder against a depositary, breach of terms of the prospectus and breach of custodian agreement.

6. PROPOSAL UCITS V

The image of investors fighting to compensate their losses seriously threatened to reduce confidence and competitiveness of UCITS funds. The Commission therefore made an Impact Assessment and produced a Proposal on new UCITS V Directive in order to regain investors' trust. The Proposal introduces rules on eligibility to act as a UCITS custodian and affirms the principle of a single depositary (Art. 22§1). Latter principle ensures that the depositary has a view over all the assets of the UCITS and that, in the event that problem occurs, there is a single point of reference (Proposal, rec. 8). Since uncertainty regarding the liability regime arises from imprecision of depositary duties and the fact that UCITS IV Directive leaves it for national legislation to define the liability regime, the Proposal aims to set down a list of uniform rules harmonising the core safe-keeping and oversight functions of depositaries across the EU. The intention is to align the conditions in which the depositary's safe-keeping duties can be delegated to a sub-custodian in order to determine liability in the event of the loss of a financial instrument that is held in custody. Proposal also sheds a new light on the issue of redress against the depositary and transparency in a case of delegation of safe-keeping duties.

6.1. Depositary duties

In order to establish the "improper performance" of depositary obligations, it is necessary to have well-defined safe-keeping and supervisory duties. Although in 2006 it was considered that safekeeping function was practically harmonised and control function differs widely, Madoff scandal pointed out the importance of defining safe-keeping function as well, specially in the context of delegation.

6.1.1. Safe-keeping duties

Assets eligible for inclusion in the UCITS portfolio are increasing in number and complexity. Acknowledging the broad type of eligible asset, the Proposal recognises that safe-keeping duty depends on the characteristics of a financial instruments and can therefore be divided into **custody duties** and **asset monitoring duties** (art. 22 § 5).⁵ As for the latter, a **record-keeping and ownership verification requirement** applies.⁶ Aforementioned diversification of assets becomes significant in the light of the **strict duty to return lost assets** which only applies to financial instruments capable of being held in custody (Proposal, rec. 14).

6.1.2. Control duties

The Proposal sets a **uniform list of oversight duties** (art. 22 §3). As a 'legal conscience' of the UCITS depository has an obligation to ensure that all transactions (sales, redemptions, cancellation of units) are carried out in accordance with applicable national laws and ensure that the value of the units of the UCITS is calculated in accordance with the applicable national laws and the fund rules or the instruments of incorporation. While carrying out the instructions of the management company and ensuring that any consideration is remitted to the UCITS within the usual time limits depository must rely on applicable national laws and the fund rules or the instruments of incorporation. The same standard applies in ensuring that the income of the UCITS is applied in a proper manner. Nevertheless, all those duties were already have been prescribed by previous UCITS Directives (art. 22.3 UCITS IV). The only additional control duty consists responsibility **for the proper monitoring of the UCITS' cash flows** (art. 22 §4) in particular, for ensuring that investor money and cash belonging to the UCITS is booked correctly on accounts. In order to prevent fraudulent cash transfers, it should be required that no cash account associated with the fund's transactions should be opened without the depository's knowledge (art. 1.3.4. Proposal).

6.2. Delegation of safe-keeping

As previously mentioned, safe-keeping of UCITS assets usually requires the use of a network of sub-custodians. Proposal sets the **conditions** under which a delegation of either custody or record-keeping can take place (e.g., level of skill in selecting sub-custodian, intensity of ongoing monitoring of sub-custodian) and requires that the tasks are not delegated with the intention of avoiding the UCITS framework (art. 22 §7). In substance, delegation will need to be objectively justified and will be subject to strict requirements regarding the selection and appointment of the sub-custodian. The depository must monitor the sub-custodian on an ongoing basis. It is also required that the third party is subject to effective prudential regulation (including minimum capital

⁵ Namely, certain financial instruments are capable of being held in custody, such as financial instruments in bearer form and those that can be registered in a financial instruments account opened in depository's books. The latter are registerd within segregated accounts opened in the name of the UCITS or the management company acting on behalf of the sUCITS.

⁶ Transferable securities (e.g. equities, bonds or money market instruments) have to be held in custody while other assets (e.g., certain derivative contracts or individually negotiated partnerships in non-listed companies) can only be recorded in a position-keeping book.

requirements and the supervision in the jurisdiction concerned) and external periodic audit to ensure that the financial instruments are in its possession. The third party also needs to segregate the assets of the clients of the depositary from its own assets and from the assets of the depositary. In Art. 22(7) sub para 3 (a) Proposal set out a list of organisational tests the depositary has to meet. These conditions are to a very large extent similar to the equivalent provisions in Article 21(11) of the AIFMD, although one additional condition has been included in Article 22(7) sub paragraph 3 (e) requiring that: “in the event of insolvency of the third party, assets of a UCITS held by the third party in custody are unavailable for distribution among or realisation for the benefit of creditors of the third party”. There were some concerns expressed by financial industry in this regard. Namely, they considered that it would be challenging in non-EU jurisdictions for the depositary to determine with a 100 percent degree of certainty in advance of appointing a sub-custodian how the insolvency rules in the jurisdiction of that delegate might apply, which could effectively exclude UCITS from investing in certain jurisdictions.

As the Madoff case shed some light on the risks associated with the **use of local third country sub-custody networks**, the Proposal additionally sets the conditions in which, exceptionally, custody can be delegated to third country custodian who do not match these standards. Those rules are considered important as UCITS increasingly seek to invest in third country jurisdictions, primarily in East Asia (Hong Kong, China, Korea). In defining those conditions two elements were taken into consideration. First, it was recognised that although investments in emerging market can be seen as the fund's strategy, the additional risks also arise for the depositary that may lead to the loss of the fund's assets (Impact assessment, 2012:74). It include cases where local rules do not impose any segregation requirements so as to protect the fund's assets from being lost or where insolvency rules do not allow for the assets to be immediately identified, isolated and returned to their beneficial owner. Second, prohibition of delegation to a non-compliant depositary in a third country would bar investments in certain third-country jurisdictions where recourse to a local depositary is mandatory. Since Commission's survey on relevant custodians has identified only two jurisdictions where the local custodian does not require to fulfil the delegation requirements, it was decided to allow the delegation even in those jurisdictions, but under additional conditions (Impact Assessment, 2012: 35,36).

Therefore, where the law of a third country requires that certain financial instruments be held in custody by a local entity and no local entities satisfy the delegation requirements, the depositary may delegate its functions to such a local entity *only where the investors of the relevant UCITS are (prior to their investment) duly informed that such delegation is required due to legal constraints in the law of the third country and if UCITS (or the management company on behalf of the UCITS) have instructed the depositary to delegate the custody of such financial instruments to such a local entity* (Proposal, 2012:22).

6.3. Liability standard

According to pre-Madoff UCITS legal framework, liability for loss of a financial instrument that is held in custody arises in case of **'unjustifiable failure to perform**

obligations' or 'improper performance' of these duties (art. 24 UCITS IV). These terms have given rise to different interpretations in the member states and thus differences in investor protection.

As highlighted in recital 7 of the Proposal, there was a need to clarify the liability of depositaries in cases **UCITS assets are lost in custody**, but also in the case of **depositaries' improper performance of their oversight duties**. The second public consultation confirmed the shared opinion among regulators and industry practitioners that a "loss" of assets should be understood as "a situation where the entrusted assets are permanently and irretrievably no longer available to the custodian and that rights over them are therefore no longer exercisable" (Impact assesment, 2012:190).

As for **the loss of assets**, UCITS V imposes **strict liability standard**. According to art. 24 the depositary is liable to return a financial instrument of the identical type or of the corresponding amount to the UCITS, without undue delay. No further discharge of liability in case of loss of assets is possible (art. 24. 3. and 4.), except where the depositary is able to prove that the loss is due to an **"external event beyond its reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary"**. In this context, a depositary should not be able to rely on internal situations such as a fraudulent act by an employee to discharge itself of liability (Proposal, rec. 22). Also, according to Article 24(2) of the Proposal, the depositary does not escape potential liability for loss simply by delegating the duty of custody.

Most representatives of the mutual fund industry considered it important to maintain wording relating to 'unjustifiable failure' pointing out that imposing a stricter liability standard is very likely to result in higher costs being borne by final investors. Commission find that there is no clear correlation between the level of liability and the amount of depositary costs (Impact assesment,2012:39).

As for other situation, the Proposal imposes **negligence standard** (art. 1.5). Improper performance may result in the loss of assets but also in the loss of the value of assets, if, for example, a depositary "tolerated investments that were not compliant with fund rules, while exposing the investor to unexpected or anticipated risks" [Proposal, rec.7].

6.4. Redress against the depositary

The aforementioned case held before Luxembourg court indicated different level of protection for investors of UCITS in contractual form as opposed to investors of UCITS in company form. The right for investors to invoke claims directly or indirectly depended on the legal nature of the relationship between the depositary, the management company and the unit holders. The Proposal, as opposed to AIFMD, aims to provide same level of protection, irrespective of the legal form that a UCITS fund takes (art. 24(5), rec. 23).

6.5. Transparency requirements

As seen in Madoff related cases held before French, Italian and Irish courts, investors were complaining that none of the delegation arrangements were disclosed in prospectus. Luxembourg law did not formally require the disclosure of depositary delegation neither to CSSF nor to the investors (Riassetto, 2009:9). The Proposal, therefore, also regulates disclosure of the depositary network and sub-custodians in the prospectus. According to para 2.2 of the Annex to the Proposal the prospectus of a UCITS must contain, inter alia, “a description of any safe-keeping functions delegated by the depositary, the identification of the delegate and any conflicts of interest that may arise from such delegation”. Article 23.1(f) of the AIFMD contains a similar disclosure requirement, but with the distinction that the AIFMD stipulates that this information must not be necessarily contained in the prospectus.

7. CONCLUSION

Although division between management and custody duty as well as segregation of the assets the fund, management company and depositary were considered to be a crucial pillars of investor protection, UCITS legal framework appeared not to be flexible enough to recent developments of the mutual fund market. Since the investment fund industry is a vital part of the EU financial sector, one could criticize that Commission's Proposal should have been made sooner, in order to prevent any bypass of liability by the means of double delegation. Allowing the delegation of depositary tasks without any conditions seemed to be too risky. In any case, the aligning of definition of depositary as well as liability regime and conditions of delegation was necessary in order to introduce depositary passport and to facilitate (even more) the cross border offer of UCITS units. This aim is considered to be achieved by forthcoming UCITS VI Directive.

Distinction between custody and recordkeeping tasks also recognises the split between (electronic) custody and recordkeeping, reflecting the trend toward dematerialised securities. The Commission is empowered to adopt measures specifying the conditions subject to which the depositary is able to exercise its custody duties over financial instruments registered with a central depositary. The only duty which can be delegated is safekeeping. In the case of delegation of custody, the strict liability regime applies. In any case there is no duty of depositary to control the opportunism of management company's decision. Although some objections have been made that obligation of result reforms the role of depositary into guarantor, Madoff affaire has pointed out the necessity of such a solution.

While the Proposal harmonises depositary liability and introduces a higher level of transparency, the issue of investor's redress against the depositary could, in some cases, at least be considered same as status quo. Namely, in the light of Luxembourg court ruling and the Proposal, the expected development in jurisdictions which allow establishment of UCITS in company form, will probably go in the direction of national principles of company law.

The Proposal is presented as part of legislative package composed of two others legislative proposals: a proposal for a regulation on key information documents for packaged retail investment products (PRIIPS) and a revision of the Insurance Mediation Directive (IMD).

REFERENCES

- Antonie Maffei, Controverse autor des obligations du depositaire, *Revue de droit Bancaire et Financier* – revue bimestrielle Lexis Nexis Jurisclasseur, Janvier-Février 2011, available at: http://www.depardieu.com/web/content/download/783/6193/file/110200_Revue%20droit%20bancaire%20et%20financier_Controverse%20autour%20des%20obligations%20du%20d%C3%A9positaire_AM.pdf, accessed: 15.03.2013.
- Asset Management in Europe: Facts and Figures, EFAMA's Third Annual Review, april 2010, available at: <http://www.efama.org/Publications/Statistics/Asset%20Management%20Report/Asset%20Management%20Report%202010.pdf>, accessed: 12.03.2013.
- Assignment devant le Tribunal d'Arrondissement de et à Luxembourg siégeant en matière commerciale suivant la procédure civile, available at: <http://www.victimefraudemadoff.org/images/Luxalpha%20assignment.pdf>, accessed: 15.03.2013.
- Case No. 8304, Cassazione Sez. Un. Civili, 08 april 2011, Italy, available at: www.ilcaso.it/giurisprudenza/archivio/5774.php, accessed: 18.03.2013.
- Case No. 10-24006, Cour de cassation, chambre commerciale, France, 12 July 2011, available at: <http://www.juricaf.org/arret/FRANCE-COURDECASSATION-20110712-1024006>, accessed: 14.03.2013.
- Circular IML 91/75 of CSSF, available at: <http://www.cssf.lu/en/laws-and-regulations/circulars/news-cat/44/>, accessed: 15.03.2013.
- CSSF Press Release on the Madoff case, 18 November 2009, available at: <http://www.cssf.lu/en/publications/press-releases/news-cat/73/>, accessed: 15.03.2013.
- CSSF Press Release on the Madoff case, 27 May 2009, available at: <http://www.cssf.lu/en/publications/press-releases/news-cat/73/>, accessed: 15.03.2013.
- Code Monétaire et Financier, Available at: http://www.legifrance.gouv.fr/affichCode.do;jsessionid=A34C103EF7FA3A7B9285F67DE4FEDD10.tpdjo04v_1?idSectionTA=LEGISCTA000006184596&cidTexte=LEGITEXT000006072026&dateTexte=20100521, accessed: 15.03.2013.
- Committee of European Securities Regulators: Mapping of duties and liabilities of UCITS depositaries, CESR/09-175, January 2010, available at: http://62.1.43.74/2Tomeis/UplFiles/10_175.pdf, accessed: 18.03.2013.
- Commission Staff Working Document, Impact Assessment accompanying the document Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions, available at: http://ec.europa.eu/internal_market/investment/docs/ucits-directive/20120703-impact-assessment_en.pdf, accessed: 13.03.2013.
- Council Regulation No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, OJ L 012, 16.01. 2000.
- Directive 2009/65/EC of the European Parliament and of the Council 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), available at: http://ec.europa.eu/internal_market/investment/docs/ucits-directive/directive_2009_65_ec_en.pdf, accessed: 11.03.2013.

- Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010, available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:174:0001:01:EN:PDF>, accessed: 11.03.2013.
- Directive 2001/107/EC of the European Parliament and of the Council of 21 January 2002 amending Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) with a view to regulating management companies and simplified prospectuses, Official Journal L 041 , 13/02/2002 P. 0020 – 0034, available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32001L0107:EN:HTML>, accessed:11.03.2013.
- Directive 2001/108/EC of the European Parliament and of the Council of 21 January 2002 amending Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), with regard to investments of UCITS, Official Journal L 041 , 13/02/2002 P. 0035 – 0042, available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32001L0108:EN:HTML>, accessed: 11.03.2013.
- Financial Regulation newsletter, Special issue AMF annual conferenc 2009, available at: http://www.amf-france.org/documents/general/9265_1.pdf, accessed: 12.03.2013.
- In re Herald, Primeo and Thema securities litigation, United States District Court, Southern District of New York : 09 Civ. 289 (RMB), available at: http://securities.stanford.edu/1042/_01/2011128_r01x_0900289.pdf, accessed: 14.03.2013.
- Isabelle Riassetto, Delegation et gestion collective, 2009, available at: <http://www.philippelaw.eu/UploadDirectory/UserFiles/files/Compte-rendu%20-%20DELEGATION%20ET%20GESTION%20COLLECTIVE.pdf>, accessed: 15.03.2013.
- Kalix Fund v. HSBC International Services (Ireland) Limited [2009] IEHC 457, High Court of Ireland, available at: <http://ie.vlex.com/vid/kalix-fund-hsbc-institutional-servies-70533027>, accessed: 18.03.2013.
- Kruse et al v. Securities Investor Protection Corp et al, 2nd U.S. Circuit Court of Appeals, Nos. 12-410, 12-437, 12-483 and 12-529., available at: <http://www.madofftrustee.com/document/dockets/002881-bricklayersbrief12-410docket122.pdf>, accessed: 14.03.2013.
- Luxalpha SICAV, sales prospectus, 2008, available at: http://www.luxalphainliquidation.lu/pdf/informations/prospectus/complets/November_2008.pdf, accessed: 15.03.2013.
- Magnus, Ulrich, Makowski Peter, Brussels One regulation, 2007 by Sellier, available at: http://books.google.hr/books?id=AfvGAI_b7wYC&printsec=frontcover&source=gbs_ge_summary_r&ad=0#v=onepage&q&f=false, accessed: 18.03.2013.
- Opinion and Order, Picard v. HSBC Bank Plc, et al., No. 11-CV-763 (JSR), (S.D.N.Y.Jul. 28, 2011), available at: <http://law.justia.com/cases/federal/district-courts/new-york/nysdce/1:2011cv00763/374660/40>, accessed: 14.03.2013.
- Pierre Clauss, Thierry Roncalli, Guillaume Weisang, Risk Management Lessons from Madoff Fraud, available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1358086, accessed: 15.03.2013.
- Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions, available at: http://ec.europa.eu/internal_market/investment/docs/ucits-directive/20120703-proposal_en.pdf, accessed: 13.03.2013.
- SEC v. Bernard Madoff and BLMIS, 2008, United States District Court, Southern District of New York, Available at: <http://www.justice.gov/usao/nys/madoff/trusteeorder.pdf>, accessed: 15.03.2013.

- Société générale v. Day Trade Asset Management, et autres, Arrêt n°500 du 4 mai 2010 (09-14.187) - Cour de cassation , Chambre commerciale, financière et économique , available at: http://www.courdecassation.fr/publications_cour_26/arrets_publies_2986/chambre_commerciale_financiere_economique_3172/2010_3324/mai_3561/500_4_16219.html, accessed: 15.03.2013.
- Société RBC Dexia Investor services bank France v. Delta alternative management, et al., Arrêt n°497 du 4 mai 2010 (09-14.975) , Cour de cassation , Chambre commerciale, financière et économique , available at: http://www.courdecassation.fr/publications_cour_26/arrets_publies_2986/chambre_commerciale_financiere_economique_3172/2010_3324/mai_3561/497_4_16217.html, accessed: 15.03.2013.
- Tribunal d'arrondissement de Luxembourg, siégeant en matière commerciale, 8 juillet 2011, n°123.486 et 136.373, Bulletin Droit&Banque , extrait 50, 2012, Association Luxembourgeoise des Juristes de Droit Bancaire, available at: www.brucherlaw.lu/fileadmin/.../Bulletin_50_7.pdf, accessed: 14.03.2013.
- Tribunal d'arrondissement de Luxembourg, siégeant en matière commerciale, 19 octobre 2011, n°126.443, Bulletin Droit&Banque , extrait 50, 2012, Association Luxembourgeoise des Juristes de Droit Bancaire, available at: www.brucherlaw.lu/fileadmin/.../Bulletin_50_7.pdf , accessed: 14.03.2013.
- United States of America v. Bernard L. Madoff, 2009, United States District Court, Southern District of New York available at: <http://www.justice.gov/usao/nys/madoff/20090310criminalinfo.pdf>, accessed: 15.03.2013.
- United States of America v. Frank DiPascali, Jr., 2009, United States District Court, Southern District of New York , available at: <http://www.justice.gov/usao/nys/madoff/20090811dipascaliiinformationsigned.pdf>, accessed: 15.03.2013.
- Unnamed Petitioner v. UBS SA, UBS Third Party Management Co. SA, UBS Fund Services SA, UBS AG, 04 March 2010., available at: <http://www.justice.public.lu/fr/actualites/2010/03/luxalpha-recevabilite-qualite-actionnaire/index.html>, accessed: 13.03.2013., English version available at: <http://www.cicilycorbett.com/articles/LuxFinal.pdf>, accessed: 14.03.2013.
- Working Document of the Commission services , Consultation paper on the UCITS Depository function, available at: http://ec.europa.eu/internal_market/consultations/docs/2009/ucits/consultation_paper_en.pdf, accessed: 12.03. 2013.

SESSION III

WESTERN BALKANS;
TRADE,
COOPERATION AND
EU INTEGRATION
PERSPECTIVE

Jiří Dušek

College of European and Regional Studies, Ceske Budejovice, Czech Republic

Lubomír Pána

College of European and Regional Studies, Ceske Budejovice, Czech Republic

CURRENT SITUATION OF TURKEY'S ACCESSION TO THE EUROPEAN UNION

ABSTRACT

The European Union last expanded in 2007 when Romania and Bulgaria joined. However, this is by far not the end of the geographical expansion of the EU. Croatia, which is due to join the EU in 2013, will become the 28th state. Apart from that, there are 5 further candidate countries – Iceland, Macedonia, Montenegro, Serbia and Turkey, which is among the most problematic candidate countries.

This contribution focuses on an analysis of the current state of Turkey's accession into the EU in the context of historical, political and legal aspects. Also analyzed will be attitudes of EU citizens in Central Europe to the question of Turkey's accession into the EU, as well as the capacity of EU to accept new countries with varying levels of economic development, a different culture or even religion, including the potential revision of Copenhagen criteria. A follow-up analysis then outlines possible scenarios for future expansion of the EU, or more precisely, strategies for negotiations with Turkey, the results of which can have major influence on future expansion of the EU for countries in the Balkans or in the former Soviet Union. Also touched upon will be the area of economic migration from Turkey into EU countries, especially Germany, which has a negative past experience with so-called "Gastarbeiters" (guest workers). This experience can have an impact on future decision-making of EU leaders in the question of Turkey's integration into the EU.

Keywords: European Union, Schengen Area, Turkey, Turkey's accession to the EU

JEL classification: F150

1. INTRODUCTION

Although the year 2004 was a year of unprecedented expansion of the EU, its geographic expansion does not stop here. Bulgaria and Romania joined the EU on 1st January 2007 and Croatia is about to join on 1st July 2013. However, there are also other candidate countries... with different time horizons. The eastern expansion of the EU has shown that within the EU itself, this geographic expansion often comes with fear and resentment of citizens, especially in the old EU countries. Moreover, the

ability of the EU to absorb more countries is not unlimited and the joining of more and more countries with varying levels of economic development, a different culture or even religion prompts a lot of questions.

Concerns related to EU expansion are not new. They were already present before the eastern expansion of 2004. Up until 1995, the EU based all expansions only on detailed bilateral negotiations – no requirements were defined in advance. The only criterion for EU accession was geographic affiliation to Europe. Also, motivation to accept new members was often to a large degree political – this is especially true for Greece (1981), Spain and Portugal (1986), where membership in the European Community was supposed to help these countries to foster democracy which started to be built after the fall of dictatorships. However, when in the early 1990s the EU found itself face to face with strong interest to join the EU from the ex-communist countries of central and eastern Europe, it defined basic requirements which every country had to fulfil, in order to be able to join the EU. So-called Copenhagen Criteria were drawn up, which every country aspiring to join had to fulfill (Dušek, 2011).

The European Union Treaty says that EU membership can be applied for by any country which respects EU's democratic principles and commits to uphold them. More precisely, a country can join the EU only when it fulfils all requirements for membership (European Union, 2013):

- political – it has to have stable institutions ensuring democracy, a legal state and human rights,
- economic – it has to have a functioning market economy and ability to withstand competition pressures and market forces within the EU,
- legal – it has to adopt the valid legal system and jurisdiction of the EU – especially the major targets of political, economic and monetary union.

The whole process of expansion consists of 3 stages (all stages must be approved by all existing EU members):

- The country is offered a prospect of membership. This means that when a country is ready, it is awarded the status of a candidate country,
- The country gets the status of a candidate country for EU membership – this, however, does not automatically mean that formal negotiations will be started,
- Formal negotiations on membership are started with the candidate country. This process usually requires reforms leading to adoption of valid EU laws.

When negotiations and the related reforms are concluded to mutual satisfaction, the country can join the EU (again, this has to be approved by all existing member states). At the moment, the EU is offering the prospect of membership to 9 countries: Albania, Turkey, Iceland and all countries of former Yugoslavia (except Slovenia which already is an EU member). The status of a candidate country was given to these 5 countries: Turkey, Serbia, Former Yugoslav Republic of Macedonia, Iceland and Montenegro. Croatia should become an EU member state in the middle of 2013.

That Iceland or Montenegro will eventually become EU member states can be expected. However, whether Turkey will eventually join the EU cannot be predicted at this time. The relations between Turkey and the EU have historically been among the

most complicated. The membership of Turkey in the EU is to a large extent a question of identity of the EU. It has to decide whether it is above all an organisation based on certain values and the culture of the Christian-Jewish civilization, or whether it is only a supranational political and technocratic project which is open to every country situated in the area of geographic Europe which fulfils certain criteria (Pehe, 2004).

Modern Turkey was created on the foundations of the Ottoman Empire in 1923, when a republic was founded by Kemal Atatürk. The country was secularized and many reforms were introduced which brought Turkey closer to developed western Europe. Today, Turkey is a member of many significant world organisations – e.g. the UN; since 1949 it has been a member of the Council of Europe, in 1952 it became a member of NATO, and in 1961 it joined the Organization for Economic Cooperation and Development (OECD). At about this time, cooperation was also started with the European Economic Community – in 1959, Turkey applied for accession to the EEC. Four years later, the so-called Ankara Association Agreement was concluded between Turkey and the EEC and the first financial protocol was signed. In 1970, the Association Agreement was amended with the Supplementary and the Financial Protocols, which came into force in 1973 and it defines conditions for the functioning of a customs union. However, due to Turkish invasion into Cyprus, the customs union is only created more than 20 years later, in 1994. Turkey's application to join the EC was submitted 7 years earlier. The intensification of economic relations and determination to integrate Turkey into the EU culminated in 1999 when Turkey was awarded the status of a candidate country. The actual accession negotiations were not started until 2005 in a total of 35 negotiating chapters. 8 years later, in 2013, only one chapter has been closed (science and research) – the integration process is stagnating and the future prospects are unclear...

2. MATERIAL & METHODS

The contribution focuses on an analysis of the current state of Turkey's accession into the EU in the context of historical, political and legal aspects of the accession. In the practical part of the contribution, the very different opinions of EU citizens on the question of Turkey's accession to the EU will be pointed out – data will draw on primary sources on which the authors themselves worked, as well as on secondary sources. With the help of an analysis, possible scenarios for possible further integration of Turkey into the EU will be laid out in the final part of the contribution. The analysis done in the contribution is based on resources of the European Commission, the Ministry of Foreign Affairs of the Czech Republic, the Representative Office of the Czech Republic in Ankara and the CzechTrade agency. The main methods used in the article are analysis, description and comparison.

3. RESULTS AND DISCUSSION

The regional significance of Turkey is growing. It is helped by the stable internal political situation and strong economic growth, which stands in direct contrast to surrounding countries such as Greece, Iraq, Iran or Syria.

Lately, Turkey has been in the forefront of many international economic and political debates. On the one hand, despite the economic crisis engulfing neighbouring Europe, Turkey remains the second fastest growing economy in the world, second only to China. On the other hand, there is almost no topic of global agenda – from Iraq and Afghanistan to Somalia, Iran and the Arab Spring, from sustainable development to dialogue between civilizations where Turkey does not play a significant role. This is a relatively new phenomenon. Until 10 years ago, Turkey was not considered more than a loyal ally within NATO. This started to change in 2002 when a period of political stability started which gave birth to a vision of a stronger Turkey – and strong determination to turn this vision into reality (Gül, 2012). Despite this, Turkey's membership in the EU is still quite a distant prospect.

Debates about Turkey's possible accession into the EU have been going on for decades. Turkey officially applied in 1987, but it only acquired official status after the Helsinki Summit in 1999. The EU adhered to the pre-defined deadline of 3 October 2005 and started accession negotiations with Turkey. Until the last moment, Austria tried to ensure that the possible outcome of accession negotiations is not necessarily a full EU membership but possibly a certain form of affiliation instead. This failed to be pushed through. At that time, it was expected that the accession negotiations would last for about 10 years and would be concluded by the end of the programme period 2007-2013. Proponents of accepting Turkey into the EU were arguing with stabilization of Turkey's institutions and legal order and stronger position of EU's economy in the world. In their opinion, if Turkey fulfilled all requirements for accession, its accession could not be postponed. Accession into the EU would also be a form of reward for Turkey's long-standing membership of NATO and the progress in the area of human rights.

However, negotiations came to a deadlock... At the moment, almost half of the total of 35 chapters/negotiating topics is blocked by Cyprus, France or the whole EU. Unfortunately, this often includes key areas in which Turkey can offer a lot to the EU, such as external relations or the energy industry. At the beginning of 2013, the situation is dismal. From 35 chapters:

- 1 chapter is closed, 13 opened,
- 17 chapters blocked, out of which chapter 22 Regional Policy & Coordination of Structural Instruments was unblocked at the beginning of 2013.

Even at first sight simple areas such as education or culture can become problematic in debates between EU and Turkey if, e.g., equal access to education of both sexes is required (Beneš, 2006).

Although at the beginning, around the year 2005, it seemed that full membership is only a question of time, political changes in major EU countries made the negotiating position of Turkey more difficult. The socialist Gerhard Schröder was succeeded by the conservative Angela Merkel as German Chancellor in 2005, while Nicolas Sarkozy replaced Jacques Chirac in 2007. And although Nicolas Sarkozy was replaced by François Holland in 2012, the stance of France did not change and it still refuses any Turkish presence in the EU. Germany, meanwhile, pushes for a form of special partnership. Anti-Turkish and anti-islamic rhetoric is also increasingly often heard in

Austria and the Netherlands. On the other hand, Turkey has the support of Great Britain, Italy, Spain, the Scandinavian countries and the majority of new member states.

Gradually, the road of Turkey to Europe has been hampered by three obstacles. The first and the biggest is Cyprus, which joined the EU in 2004 with the eastern European countries. Kofi Annan, the Secretary-General of the United Nations at the time did the impossible to unite the island before its entry into the EU. In the follow-up referendum, however, it showed that whereas the Turkish Cypriots almost unanimously supported the unification, the local Greeks were against by the same majority. The crucial internal problem are skirmishes between a secular military organisation and the ruling Islamic AKP party. The threat of political upheaval has become almost a routine, as have Constitutional Court sessions which deal with political arguments on a daily basis. The high frequency of these events only strengthens Turkey's image as a country in political turmoil. The situation has also been complicated by the economic crisis. Deteriorating economy, fiscal problems in the eurozone and resistance to further immigration from new member states only confirmed the view that the central and eastern European countries joined the EU too soon, which naturally does not help further expansion of the 27-member club. Perhaps not surprisingly, EU membership of Turkey starts to lose support even among Turks themselves. In 2008, 68% approved of it, 27% were against. In 2010, entry into the EU was supported by only 54% of Turks, 40% were against. There are increasing and not fully unsubstantiated voices from Ankara that Europe needs Turkey increasingly more, whereas Turkey needs Europe less every day (Kopecká, 2010). This situation escalated in November of 2012 in the form of harsh statements and setting of an ultimatum by the Turkish prime minister Erdogan who announced on a visit to Germany that Turkey would only wait for EU membership until 2023 at the latest (the hundredth anniversary of the creation of the Turkish state) – after that, Turkey does not see its future in the EU.

However, Turkey probably does not fully realize the advantages connected with the status of an EU candidate country and with the prospect of possible integration. Thanks to good relations and support from Europe, Turkey has the status of a local hegemon. This brings with it an influx of direct foreign investments from the West, as well as the East. Any self-imposed isolation of Turkey or a turning of integration efforts towards the east would significantly damage Turkey and its economy. However, the current dragging of feet, when it comes to EU membership is also not optimal in the long run. The longer this lasts, the more will support of Turkey drop, not only within Turkey, but also in individual EU countries.

The territorial composition of Turkish foreign trade has been showing a significant share belonging to EU countries for many years. The trade link between Turkey and the EU is not only important in view of the customs union between these two countries, but also has a political dimension – it shows how Turkey is economically intertwined with the EU, although Turkish exports dropped by about 10% in the last 5 years and at the moment, only slightly over 30% of Turkish exports are exported into the EU. The reason behind this development is not only the economic crisis, but also the strained EU-Turkey relations, which got even worse in the second half of 2012 during the

Cyprus EU-presidency. Cyprus has had disputes with Turkey since 1974 when Cyprus was divided into the southern “Greek” and the northern “Turkish” part.

There is no question that Turkey and the EU need each other. According to Javier Solana, a former high representative of the EU for foreign and security policy and a former NATO secretary general, EU member states now represent 75 percent of foreign investments into Turkey and about a half of Turkish exports and the travel industry. On the other hand, energy security of Europe depends on cooperation with Turkey in the area of transport of oil and natural gas from Central Asia and the Middle East. The EU and Turkey also need each other politically. Membership of Turkey in the EU would bring many safety benefits and strategic advantages, starting from the bond between EU and NATO, of which Turkey has long been a member (Solana, 2011).

In 2010, the Bogazici University in Istanbul, together with the Spanish University of Granada did an opinion poll research in several European countries regarding accession of Turkey into the EU. 47% of respondents were in favour of Turkey joining the EU, the same percentage (47%) were against. Six percent of respondents did not express their opinion. If the same question was asked in a referendum, 52% of respondents would answer negatively. 41% would be in favour and 7% did not express their opinion. This discrepancy can be explained by the fact that in referendums, people usually prefer the status quo and hesitate with changes. The research was done in five European countries: Germany, Spain, France, Poland and Great Britain. Most people disagreeing with EU membership of Turkey were in France (64.4%), Germany (62%) and in Great Britain (46.3%). By contrast, 54.1% of people polled in Poland and 53.2% of people polled in Spain agreed with Turkey’s membership in the EU. Regarding arguments against EU membership of Turkey, most respondents (38.9%) chose the answer according to which Turkey is a Muslim country, which is incompatible with Europe’s Christian roots. Only 14.6% of respondents chose the answer that Turkey does not lie on the European continent. When asked whether it would be unfair to break off membership negotiations with Turkey, 58% said “yes”, 38% said “no” and 4% of respondents gave no answer (Yilmaz, 2010).

Research carried out by Andrea Erol in 2011 in cooperation with Jiří Dušek from College of European and Regional Studies in České Budějovice shows similar results. In the first half of 2011, an opinion poll on accession of Turkey into the EU was carried out in Austria on a representative sample of 100 Turks and 100 Austrians. The questions were answered by Turkish and Austrian citizens with permanent residency in Austria. All respondents were from the towns of Gmunden, Linz, Wels or Marchtrenk (Upper Austria).

**Table 1: Opinion poll results – „Accession of Turkey into the EU“
(carried out among Turkish and Austrian citizens in 2011)**

Statement	Austrians			Turks		
	yes	don't know	no	yes	don't know	no
Fear of EU membership of Turkey	93 %	0 %	7 %	27 %	0 %	73 %
Turkey is mainly an Asian country	62 %	0 %	38 %	39 %	0 %	61 %
EU membership of Turkey could have a negative impact on security in Europe	82 %	9 %	9 %	67 %	14 %	19 %
EU membership of Turkey could have a negative impact on employment, social and economic development in other EU countries	55 %	20 %	25 %	60 %	27 %	13 %
As an EU member, Turkey could set an example to neighbouring Islamic countries on a way to democracy	16 %	19 %	65 %	13 %	13 %	74 %
EU membership of Turkey would strengthen democracy in the country	50 %	13 %	37 %	30 %	12 %	58 %
EU membership of Turkey would enable other EU countries access to eastern markets	46 %	21 %	33 %	48 %	13 %	39 %
Do you agree with Turkey accessing the EU?	16 %	14 %	70 %	59 %	11 %	30 %

Perhaps not surprisingly, the results of the research exactly correspond with nationality of the respondents. Regarding the opinion on EU membership of Turkey, the negative stance of Austrians corresponds to the opinions of French and German citizens mentioned above, while more than half of Turkish citizens are in favour of EU membership of Turkey. It is true that Austria supports ambitious integration strategies for countries from western Balkans and southern Europe. When it comes to EU membership of Turkey, however, this country is still of the opinion that certain conditions must be fulfilled. Austria is known as one of the biggest opponents of Turkish entry into the EU, together with Germany. An important role plays a negative experience with so-called foreign guest workers – Gastarbeiters – and an un-integrated Turkish minority living in these two countries. Generally speaking, the Austrian public does not support further expansion of the EU, be it because of fears concerning crime or a loss of their economic well-being. Only the accession of Croatia and Iceland are viewed positively.

By joining the EU, Turkey could help Europe to increase competitiveness, contribute in the area of global security and help tackle diversity, with which current Europe is struggling (Král, 2007). However, there are many more arguments against EU membership of Turkey. Depending on author, these are the main problem areas:

- Islamic religion → the only Muslim country in the EU,
- integration of ca. 75-million Turkish community into a 500 million European Union → problem of a possible failure of a multicultural approach within EU,

- geopolitical factors → integration of Turkey would require a fundamental revision of European security policy due to borders with Iraq, Iran and Syria,
- the problem of human rights → despite major progress (e.g. the abolition of capital punishment), there are still significant differences compared to European standards,
- cultural problem → Christian and Orthodox Europe has common historical roots, while Turkish threat united European countries for centuries,
- the question of Cyprus → it is not possible to join the EU and at the same time not acknowledge and boycott one of the member states,
- problematic positions and slow progress of the negotiation process → between the years 2005-2013, only one chapter out of 35 has been closed, unwillingness to accept requirements of the EU,
- negative experience with Turkish minority in Central Europe → fear and nationalism in “old” EU countries,
- economic and financial impact of membership → according to current rules of EU regional policy, most EU transfers would have to be re-directed to Turkey as the poorest and the second most populous country in the EU,
- political consequences → second most populous country = very strong position in EU institutions, weakening of position of “old” EU countries,
- foreign policy → foreign policy is different from EU, good relations with Iran, bad relations with Israel etc.

4. CONCLUSION

In English, the European Union motto “In varietate concordia” means “United in diversity”. Although this motto is over 10 years old and the EU is still taking pride in it, one of the main reasons for rejecting EU membership of Turkey is its too big economic, political and cultural difference. Turkey started its journey into the EU in late 1950s and after more than 50 years, it is still not clear whether Turkey will ever be an EU member or not. According to the authors of this article, fatal mistake was made in the 1980s, when in 1987 Turkey made an application for accession into the EU, which was turned down two years later because of non-compliance with political and economic criteria. Already at that time, the European Community should have declared clearly whether Turkey will ever be able to become a full member or offer Turkey another alternative in the form of an associated country, a special partnership etc. If the application of Morocco could have been rejected in 1987, Turkey’s application could have been rejected too. The fact that this did not happen leads to current problematic relations when the final decision on EU membership of Turkey is being postponed under various pretences. Nevertheless, the EU will have to decide in the next ten years, whether and in which direction the EU should expand. Turkey has clearly declared its requirement for final solution by the year 2023, it will not wait longer and will resign on the receding prospect of integration.

At this moment, the entry of Croatia into the EU has been decided. Behind the door (besides Turkey) are another 4 candidate countries (Macedonia, Montenegro, Iceland, Serbia). Aside from Turkey, if the integration of the 4 above mentioned countries is completed, the integration process in the Balkans will be completed and the EU will

have to decide whether and in which direction it wants to expand further. There are several possibilities – Turkey, North Africa, Israel or former Soviet Union countries, from which the most serious candidate is the Ukraine – another big European country with 46 million people. It is necessary to ask the question whether the EU is economically able to integrate such two big countries in a relatively short period of time. In our opinion not... A possible attempt to integrate the Ukraine could also damage relations of the EU with Russia.

If Turkey manages to close all chapters of the negotiation process, it does not automatically mean an accession into the EU – this also has to be approved by individual member states. Austria, Germany and France have already hinted at the possibility of using a referendum, which would most likely reject Turkey's accession. This is confirmed by the results of various opinion polls. Acknowledgment of the EU after many years of negotiations that it is not ready for integration of Turkey and an offer of integration in the form of e.g. a member of the European Economic Area would be a correct way how to conclude the more than 50-year long effort to integrate Turkey into the EU. A direct rejection could lead to radicalization of Turkey and to anti-European sentiments, which is not in the interest of either party, especially when Turkey is striving to become a member of the United Nations Security Council for the period of 2015-2016 and in 2015 it will chair the G20 group (group of world's biggest economies). Possible integration of Turkey would no doubt be the biggest test of the EU in its history and European politicians will have a chance to prove whether Europe is truly united in diversity or not. Although the Czech representative Štefan Füle – the European Commissioner for Enlargement and European Neighbourhood Policy – strongly supports accession of Turkey into the EU after it meets all conditions, in the end it will not depend only on the closure of all 35 negotiating chapters, but also on the fact that European integration is not only an economic-technical act, but most of all a political decision!

REFERENCES

- Beneš, V. (2006), Evropská unie a Turecko: krize důvěry? In *Mezinárodní politika*, 11, 2006, 10-12.
- Dušek, J. (2011), *Historie a organizace Evropské unie*, Vysoká škola evropských a regionálních studií, České Budějovice.
- Gül, A. *Turecký prezident dává světu na srozuměnou: Toto je nový kurz naší země* [online]. Praha : MAFRA, 2012, 27.5.2012 [cit. 2013-02-24]. Available at WWW: <http://zpravy.idnes.cz/turecky-prezident-pise-toto-je-novy-kurz-nasi-zeme-f88-/kavarna.aspx?c=A120523_145935_kavarna_chu>.
- Kopecká, H. *Trnitá turecká cesta k evropským hvězdám* [online]. Praha : Vláda České republiky, 2010, 10.12.2010 [cit. 2013-02-24]. Available at WWW: <<https://www.euroskop.cz/9006/17954/clanek/trnita-turecka-cesta-k-evropskym-hvezdam/>>.
- Král, D. (2007), *Bulharsko, Rumunsko... a kdo dále? Perspektivy dalšího rozšíření Evropské unie ze strany nových členských zemí a čekatelů*, Europeum, Praha.
- Pehe, J. *Má se Turecko stát členem EU?* [online]. 2004 [cit. 2013-02-22]. Available at WWW: <<http://www.pehe.cz/zapisnik/2004/ma-se-turecko-stat-clenem-eu>>.
- Rozšiřování Unie* [online]. Brusel : European Union, 2013 [cit. 2013-02-22]. Available at WWW: <http://europa.eu/pol/enlarg/index_cs.htm>.

- Solana, J. *Existuje dost důvodů k tomu, aby Turecko bylo členem EU* [online]. Praha : MAFRA, 2011, 7.7.2011 [cit. 2013-02-24]. Available at WWW: <http://zpravy.idnes.cz/javier-solana-existuje-dost-duvodu-k-tomu-aby-turecko-bylo-clenem-eu-1gy-/kavarna.aspx?c=A110613_190153_kavarna_chu/>.
- Yilmaz, Y. *Evropané jsou v otázce vstupu Turecka do EU* [online]. Praha : Vláda České republiky, 2010, 25.1.2010 [cit. 2013-02-24]. Available at WWW: <<https://www.euroskop.cz/38/15191/clanek/evropane-jsou-v-otazce-vstupu-turecka-do-eu-rozdeleni/>>.

Nebojša Savić

University of Singidunum, Faculty of Economics, Finance and Administration, Novi Beograd, Serbia,

Goran Pitić

University of Singidunum, Faculty of Economics, Finance and Administration, Novi Beograd, Serbia,

Snežana Konjikušić

University of Singidunum, Faculty of Economics, Finance and Administration, Novi Beograd, Serbia,

COMPETITIVENESS OF WESTERN BALKANS IN THE PROCESS OF EU INTEGRATION

ABSTRACT

The aim of this paper is to determine competitiveness level of eight South East European countries (SEE-8) with special focus on Western Balkan Countries (WBs). Robust data base for all countries in analyzed period (2008 vs. 2012) was collected from World Competitiveness Report, Doing Business and IMF statistics. WBs as a region succeeded in slightly improving its competitiveness during the crisis, although it is still significantly lagging behind CEE. During the analyzed period, Western Balkans was exposed to strong shocks caused by a decline in FDI inflows, as well as a decline in exports and cross-border credits. The most significant competitive advantages of WBs lie in administrative, communication and innovation infrastructure. On the other hand, there are numerous disadvantages, primarily in logistical infrastructure and then in a part of administrative and innovation infrastructure. The WBs has a very favourable location and solid resources, but productivity in their use is low. Thus, in order to reduce the competitiveness gap it must: improve logistical infrastructure and a part of administrative infrastructure; eliminate weaknesses in doing business and corruption and eliminate market dominance.

Key words: *competitiveness, development, clusters, EU, Western Balkans, South Eastern Europe*

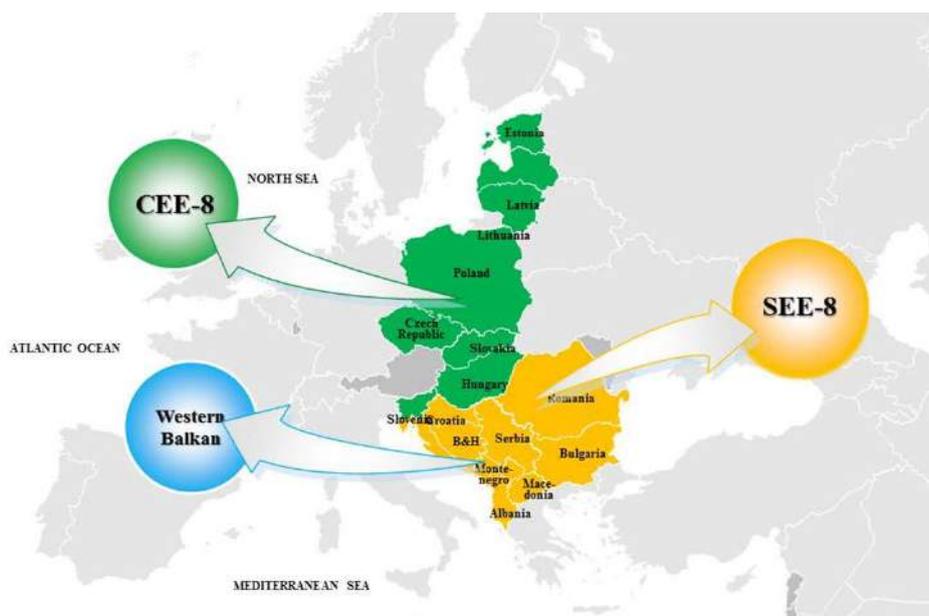
JEL classification: *F23, O14, O47, O57*

1. INTRODUCTION

The process of EU enlargement is closely associated with the countries of South East Europe (SEE). In this sense, the European integrations are set as a high priority for all countries of the European subregions. SEE group consists of eight countries - Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia (FYR), Montenegro, Romania

and Serbia (SEE-8). Within this group, there are the so-called Western Balkans countries (WBs) that include all of the above SEE-8 countries except Bulgaria and Romania (Figure 1).

Figure 1: East European Subregions – SEE-8 and CEE-8

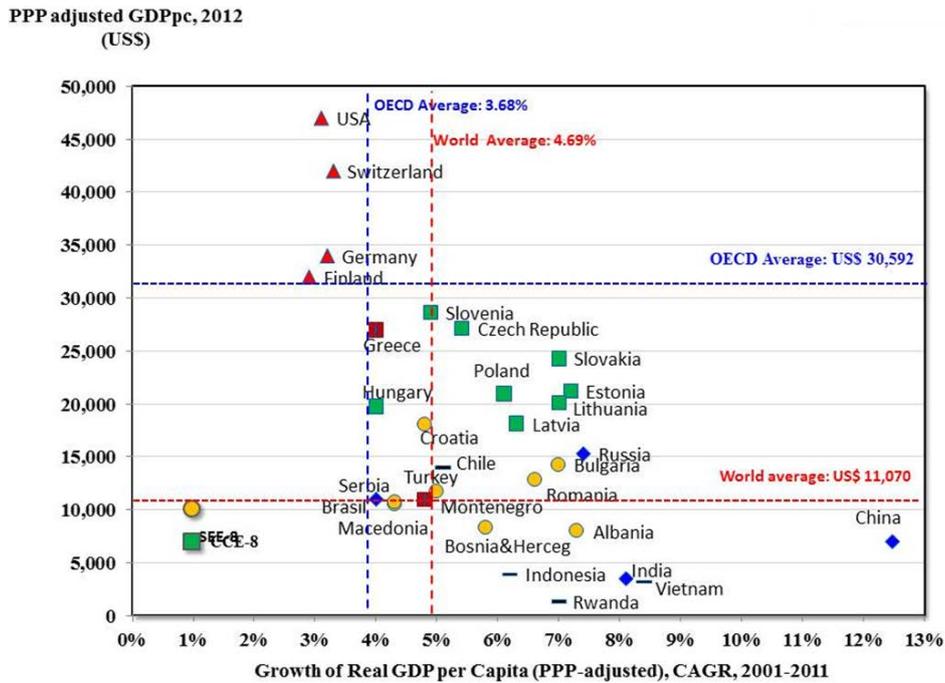


The SEE-8 countries, and in particular WBs, are exposed to a very harsh impact of the Great Depression with a series of negative effects on their development and prosperity. The aim of this study was to determine the competitive advantages and competitive disadvantages of WBs and the SEE-8. In the analysis of the competitiveness, we have used the New Global Competitiveness Index (NGCI) as a methodological basis of analysis of competitiveness.

2. LITERATURE REVIEW

The central issue of today's economic recovery is related to the level of competitiveness of the nations and regions. If the conditions of a certain location are attractive, whether it is a country or a sub-national region (such as SEE-8 or WBs), then the opportunities for the prosperity improvement will be greater. Commonly, the achieved level of prosperity is shown with the reached GDPpc ppp. Therefore, we have shown in Figure 2 the reached levels of GDPpc ppp and their rates of growth in the last ten years.

Figure 2: Prosperity Performance



In economic theory competitiveness depends on the long-term productivity with which a nation uses its human, capital and other national resources (Michael E. Porter, 2012, 6). Nations and regions compete to offer the most productive environment for business due to the fact that competitive businesses create rising incomes and good jobs.

Porter and his associates created a synthetic competitiveness index - New Global Competitiveness Index (NGCI) (Porter, Delgado, Ketels and Stern 2008), which is focused on the determinants of an economy's sustainable level of productivity. The aim of the NGCI is to identify the sources of productivity. Therefore, according to the NGCI (Porter, Delgado, Ketels, and Stern 2008, pp. 45-48), level of competitiveness of a country is determined by:

- Endowments (location, resources, institutions, market size), which create only a foundation for prosperity, since true prosperity is created by productivity in the use of endowments;
- Macroeconomic competitiveness, which sets the potential for high productivity, but is not sufficient, and
- Microeconomic competitiveness – productivity ultimately depends on improving the microeconomic capability of the economy and the sophistication of local competition.

M. Delgado, C. Ketels, M. Porter and S. Stern (2012) define foundational competitiveness by distinguishing between macroeconomic and microeconomic effects

on competitiveness, thus deepening the previously started NGCI analysis.

Macroeconomic factors exert influence on the conditions that enable a rise in productivity, but are not directly linked to the level of firms' productivity. These factors cover the following two components: (1) social infrastructure and political institutions (SIPI), including basic health and education, the quality of political institutions and the rule of law, and (2) monetary and fiscal policies (MFP), including the management of fiscal sustainability, debt level and short and medium-term inflation (Porter, M. 2012).

The microeconomic determinants of competitiveness are geared above all else toward an analysis of national business environment (NBE). That is an analysis of whether business regulation encourages or slows down investment and growth, what the organization and structure of economic activities are like, especially what local rivalry and the level of cluster development are like, as well as whether companies apply sophisticated business management practices (e.g. whether incentive pay is practiced...).

Productivity of firms depends most directly on the quality of their business environment, which is best perceived by using the Porter's diamond, as well as on the level of cluster development because clusters generate numerous external effects (Delgado, M, M. Porter and S. Stern, 2012a).

3. METHODOLOGY

In order to determine the degree of relationship between GDPpc ppp and competitiveness scores Savic, Pitic and Konjikusic (2013) argue that there was a strong direct relationship between GDPpc ppp and competitiveness scores. When considering SEE-8, one can observe a direct strong relationship, which becomes significantly weaker during The Great Recession period. Finally, the values of Spearman's correlation coefficient for CEE-8 countries (Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia) point to a direct yet not so strong relationship in 2008 and 2012.

We used Spearman's rank correlation coefficient and normalized data from World Economic Forum Global Competitiveness Report (2008, 2011 and 2012), World Bank Doing Business Report (2008, 2011 and 2012) and national statistical reports. Normalizing the data, scale is translated to the interval [0, 1]. We used One-Way ANOVA and Friedman tests with p-values analyzing GDPpc ppp and competitiveness ranks as well as NGCI methodology analyzing Porter's diamond for WBs and SEE-8.

The Friedman test is used in cases when the analyzed data were measured using an ordinal scale, while the One-Way ANOVA with Replication is applied when numerical data were measured using an interval scale. Our conclusion about the existence of a significant difference between the ranks of the perceived components is based on the p-value indicator as the output result of the Friedman test. As the null hypothesis of this test we perceived the claim that there were no statistically significant differences for a specified component in the perceived years.

We have also analyzed whether there was a significant difference among the ranks of competitiveness and GDPpc ppp for these groups of countries in 2008, 2011 and 2012.

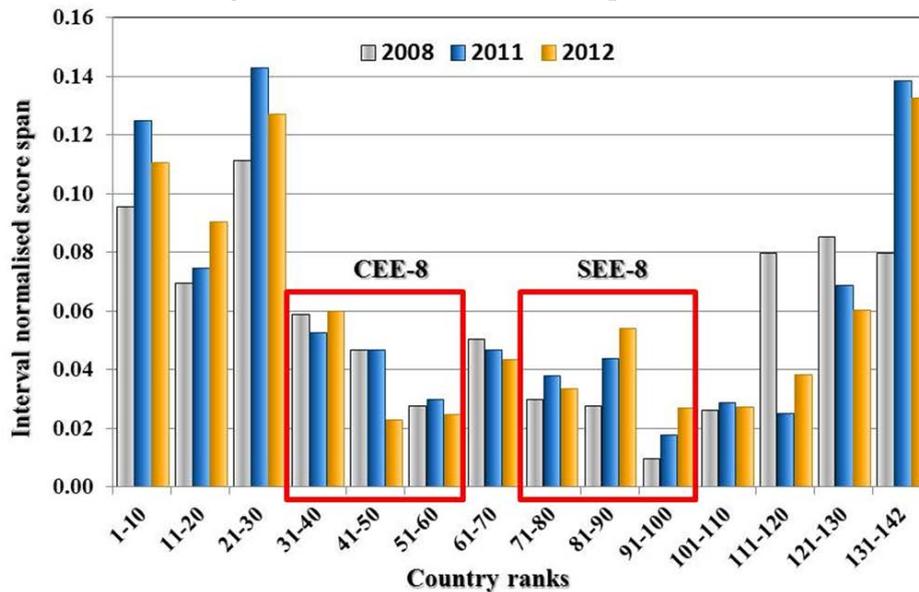
Table 1: Spearman’s correlation coefficient

	2008	2011	2012
Population	0.88	0.87	0.92
SEE-8	0.90	0.67	0.65
CEE-8	0.56	0.12 [§]	0.02 [§]

[§] Obtain data is statistically insignificant. Note: Author’s recalculations.

Data normalization enables that competitiveness scores expressed in absolute terms are reduced to relatively normalized scores within the interval [0, 1]. By this method, the country with the lowest score is assigned a value of 0 and the one with the highest score a value of 1, so that differences in scores among countries are also expressed in a more descriptive way.

Figure 3: Intervalised ranks of competitiveness



By dividing the list of ranked countries into 14 equal intervals and comparing the normalized marginal values within each interval it is possible to get an indicative picture of changes in competitiveness within the observed intervals (Figure 3). Horizontal axis depicts 14 intervals, while the vertical one depicts normalized scores showing the intensity of competitiveness by interval. The higher the column, the greater the interval, which means that the intensity of competitiveness in that interval is lower and vice versa – the smaller the column, the higher the intensity of competitiveness in that interval. It is evident that the greatest difference in

competitiveness in 2008, 2011 and 2012 is observed in the third interval, that is, from 21st to 30th rank, while the smallest is from the 91st to 100th rank. We observed the existence of strong competitiveness in the neighboring, eighth and ninth intervals. In analyzing which countries belong to those intervals, we found out that just WBs in SEE-8 were concentrated in these three intervals, especially the ninetieth (FYR Macedonia 80, Croatia 81, B&H 88 and Albania 89). On the other hand, the CEE-8 countries, as aspiration countries for SEE-8, are also markedly concentrated from the fourth to sixth interval.

4. **EMPIRICAL RESULTS**

According to economic characteristics, WBs has the same level of development and almost identical level of competitiveness as SEE-8. This is understandable due to the fact that six SEE-8 countries also belong to WBs group. It also indicates the high homogeneity of the two regions, despite the fact that the two SEE-8 countries which do not belong to WBs (Bulgaria and Romania) are already members of the EU. Table 2 illustrates the differences in levels of development before and during the Great Recession. On average, CEE-8 was and has remained the region being twice as prosperous as SEE-8 according to the level of GDPpc ppp. The averages shown in this table point to significant differences within the two regions: in SEE-8, Albania recorded the lowest level of GDPpc ppp (7,976 I\$), while Croatia recorded the highest (18,099 I\$). In CEE-8, Latvia recorded the lowest level (18,140 I\$), while Slovenia recorded the highest (28,684 I\$). With an average level of 11.200 I\$ of GDPpc ppp, WBs and SEE-8 are close to the 80-thy place among 184 countries in the world, it is an indicator of where their level of competitiveness should be located.

Table 2: GDPpc PPP in I\$

	Amount in I\$			Average annual growth rates (%)	
	2008	2011	2012	2008-2011	2008-2012
SEE-8	10.457	11.585	11.796	2.6	2.4
WBs	10.011	11.067	11.216	2.5	2.3
CEE-8	20.637	21.913	22.535	1.5%	1.8
Ranks of levels of GDPpc ppp					
SEE-8	77	78	78		
WBs	80	81	80		
CEE-8	44	45	44		

Source: IMF data. I\$ - international dollars used by IMF based on University of Pennsylvania's world tables (Penn World Tables).

Savic, Pitic and Konjikusic (2013a) analyzed the difference in GDPpc ppp at the level of the perceived groups of countries in 2008 and 2012, separately for SEE-8 and WBs and for CEE-8. There is statistically significant difference between the value of GDPpc ppp for 2008 and 2012 for SEE-8, as well as WBs.

On one hand, here may be noted that the WBs have the level of competitiveness that is

almost identical to the level of competitiveness of the SEE-8; and that the level of competitiveness of the CEE-8 is almost twice as high compared to SEE-8 and WBs, as was the case with GDPpc ppp.

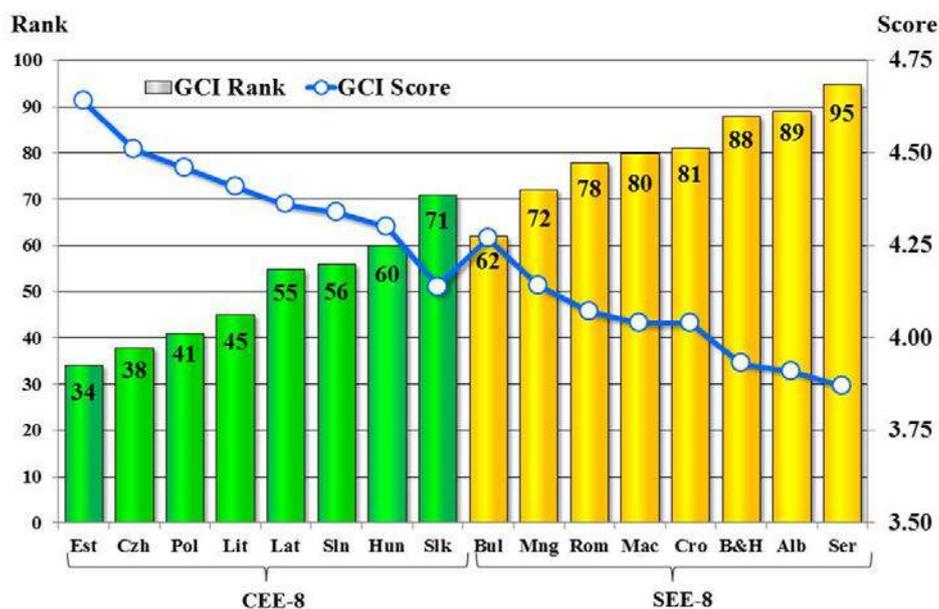
Table 3: Competitiveness indicators (ranks and scores)

	2008		2012	
	Ranks	Scores	Ranks	Scores
SEE-8	77	3.92	78	4.03
WBs	80	3.87	80	3.99
CEE-8	44	4.43	50	4.45

Source: Global Competitiveness Report (2008-2009 & 2012-2013).

During the ongoing Great Recession, the SEE-8 region deteriorated its competitiveness (its rank moved to 78th place from 77th place on average, while the score was improved from 3.92 to 4.03). Progress was made by Albania (+30 places), Bosnia and Herzegovina (+19) and Macedonia (+9), while deterioration in their rank position was recorded by Croatia (-20), Serbia (-10), Montenegro (-7). WB score was improved from 3.87 to 3.99. The competitiveness of CEE-8 countries also deteriorated (their rank dropped from 44th to 50th place, while their score was increased from 4.43 to 4.45).

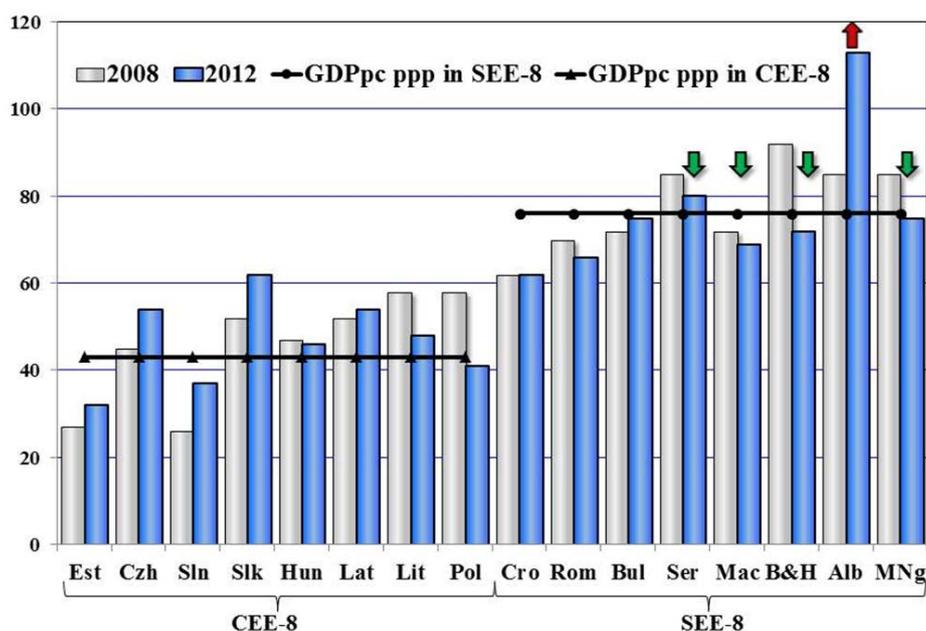
Figure 4: Country competitiveness scores and ranks position in 2012



The WBs is faced with the grave problems of systemic corruption (see Figure 5). Compared to 2008, the rank was improved by FYR Macedonia and B&H, Montenegro and Serbia but Albania deteriorated position. In order to create a more favorable

business climate significantly improvement of country corruption index must be achieved.

Figure 5: Country Corruption Ranks



Since SEE-8, including WBs, is faced with the problems of doing business, we presented the indexes of the World Bank's Doing Business in Figure 6. Doing business is much more favorable in CEE-8 (43th) when compared to SEE-8 (76th). In SEE-8, these indicators are particularly unfavorable with respect to construction permits (145th), getting electricity (114th), paying taxes (101st) and enforcing contracts (88). By comparing these two regions we determined that CEE-8 achieved better results than SEE-8 in starting business (61), getting credit (32) and protecting investors (61). In continuation of our analysis, we analyzed the competitiveness levels of two basic determinants of competitiveness: macroeconomic competitiveness, which sets only the potential for high productivity, and microeconomic competitiveness, which has a decisive impact on the competitiveness level because it is linked to the quality of national business environment. Using this methodology Savic (2012) analyzed position of Serbia in more details.

Table 4 shows the ranks in terms of the level of macroeconomic competitiveness and then its two key components – SIPI (social infrastructure and political institutions) and MFP (monetary and fiscal policies). During the entire analyzed period (2008-2012), SEE-8 countries achieved better ranks in terms of macroeconomic competitiveness relative to microeconomic competitiveness. Within this determinant of competitiveness, SEE-8 countries achieved better ranks in terms of MFP than in terms of SIPI, but this difference was almost annulled in 2012, especially due to the deterioration of MFP ranks.

Figure 6: Doing business in 2013 (ranks)

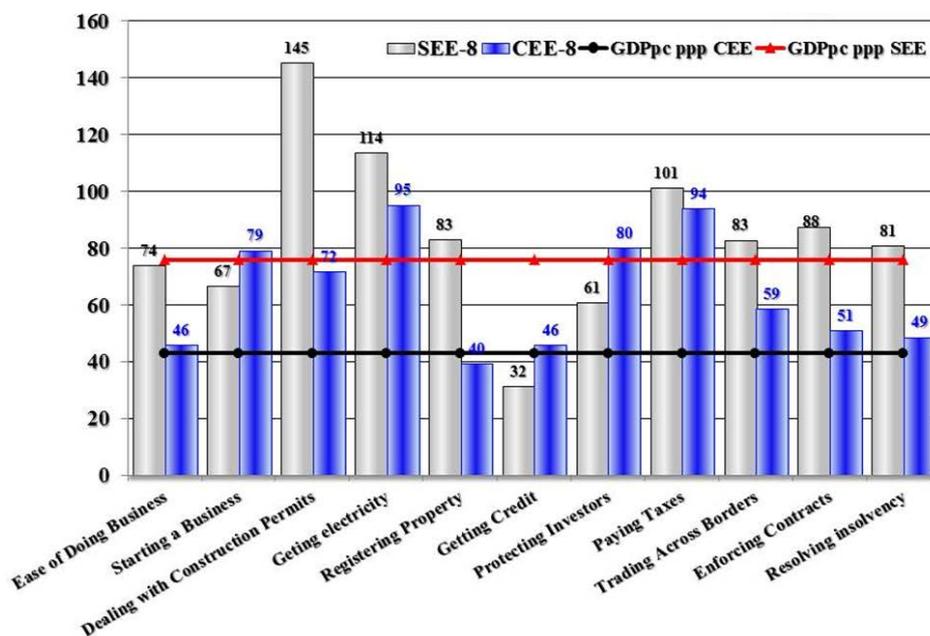


Table4: Macroeconomic determinants of competitiveness (ranks)

	Macroeconomic competitiveness		SIPI		MFP	
	2008	2012	2008	2012	2008	2012
Serbia	74	92	75	90	75	98
B&H	84	70	94	69	47	77
Romania	78	89	80	92	66	75
Bulgaria	81	78	87	85	56	45
Macedonia, FYR	70	69	75	71	48	58
Montenegro	50	50	51	44	47	80
Albania	88	76	87	76	90	77
Croatia	66	74	64	75	74	67
SEE-8	74	75	76	75	63	72
WBs	72	72	74	71	64	76
CEE-8	58	60	58	60	55	62

Note: Author's recalculations based on Porter et al. 2008. Rank versus 142 countries; overall, SEE-8 ranks 78th in 2012 ppp adjusted GDPpc and 78th in Global Competitiveness Report.
 Source: Global Competitiveness Report (2008-2009 & 2012-2013).

As a general conclusion, it can be stated that, insofar as the macroeconomic determinant of competitiveness is concerned, both SEE-8 including WBs and CEE-8 must act toward improving SIPI and, in its context, political institutions and the rule of law. It will also be necessary to improve MFP which deteriorated in both groups of countries, especially in 2012. Savic, Pitic and Barjaktarovic (2013a) argued that interest rates spread in SEE-8 are higher comparing to CEE-8.

Since value is created only at the microeconomic level, we will further analyze the microeconomic determinant of competitiveness as the most important component. Table 7 shows the two key components of the microeconomic determinant of competitiveness – NBE (national business environment) and COS (company operations and strategy).

Table 5: Microeconomic determinants of competitiveness (ranks)

	Microeconomic competitiveness		NBE		COS	
	2008	2012	2008	2012	2008	2012
Serbia	88	106	85	93	106	131
B&H	106	92	103	85	121	101
Romania	70	95	68	88	79	104
Bulgaria	80	83	75	76	102	96
Macedonia, FYR	88	86	85	73	103	116
Montenegro	72	65	69	62	85	67
Albania	100	82	98	83	108	73
Croatia	67	77	68	68	62	93
SEE-8	84	87	81	80	96	97
WBs	87	86	84	79	98	96
CEE-8	53	62	52	60	55	61

Note: Author's recalculations based on Porter et al. 2008. Rank versus 142 countries; overall, SEE-8 ranks 76th in 2012 ppp adjusted GDPpc and 81st in Global Competitiveness Report.

Source: Global Competitiveness Report (2008-2009 & 2012-2013).

In 2012, SEE-8 countries deteriorated microeconomic determinant of competitiveness but WBs made small improvements. Key generator of the deterioration is COS (Company operations and strategy) which is around 96th and 97th place in SEE-8 and WBs. Those very poor results were reflected in their overall competitiveness level. Thus, WBs and SEE-8 are faced with a very challenging task of improving COS.

The further analysis was devoted to an analysis of NBE as the essence of microeconomic competitiveness. This analysis was carried out using the Porter's diamond on the basis of NGCI methodology (see Table 6).

Table 6: Porter's Diamond in SEE-8

	1. Factor conditions		2. Context for strategy and rivalry		3. Supporting and relating industries		4. Demand conditions	
	2008	2012	2008	2012	2008	2012	2008	2012
Serbia	77	90	95	117	100	122	89	127
B&H	97	84	106	100	118	103	123	109
Romania	64	85	74	99	76	113	72	108
Bulgaria	73	73	78	89	82	92	71	52
Macedonia,FYR	75	71	97	85	105	95	100	118
Montenegro	68	60	64	71	93	101	65	64
Albania	96	80	92	68	119	122	110	54
Croatia	58	66	85	107	79	80	67	123
SEE-8	76	78	86	92	96	103	87	94
WBs	79	78	89	91	101	103	92	97
CEE-8	52	58	49	55	54	59	62	99

Note: Author's recalculations based on Porter at al. 2008. Rank versus 142 countries; overall, SEE-8 ranks 76th in 2012 ppp adjusted GDPpc and 81st in Global Competitiveness Report.

Source: Global Competitiveness Report (2008-2009, 2011-2012 & 2012-2013).

Within the diamond, SEE-8 and WBs achieved the best ranks in terms of factor conditions and the lowest ranks in terms of supporting and related industries. On the other hand, CEE-8 achieved much more balanced ranks in terms of all components of the diamond, whereby the lowest ranks were recorded in terms of demand conditions. These results were expected and they reflect the fact that competitiveness in SEE-8 countries was primarily improved in the first two components of the Porter's diamond - factor conditions and the context for strategy and rivalry. In order to achieve a considerably higher competitiveness rank, WBs and CEE-8 should also significantly improve the other two components (supporting and related industries and demand conditions). Regardless of this finding, it is evident that in 2012 the ranks of all components of the diamond deteriorated in SEE-8 and WBs and CEE-8.

In continuation of our analysis we will concentrate on the analysis of competitive advantages and disadvantages based on the analysis of the Porter's diamond for WBs and SEE-8 (Table 7).

Table 7: Competitive position of WBs (SEE-8)

Competitive Advantage		Competitive Disadvantages	
I. Factor conditions 77 (78)			
<i>Logistical Infrastructure 88 (92)</i>			
		Quality of port infrastructure	107
		Quality of air transport	103
		Quality of roads	102
<i>Administrative infrastructure 69 (72)</i>			
No. of proced. required to start a bus.	49	Ease of starting a new business	92
Time required to start a business	51	Burden of customs procedures	88
Doing business, paying taxes	66	Burden of government regulation	87
<i>Communication Infrastructure 56 (55)</i>			
Mobile telephone subscription	51		
Fixed telephone lines	54		
Internet users	54		
Internet access in schools	61		
<i>Capital Market Infrastructure 90 (87)</i>			
Doing business, Getting credit	24	Protect. of minority shareh. interests	107
		Soundness of banks	103
		Regulation of security exchange	100
		Financ. through local equity market	98
		Venture capital availability	94
<i>Innovation Infrastructure 85 (86)</i>			
Quality of math & science education	48	Brain drain	120
Tertiary education enrollment	63	Quality of scient. resear. institutions	116
		University industry collabor in R&D	95
		Availabil. of scientist and engineers	87
II. Context for Strategy and Rivalry 91 (92)			
Trade tariffs	46	Intensity of local competition	120
Strength of investor protection	49	Cooperat.in labor-employer relations	107
		Prevalence of foreign ownership	105
		Extent of market dominance	105
		Business impact of rules on FDI	105
		Efficacy of corporate boards	105
		Strength of aud. and report.stand.	102

III. Supporting and related industries and clusters 104 (103)		
	State of cluster development	115
	Local supplier quantity	107
	Local avail. of resear & training serv	101
	Availability of latest technologies	98
	Local supplier quality	97
IV. Demand condition 99 (94)		
	Buyer sophistication	98
	Gov't procurem. of advantech prod	90

Note: Author's recalculations based on Porter et al. 2008. Rank versus 142 countries; overall, SEE-8 ranks 76th in 2012 PPP adjusted GDPpc and 81st in Global Competitiveness Report.
Source: Global Competitiveness Report (2012-2013).

The most significant competitive advantages of WBs in 2012 lay in administrative, communication and innovation infrastructure within the factor conditions. On the other hand, there are numerous disadvantages in 2012, primarily in logistical infrastructure and then in a part of administrative and innovation infrastructure; weaknesses are also perceived in capital market infrastructure. Apart from these weaknesses in the factor conditions of the diamond, WBs especially display competitive disadvantages in the second part of the diamond, in the context for strategy and rivalry, due to very low ranks in terms of the intensity of local competition (120th), cooperation in labor-employer relations (107th), extent of market dominance (105th)...

Undeveloped logistical infrastructure and part of administrative infrastructure, as well as the weaknesses of the conditions of doing business and corruption, reflected in unfavorable doing business indicators, must be eliminated. The second important action is to eliminate an excessive extent of market dominance and weak local competition, which is reflected in a low market efficiency and unfavorable context for strategy and rivalry. The third action concerns the strengthening of existing clusters in the countries in this region, which have not yet been elevated to the supranational level and linked into strong regional clusters, especially in the fields of tourism and food processing, as well as knowledge-intensive activities, including ICT, creative industries and life sciences (Savic, Pitic, Dzunic and Brkic, 2011).

WBs countries must increase the attractiveness of their region in order to attract new investments. Due to a different EU accession pace, the political and business elites in the region are faced with the need to develop the concept of improving competitiveness at the supranational level.

5. CONCLUSION

During the Great Recession, from 2008 to 2012, WBs kept their competitiveness rank unchanged (ranked at 80th place), while their score increased from 3.87 to 3.99. Their rank in terms of GDPpc PPP also remained unchanged (ranked at 80th place), with the

average annual growth rate being 2.3%.

However, the described competitiveness dynamics of WBs depict great differences among them. The greatest improvement in competitiveness was recorded by B&H and Albania (+19 places) and Bulgaria (+14 places), while the greatest deterioration was recorded by Croatia (-20) and Serbia and Romania (-10).

When analyzing the Porter's diamond in 2012 for WBs we established competitive advantages primarily in factor conditions (in a part of administrative infrastructure, communication infrastructure and in a part of innovation infrastructure) and then in a part of the context for strategy and rivalry. On the other hand, there are distinct competitive disadvantages in all four elements of the Porter's diamond: in factor conditions (especially in logistical infrastructure, a part of administrative infrastructure, capital market infrastructure and a part of innovation infrastructure), than in the context for strategy and rivalry (primarily due to the low intensity of local competition, extent of market dominance and cooperation in labor-employer relations), than in supporting and related industries (primarily due to the low level of cluster development and low quality and quantity of local suppliers) and, finally, due to undeveloped demand conditions (primarily due to the low level of buyer sophistication).

If WBs countries wish to improve their competitiveness more significantly, which requires a long-term increase in productivity in use of all available resources of the Region as a basis for increasing GDPpc ppp, it is necessary to implement a number of the following measures with strong synergetic effects within the Region: (i) in the context of improving NBE it is necessary to strengthen regional infrastructure (logistic, energy, financial and research-educational), remove trade and investment barriers, reduce market dominance and local monopolies and protect consumers, (ii) in the context of macroeconomic policies it is necessary to coordinate measures in financial markets and found a strong regional development bank, and (iii) in the context of political institutions it is necessary to strengthen the sharing of best practices in government practice, create regional institutions, especially for dispute resolution mechanisms and economic statistics, and developing a regional approach with international organizations. A great contribution to these processes would be made by reduced corruption, which is at a very high level in SEE-8 countries, and the general improvement of doing business indicators.

REFERENCES

- Delgado, Mercedes, Christian Ketels, Michael Porter and Scott Stern. 2012. „The Determinants of National Competitiveness“, NBED Working Paper 18249, July 2012. National Bureau of Economic Research, Cambridge, Mass.
- Delgado, Mercedes, Michael Porter and Scott Stern. 2012. „Clusters, Convergence, and Economic Performance“, NBED Working Paper 18250, July 2012. *National Bureau of Economic Research*, Cambridge, Mass.
- Porter, Michael E., 2012. “Regional Competitiveness and the Role of Business”, lecture delivered at Sintonia, Puebla, Mexico, April 27, 2012.
- Porter, Michael E., Mercedes Delgado, Christian Ketels and Scott Stern. 2008. “Moving to a New Global Competitiveness Index“. In *The Global Competitiveness Report 2008-2009*, ed. Michael E. Porter and

- Klaus Schwab, 43-63. Geneva: World Economic Forum.
- Savic, Nebojsa. 2012. "Comparative Analysis Based on New Competitiveness Index", *Panoeconomicus*, 2012, Volume 59, Issue 1, Pages: 105-115.
- Savic, Nebojsa, Goran Pitic and Snezana Konjikusic. 2013. "Relative Competitive Position of East European Countries in 2011", *Journal of Competitiveness and Strategy*, January 2013, Vol. 3. Pages: 36-48, ISSN 2250-3587.
- Savic, Nebojsa, Goran Pitic and Snezana Konjikusic. 2013a. "Microeconomic and Macroeconomic Determinants of Competitiveness of East European Countries in 2012", *International Journal of Economic Policy in Emerging Economies*, Special Issue on: "Competitiveness Policies from the Emerging Blocks: a Checkpoint on the Reality of Development through Policy", 2013, ISSN 1752-0452 (forthcoming).
- Savic, Nebojsa, Goran Pitic and Lidija Barjaktarovic. 2013b. "Forced Changes in Banks Financing Growth in East European Countries". Rajmund Mirdala, ed. *Financial Aspects of Recent Trends in the Global Economy*, March 2013, Vol. II. Pages: 188-203, ISSN 978-606-93129-6-4.
- Savic, Nebojsa, Goran Pitic, Marija Dzunic and Ivan Brkic. 2011. "The role of clusters in improvement of regional cooperation and development", proceedings of the 7th ASECU International Conference, Rostov-on-Don.
- The World Economic Forum. 2008. *Global Competitiveness Report 2008-2009*. Geneva.
- The World Economic Forum. 2011. *Global Competitiveness Report 2011-2012*. Geneva.
- The World Economic Forum. 2012. *Global Competitiveness Report 2012-2013*. Geneva.
- The World Bank. 2008. *Doing Business 2008*. Washington, DC: The World Bank.
- The World Bank. 2011. *Doing Business 2012*. Washington, DC: The World Bank.
- The World Bank. 2012. *Doing Business 2013*. Washington, DC: The World Bank.

Gligor Bishev

University "St. Kliment Ohridski" Bitola, Faculty of Economics Prilep, Prilep,
Macedonia

Dragica Odzaklieska

University "St. Kliment Ohridski" Bitola, Faculty of Economics Prilep, Prilep,
Macedonia

EFFECTS OF THE GLOBAL ECONOMIC CRISIS ON THE ECONOMIES OF THE WESTERN BALKANS

ABSTRACT

Financial crisis that hit the market of substandard securities (subprime market) in 2007 in USA quickly spread and took a global scale, thus transferring from the financial to the real sector in many countries. Weaknesses in the area of systemic regulation and supervision in the area of financial flows, i.e. excessive deregulation of financial markets and excessive risk taking by investors, were the immediate causes of the crisis. The financial crisis was all-embracing and questioned the solvency and liquidity of the banking institutions. Capital and cash markets froze. Reducing the amount of crediting and incorporation of high risk premiums widened and prolonged recessionary pressures.

The global crisis was transferred to the Western Balkans countries at the same time through the account of goods and services of balance of payments - reduced demand for goods and services, and through capital account of balance of payments - reduced capital inflows based on foreign direct investment, portfolio investment, loans and transfers from abroad. Namely, the countries with higher level of indebtedness, where banks based the credit expansion on foreign loan savings, have experienced significant credit contraction. In the Western Balkans countries where the pre-crisis credit expansion relied mostly on domestic savings, credit collapse dynamics during and after the crisis were more moderate. The correlation between the depth and duration of the crisis in certain countries of the Western Balkans and the dynamics of lending activity is apparent. From that point, rebuilding the global financial flows and effective credit risk management emerge as key factors for the permanent restoration of economic growth in the Western Balkans countries. The emphasis in this paper will be placed on the transfer channel of the crisis in the economies of the Western Balkans, the role of the banking sector in the transmission of the crisis and relation between credit expansion and economic growth. Also, recommendations for overcoming the consequences of the crisis and maintaining sustainable economic growth in the countries of the Western Balkans will be listed.

Keywords: economic crisis, banking sector, credit expansion, economic growth

JEL classifications: G01

1. INTRODUCTION

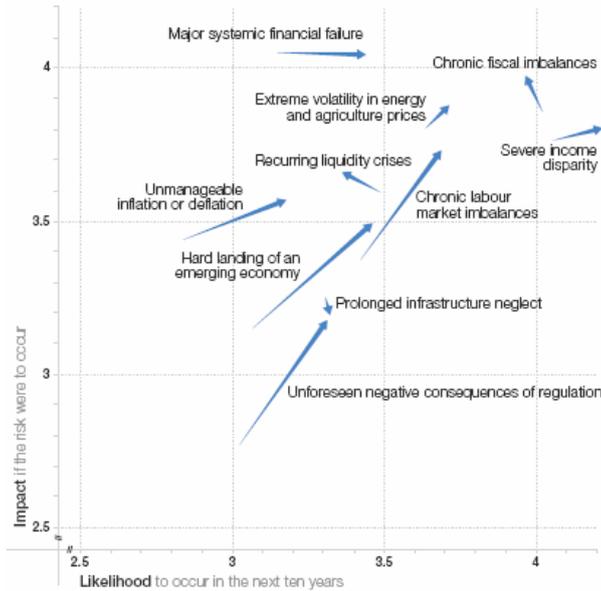
After six years of historically low interest rates and ultra loose monetary policy it cannot be concluded, still that the economic crisis is over. It started as crisis on subprime securities market in 2007 in USA; then was transformed into house and stock market collapse 2008-2010; recession 2008-2010; insolvent banks 2008-2011; and currently into insolvent and illiquid banks into periphery of European Union and sovereign debt crisis.

Namely, in order to revive the economic activity, central banks world wide expanded significantly their balance sheet and reduced interest rates at record low levels. However, this was not materialized in higher credit and money supply growth, higher private consumption and finally in higher growth and employment. Unemployment remained high. (Financial Times, Wednesday, 13 February 2013, p.21).

For 2013 the main challenge for economic recovery of each country remains to establish liquid and solvent financial system. That can be confirmed by data from survey realized by the World Economic Forum (WEF_GlobalRisks_Report_2013.pdf). Namely, the World Economic Forum 's Global Risks 2013 report is developed from an annual survey of over 1.000 experts from industry, government, academia and civil society who were asked to review a landscape of 50 global risks. The global risk that respondents rated as having the highest impact if it were to manifest, over the next 10 years is major systemic financial failure (figure 1). The financial sector failure becomes high risk for economic recovery. Sound and deep financial system is essential for supporting economic growth in every national economy. This especially refers to Balkan Countries where liquid and healthy financial system efficiently allocates scare domestic and foreign savings, and processes expansion of central bank balance sheet into more credit and money to companies and households. Due to underdeveloped capital and stock markets, in these countries, loans from commercial banks are remaining basic source of funding for corporate and household sector.

In the focus of this paper will be the effects of global financial crises on several Balkan countries: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, Montenegro, Romania and Serbia.

Figure 1: Global risks landscape 2013 versus 2012



Source: World Economic Forum, Global Risks 2013, Eighth Edition, available at http://www3.weforum.org/docs/WEF_GlobalRisks_Report_2013.pdf p. 4

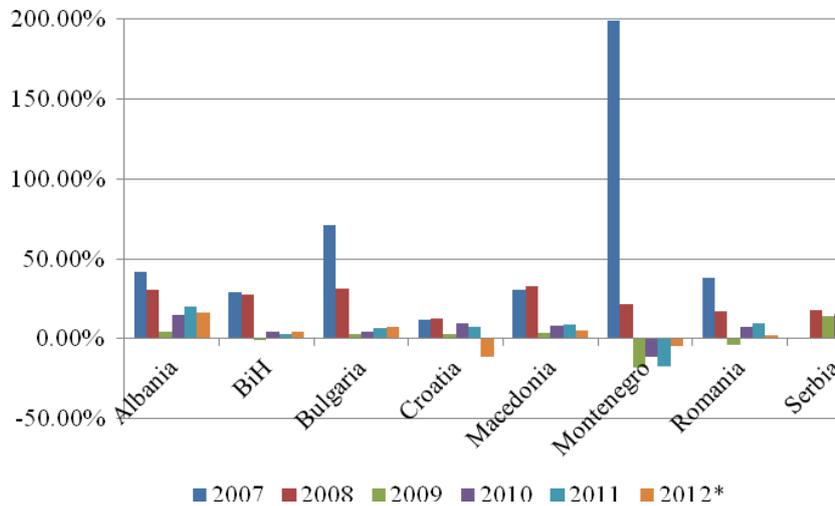
2. MACROECONOMIC DEVELOPMENTS OF THE WESTERN BALKAN COUNTRIES

2.1. Strong growth and swift convergence towards EU, before crisis

A decade before the crisis was a decade of strong economic growth in the countries of Balkan region. The average growth rate reached 6.6 percent in 2007, varying from 5.1 percent in Croatia, to 10.7 percent in Montenegro. This enabled the process of convergence towards EU to be accelerated. During this decade two Balkan countries (Romania and Bulgaria) became EU countries, Croatia got a date for EU accession (July 1, 2013), Macedonia become a candidate country, waiting green light to start negotiations, Montenegro started negotiations for EU accession, and Albania and Serbia signed Stabilization and association agreement.

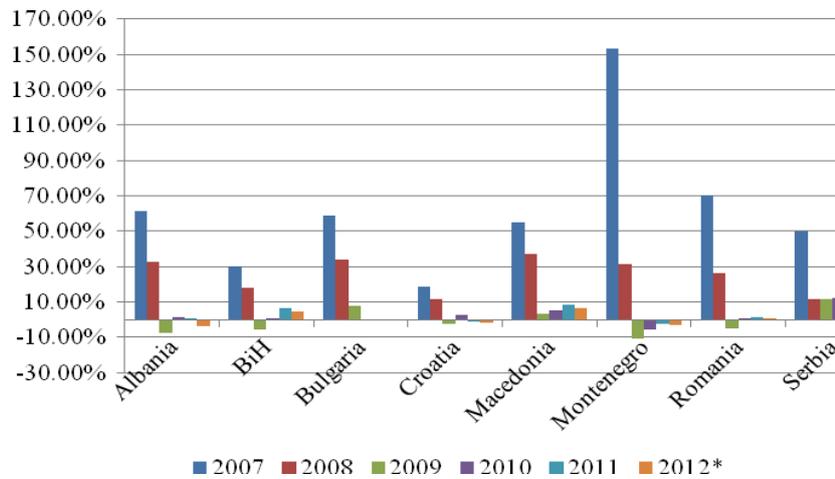
The economic growth was driven by extremely high credit growth that in corporate sector in 2007, reached growth rates of almost 200 percent in Montenegro, 70 percent in Bulgaria and 42 percent in Albania. Growth of loans to household sector was even higher: 155 percent in Montenegro, 71 percent in Romania, 62 percent in Albania, 59 percent in Bulgaria, 55 percent in Macedonia, and 50 percent in Serbia (See Figures 2 and Figure 3).

Figure 2: Loans to Private Enterprises (growth in % yoy)



Source: World Economic Outlook, World Development Indicators, Raiffeisen Research, Central Banks Sites

Figure 3 Loans to Households (growth in % yoy)



Source: World Economic Outlook, World Development Indicators, Raiffeisen Research, Central Banks Sites

During a Decade 1997-2007 the unemployment on average was reduced by one third. However, it remained still high and living standard measured by Gross Domestic Product per capita at PPP around 40 percent of EU average (table 1): Croatia has the highest GDP per capita (16.162 at PPP), while Bosnia and Herzegovina and Albania have the lowest GDP per capita (both around 7.000-8.000 at PPP). Most industrial sectors in Western Balkans countries are not as strong as those in Central Europe and the sub-region's infrastructure lacks the level of development in CE.

Table 1: Gross domestic product per capita, PPP for 2011

Gross domestic product per capita, PPP for 2011 (constant 2005 international \$)	2011
Croatia	16,162
Bulgaria	11,799
Montenegro	10,402
Romania	10,905
Serbia	9,809
Macedonia	9,451
Albania	7,861
B&H	7,607

Source: Factfish World Statistics and Data Research

Table 2: Real GDP growth in %

	2006	2007	2008	2009	2010	2011	2012e	2013f
Albania	5.4%	5.9%	7.8%	3.3%	3.9%	3.1%	2.5%	1.7%
B&H	6.0%	6.1%	5.7%	-2.9%	0.7%	1.9%	0.0%	1.0%
Bulgaria	6.5%	6.4%	6.2%	-5.5%	0.4%	1.7%	1.0%	1.5%
Croatia	4.9%	5.1%	2.1%	-6.9%	-1.2%	0.0%	-1.0%	1.0%
Macedonia	5.0%	6.1%	5.0%	-0.9%	2.9%	2.8%	0.0%	2.2%
Monenegro	8.6%	10.7%	6.9%	-5.7%	2.5%	2.5%	0.2%	1.5%
Romania	7.9%	6.3%	7.3%	-6.6%	-1.6%	2.5%	0.5%	2.5%
Serbia	3.6%	5.4%	3.8%	-3.5%	1.0%	2.0%	0.0%	2.0%

Source: World Economic Outlook, Raiffeisen Research, Central Banks Sites

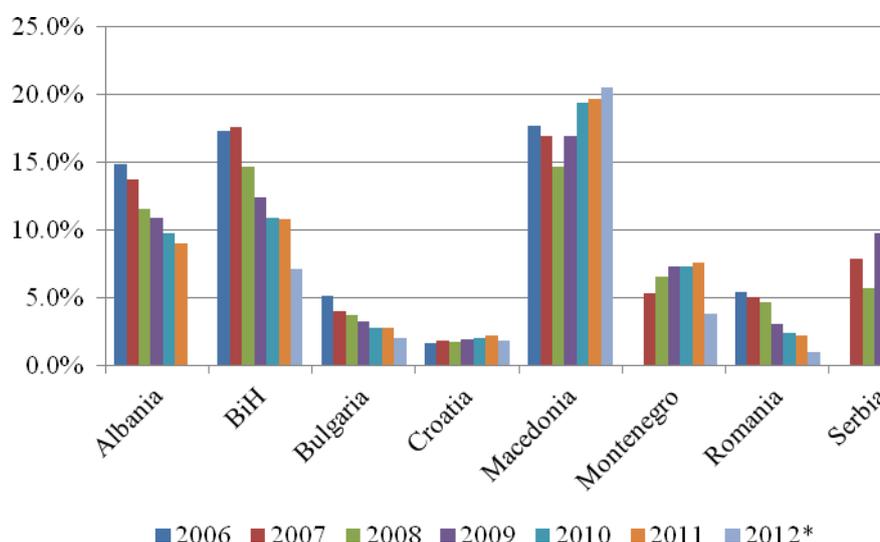
Table 3: Loans to deposits in %

	2007	2008	2009	2010	2011	2012*
Albania	46.40%	61.50%	64.80%	60.10%	61.30%	62.00%
B&H	98.70%	122.60%	116.70%	116.40%	117.80%	119.70%
Bulgaria	97.70%	120.30%	121.20%	114.80%	106.10%	110.37%
Croatia	94.30%	101.60%	101.00%	103.00%	103.20%	103.88%
Macedonia	77.88%	92.85%	92.42%	87.49%	86.43%	89.37%
Montenegro	124.64%	175.26%	160.01%	146.42%	116.28%	101.05%
Romania	110.60%	123.80%	111.20%	109.70%	111.20%	114.49%
Serbia	98.00%	122.40%	115.20%	127.50%	125.60%	132.92%

Source: World Economic Outlook, World Development Indicators, Raiffeisen Research, Central Banks Sites
Note: * Latest available data

The credit expansion and strong economic growth were financed by exceptionally high foreign inflows based on remittances (on average around 18 percent of GDP), FDIs (on average around 14 percent of GDP) and high borrowing of funds of domestic banks from their parent banks. Thus, except in Albania and Macedonia, in 2010 in all other countries of Balkan region under review, loans to deposit ratio over-shoot 100 percent: Montenegro 160 percent; Bulgaria 121 percent; Bosnia and Herzegovina 117 percent; and Serbia 115 percent (Table 3). Thus, it became obvious that in the Western Balkan region credit and economic growth can be renewed on pre-crisis levels only if foreign savings is imported through borrowing of local banks from foreign markets.

Figure 4: Private transfers received as a % of GDP



Source: World Economic Outlook, World Development Indicators, Central Banks Sites

The private transfers are especially high in Macedonia (around 20% of GDP – figure 4). They grew constantly despite the influence of the global economic crises. There was no common pattern of movement of foreign transfers after the crisis in the Western Balkan Countries. In Albania, Bosnia and Herzegovina, Bulgaria, Montenegro and Serbia, there was significant reduction of inflows on this base. In Croatia, although they account small portion of GDP (4.5 percent), foreign private transfers doubled. In Macedonia (20 percent of GDP), and Serbia (10 percent of GDP), foreign private transfers increased significantly.

Foreign direct investments that were bringing not only foreign savings, but also know how and new technologies, at the end of 2012 dropped to 40 percent of its pre-crisis level. Movements of FDIs per country are presented in Table 4.

Table 4: Foreign Direct Investment Inflows as % of GDP

	2006	2007	2008	2009	2010	2011	2012*
Albania	3.6%	6.1%	9.6%	11.1%	9.2%	10.6%	
B&H	6.8%	11.8%	5.4%	0.8%	2.0%	2.1%	3.8%
Bulgaria	23.7%	32.9%	19.9%	8.0%	3.9%	4.8%	3.5%
Croatia	6.9%	8.5%	8.7%	5.5%	1.4%	2.0%	1.4%
Macedonia	6.5%	9.0%	6.2%	2.8%	3.3%	4.9%	1.3%
Montenegro		25.5%	21.2%	36.9%	18.5%	12.4%	13.4%
Romania	9.3%	6.1%	6.9%	3.1%	2.0%	1.4%	1.2%
Serbia		8.8%	6.3%	4.8%	3.5%	5.9%	0.6%

Source: World Economic Outlook, World Development Indicators, Central Banks Sites
Note: * Latest data available

Inflow of foreign savings was neutralized by high and persistent current account deficits. However, these countries gained a considerable reputation for overcoming the immediate impact of the global economic crises by implementing serious economic restructuring.

2.2. Lack of foreign funding blocked the growth during and after the crisis

Although credit is not factor of economic growth, it is closely connected with economic development, because as J. Schumpeter emphasized, “you cannot become an entrepreneur if previously you do not become a debtor”. From Table 5, it can be noticed that the stagnation in the Western Balkan countries in the period of 2009 – 2012, was associated firmly with the stagnation of credits to private sector.

Economic growth was strongly associated with credit growth to companies, while credit growth to households was associated with bubble and bust on real estate market. From Table 5 is evident that countries that recorded moderate credit growth (Albania and Macedonia) achieved positive cumulative GDP growth in the period 2009-2012. Credit growth in these countries relied exclusively on domestic savings (loans to deposits 62 percent and 89 percent, respectively). In other countries credit growth was weak, which was connected with cumulative drop of GDP. Exception was Serbia, where credit growth was moderate (on average 13 percent credit to companies), while GDP stagnated.

With regards to the differences in the loan growth rates in the countries of the Western Balkans, two features are of importance.” First, past loan expansion that was too aggressive appears to act as a constraint on growth. Second, relatively high loan to deposit ratios (these tend to be relatively high in those counties that experienced very strong banking sector expansion in recent years) appear to be another important growth constraint in the current environment as well” (CEE Banking Sector Report 2012, Raiffeisen research, p. 18-19).

Table 5: Average economic and credit growth in the period 2009-2012

Country	Average growth rate of GDP	Average rate of credit growth to companies	Average credit growth rate to households
Albania	3.2	14.1	-2.2
B&H	-0.1	2.4	1.2
Bulgaria	-0.6	5.2	1.5
Croatia	-2.7	1.9	-0.7
Macedonia	1.2	6.4	5.7
Montenegro	-0.1	-12.8	-5.5
Romania	-1.3	3.9	-0.7
Serbia	-0.1	13.0	9.6

3. SOUNDNESS AND LIQUIDITY OF BANKING INDUSTRY IN WESTERN BALKANS COUNTRIES

The banking sector of Western Balkans showed a high degree of resilience during and aftermath of crisis. It remained well capitalized, although non-performing loans (NPLs) exploded in comparison to pre-crisis levels.

Table 6: NPL Ratio in %

	2007	2008	2009	2010	2011	2012*
Albania	3.40%	6.60%	10.50%	14.00%	18.80%	21.10%
B&H	3.00%	3.10%	5.90%	11.40%	11.80%	12.70%
Bulgaria	2.00%	2.40%	6.10%	11.90%	14.90%	16.62%
Croatia	4.80%	4.90%	7.80%	11.20%	12.40%	10.10%
Macedonia	7.50%	6.70%	8.90%	9.00%	9.50%	10.60%
Montenegro	3.20%	7.20%	12.40%	14.90%		
Romania	1.70%	2.80%	7.90%	11.90%	14.10%	16.80%
Serbia	11.30%	11.30%	15.70%	16.90%	19.00%	19.90%

Source: World Economic Outlook, World Development Indicators, Raiffeisen Research, Central Banks Sites
Note: * Latest available data

In Croatia, Macedonia and Bosnia and Herzegovina, NPLs were between 10.1 to 12.7 percent of loan portfolio. In other countries bad loans reached a level between 15 and 20 percent. Price of risk become enormous and was keeping interest margin and lending rates high. Thus, vicious circle was created: high NPLs, high lending rates, no eligibility for finance for low risk projects that require lower rates, stagnant credit growth, and protracted economic stagnation.

Table 7: NPL Coverage in %

	2007	2008	2009	2010	2011	2012*
Albania	47.20%	42.80%	51.30%	51.20%	52.00%	53.64%
B&H	37.20%	37.90%	34.40%	32.90%		
Bulgaria	100.40%	100.90%	78.30%			
Croatia	54.40%	48.70%	42.50%	40.90%	42.83%	43.63%
Macedonia	117.00%	120.30%	101.80%	101.20%	102.20%	101.30%
Montenegro	73.60%	55.60%	46.30%	45.70%	45.90%	
Romania	61.60%	60.30%	50.60%	52.50%	56.50%	56.70%
Serbia		187.80%	168.10%	163.50%	129.20%	127.90%

Source: World Economic Outlook, World Development Indicators, Raiffeisen Research, Central Banks Sites
Note: * Latest available data

At the end of 2012 bad loans in Serbia and Macedonia, were fully provisioned (in Serbia 128 percent). In other countries of Balkan region, non-performing loans on average were provisioned 50 percent.

Table 8: Capital Adequacy Ratio in %

	2007	2008	2009	2010	2011	2012*
Albania	17.10%	17.20%	16.20%	16.20%	15.60%	15.70%
B&H	17.10%	16.30%	16.10%	16.20%	16.40%	16.75%
Bulgaria	13.80%	14.90%	17.00%	17.50%	17.50%	16.66%
Croatia	16.40%	15.20%	16.40%	18.80%	19.20%	20.48%
Macedonia	17.00%	16.20%	16.40%	16.10%	16.80%	17.10%
Montenegro	17.10%	15.00%	15.70%	14.30%	16.51%	
Romania	13.80%	13.80%	14.70%	15.00%	14.50%	14.70%
Serbia	27.90%	21.90%	21.40%	19.90%	19.10%	16.40%

Source: World Economic Outlook, World Development Indicators, Raiffeisen Research, Central Banks Sites
Note: * Latest available data

Solvency of the banking industry during and aftermath the crisis has been extremely high. Capital adequacy ratio in all countries, at the end of 2012 was above 15 percent, with 20.5 percent being top performer banking industry in Croatia (table 8). However, financial stability was not enough for ensuring credit support to the economy. “Financial stability, when lost, has deep and long-term impacts on both employment and growth. The cost of preventing a financial crisis is much lower than the cost of living it. The recent developments have reminded us this economic dictum once again” (Erdem Basci, BIS Review, 18 March, 2013, p. 2).

Fragmentation of Euro area credit markets, constrained flow of funds to Western Balkan countries. Although leverage ratios remained low in the banking sector, countries of Western Balkans did not have access to the liquidity that has been injected

in the system by ECB. The fact that more than 85 percent of ownership structure of banks is in hands of foreign internationally active banking groups is not alleviating the flow of funds. Even inter banking Group flow of funds from headquarters to subsidiaries in Western Balkans are blocked.

New challenge for financial stability in Balkan countries are financial crisis in Greece, Slovenia, Cyprus and vulnerability of banking sector in periphery of European Union. In certain Balkan countries, presence of subsidiaries from crisis affected countries is high: almost half of banking sector in Macedonia, one third of the banking sector in Bulgaria, and less than fifth of the banking sector in Serbia.

4. CONCLUSION

The global economic crisis that exploded in 2008 caused cyclic decline of the economic activity. The insolvency of many banks and financial institutions in USA, and Europe and the process of deleveraging that followed significantly reduced the possibility of new funding, i.e. the inflow of foreign capital in developing countries. Namely, in order to revive the economic activity, central banks worldwide reduced interest rate at record low levels and expanded significantly their balance sheet. However, this was not materialized in higher credit and money supply growth, higher private consumption and finally in higher growth and employment.

For 2013 the main challenge for economic recovery of each country remains liquid and solvent financial system. This is especially important for Balkan Countries where liquid and healthy financial system efficiently allocates scarce domestic and foreign savings, and processes expansion of central bank balance sheet into more credit and money to companies and households. In these countries economic growth was strongly associated with credit growth to companies, while credit growth to households was associated with bubble and bust on real estate market. Namely, countries that recorded moderate credit growth (Albania and Macedonia) achieved positive cumulative GDP growth in the period 2009-2012. Credit growth in these countries relied exclusively on domestic savings, having in mind that loan to deposit ratio has been below 100 percent. In other countries, where loans to deposit ratio has been above 100 percent, credit growth was weak, which was connected with cumulative drop of GDP. Due to the lack of developed capital markets in these countries, as well as unprecedented conditions to obtain additional financing in the international financial market, loans remain basic source of funding for corporations and individuals. Thus, it became obvious that in the Western Balkan region credit and economic growth can be renewed on pre-crisis levels only if foreign savings is imported through borrowing of local banks from foreign markets.

Coordinated action for preserving financial stability in Western Balkans and re-establishing financial flows is crucial for tackling stagnation in this region. Actions of supervisory authorities from these countries only, will be not sufficient. Creating Balkan Stability Fund for preserving financial stability and encouraging credit flows towards Western Balkans, under the auspices of EU and IMF will be clear and direct response in order to renew prosperity.

REFERENCES

- Basci Erdem, (18 march 2013) *Turkish-Austrian economic relations in a European and international context*, BIS Review
- Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools,(January 2013) Basel Committee on Banking Supervision,
- Benes Jaromir, Kumhof Michael, (2012) *The Chicago Plan Revisited*, IMF Workin Paper
- Bishev Gligor, (18 November, 201) Anti-recessionary monetary policy and deleveraging, in Finance and Monetary policy after the global financial crisis, University "Ss. Cyril and Methodius", Skopje, Faculty of Economics
- Bishev Gligor, Misheska Vesna, (March, 2012) *Soundness of the banking sector and economic recovery in the EU, Political thought, The future of Euro: Challenges for financial stability*, Konrad Adenauer Stiftung, Skopje
- Bishev Gligor, (16.10.2009), *Credit risk management during crisis period*, EOS Congress, Berlin.
- Borio Claudio, (2012), *The financial cycle and macroeconomics: What have we learnt? , BIS Working Papers No 395, December 2012*
- Caruana Jaime,(November 2012), *International Monetary Policy Interaction: Challenges and Prospects*, Bank for International Settlements,
- CEE Banking Sector Report, Raiffeisen Research, 2012*
- Constancio Vitor, *The global financial crisis-5 years on*,BIS central bankers' speeches
- McKinsey Global Institute, (January 2012), *Debt and deleveraging: Univen progress on the path to growth*
- McKinsey Global Institute, (March 2013), *Financial globalization: Retreat or reset? Global capital markets 2013*
- Corbo Vittorio, *Some policy lessons for emerging economies*, BIS paper No 32, 35-36
- Moss Frank, (January 2013), *Managing turbulent times-the ECB and EMU from 2008 to 2013, National bank of the Republic of Macedonia*
- Ortiz Guillermo, *Global Banking: trends and policy issues-a host country perspective*, BIS paper No 32, 30-34
- Turner Adair,(February 2013), *Debt, money and Mephistopheles: How do we get out of this mess?*, Cass business school
- Wolf Martin, *The case for helicopter money...*, *Financial Times*, Wednesday, 13 February 2013, p.21

Boban Stojanović

University of Niš, Faculty of Economics, Niš, Serbia

Jelena Stanković

University of Niš, Faculty of Economics, Niš, Serbia

Vesna Janković-Milić

University of Niš, Faculty of Economics, Niš, Serbia

EUROPEAN INTEGRATION INFLUENCE ON BUSINESS CLIMATE IN SERBIA – PERCEPTIONS AND EXPECTATIONS OF BUSINESS COMMUNITY

ABSTRACT

This paper presents the research results on the business community in Serbia and its perception on the impact of European integration on the business environment in Serbia.

Author's aim is to highlight the factors of business success that business community in the Serbia sees as crucial for its development. This paper provides a statistical analysis of the research results related to the perception of the business community on this issue and adequate conclusions. At the same time, it is presented an analysis of the business community opinion in terms of positive and negative factors that are the result of European integration. The methods which are used in order to conduct analyses are: descriptive statistics, chi-square test and factor analysis. The results show that most of the enterprises in the sample are oriented toward the domestic market and that only the smaller group has experience in dealing with the European Union. Thus, the analysis is based on the two groups of companies - EU market oriented companies versus domestic market oriented companies. The first topic that has been analyzed in the paper refers to the factors that have the most negative impact on current or future product and service development. Respondents were offered the set of factors and they selected the most negative. The next task was the analysis of the factors which are most important for the company if Serbia access to the EU. These factors were classified into two groups: positive and negative. Each group consists of several factors and respondents were able to choose three which are, according to their opinion, most significant among them. The applied analyses showed that there is statistically significant difference in the perception of those two groups about opportunities and threats brought by accession of Serbia to the EU market.

Keywords: *Local Economic Development, European Integration, Business Climate, Business Success Factors, Statistical Analysis*

JEL classification: *C83, C12, D01, L25*

1. INTRODUCTION

Accession to the European Union is a strategic issue for Serbia, both in economic and in the geopolitical terms. Relations between Serbia and the European Union (EU) took on a different quality and character through history. Even in the period preceding the beginning of European integration, relations with the countries of the former Yugoslavia and the countries that would be the forerunner of the Union (Belgium, France, Italy, Luxembourg, Netherlands and Germany) were very diverse and generally were reflected traditional military-political alliances and rivalries of the time.

As the official start of long successful collaboration it is usually taken 1970, when it signed the first trade agreement between the European Economic Community (EEC) and Yugoslavia (SFRY). Collaboration is constantly promoted from year to year and culminated in 1990, when Yugoslavia was officially included in the PHARE program of the European Community - program to assist the restructuring of the countries of Eastern and Central Europe. But the breakup of Yugoslavia and the following events led to the cancellation of all forms of cooperation.

After the political changes in Yugoslavia (FRY), in 2000, convergence, networking and cooperation with the EU, once again became a top foreign policy priority. Entering our country to the EU was highlighted as a long-term goal of this policy. A European perspective today is one of the few political programs that incorporate most of the Serbian public. Although to date made many strides in this direction, this process is not without its challenges, both on the domestic and the foreign policy.

During this period, the most significant progress in relations between Serbia and of the European Union is reflected precisely in expanding and deepening economic relations. In the decade that preceded it, they came to refer it to the European Union is the largest trading partner of Serbia, that more than 50% of total Serbian exports go to the EU territory, and with over two billion invested grants in Serbia since 2000. The EU has the largest donor of financial resources that support political and economic reform in Serbia (according to the EU Delegation to Serbia, www.europa.rs/srbijaIEu.html).

On March 1, 2012, by decision of the European Council, Serbia became a candidate for EU membership. Serbia, as well as many Eastern European countries in the accession process making significant efforts and reforms, in order to achieve EU standards. But what does EU membership mean for Serbia and other Central and Eastern European (CEE) countries? What are the impacts of policy changes for the economies of these countries? Will EU membership result in a shift in competitiveness in the region? Which countries will benefit most and why? What are the benefits and challenges associated with the enlarged European Union and how will these affect the direction of investments, labor, and the public sector, for example? (Mockaitis, 2005)

The positive and negative aspects of EU membership are discussed by Hallett et al. (2005) in their paper "The European Economy at the Cross Roads: Structural Reforms, Fiscal Constraints and the Lisbon Agenda." The authors compare the pros and cons of joining the rigid EU structures for flexible economies, such as Britain, and less flexible economies, such as Germany and the Eastern countries, as well as the reasons behind

the slow moving market reform throughout Europe. The authors suggest that incentives for joining the EU are not uniform for all countries and likely resemble a give and take scenario, with more of the giving, or absorption of the negative effects of reforms being the burden of flexible economies.

Although reforms in the CEE countries have been ongoing for over a decade and a half, it is apparent that we have still only scratched the surface and have much yet to learn about and from one another (Plikynas, 2005). The situation is similar in Serbia, as well. It still is not clear to what extent EU membership will positively or negatively influence the domestic economies of the newly acceded countries.

In the case of Serbia, membership in the European Union represents an opportunity for stable development and rise of national competitiveness (Katic et al, 2011).

Strategic course of Serbia is integration in EU and entering European and world market of domestic companies and business in competition of high number of successful, export-oriented companies from other countries, multinational companies with world known products – brands, modern organized companies with the usage of the most contemporary information technology and modern designed organizational structure with highly educated, competent and experienced management (Katic et al., 2011). As for every European country, so for Serbia, European Union represents opportunity for stable development and amplification of national competitiveness.

The topic of this paper is to examine the attitudes of the business community in Serbia, about the factors (positive and negative) that affect the business environment and their business if Serbia joins the EU.

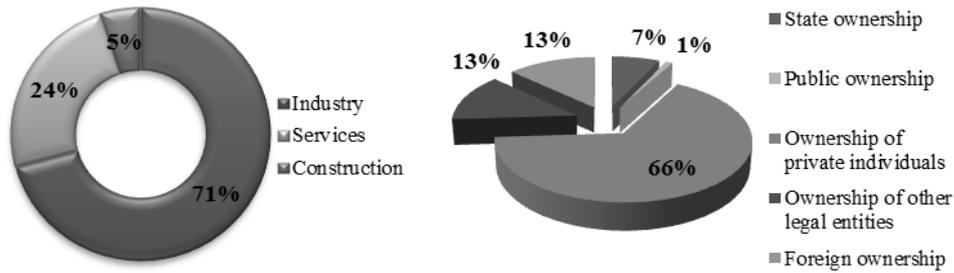
2. SAMPLE RELEVANCE, HYPOTHESES AND THE RESEARCH METHODOLOGY

The research was conducted in 2012 among Serbian companies in aim to collect information about the opinion of economic sector on a range of issues related to the problems and prospects of their business, but as well to the role of institutions in creating a favorable business environment. In addition to general information, the respondents were asked questions related to labor, investment plans, perception about their weaknesses and strengths, competitive capabilities, future business development plans and questions about the role of institutions in the development of business friendly environment. A significant part of the questionnaire was related to issues of European integration and the positive and negative aspects of this process on Serbian economy. Precisely those questions are the subject of analysis in this paper.

The research included 240 companies in Serbia and 23,564 employees of which 9,122 are women. Such gender structure (women's labor force of 38.42%) corresponds to the structure of the global labor force, where women's participation is 40% (according to the International Labour Office). Enterprises in the sample are from the following sectors: (1) industry sector, (2) construction and (3) service sector (Figure 1). Most of the enterprises in the sample (71%) is in the field of industrial production. The

ownership structure of the companies in the sample includes all forms of ownership that currently exist in Serbia and the sample can be considered relevant from that aspect, as well (Figure 1). The largest share in the ownership of companies in the sample have private individuals, as much as 66%.

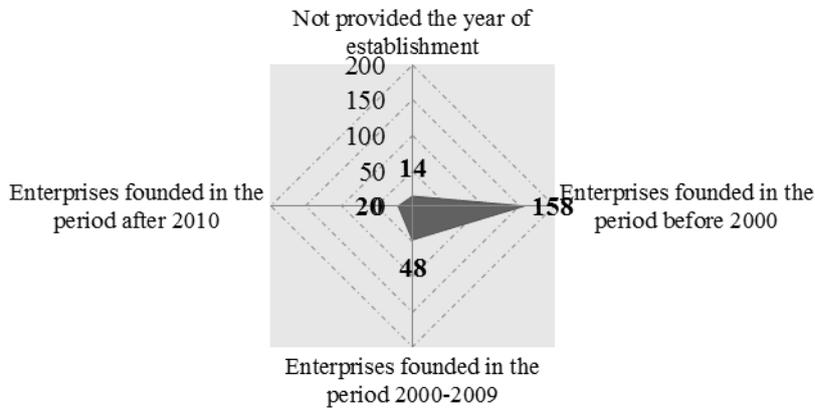
Figure 1: The structure of the sample by type branch and ownership



Source: Author's Preview

Most companies in the sample operated for more than 10 years, and their perceptions of the factors affecting their business can be considered real and with strong experiential support. As can be seen in Figure 2, only 20 companies in the sample can be considered "new" since were founded in the period after 2010.

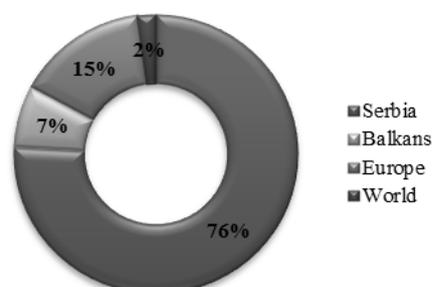
Figure 2: The structure of the sample by year of establishment



Source: Author's Preview

Interviewed business companies are generally oriented on Serbian market. In the observed sample there are 72 companies that, beside domestic market, are oriented towards EU market. The rest of the observed companies are oriented to the market of Balkan countries. The number of observed companies that are widely oriented (world market) is negligibly small (only 2%), as it is presented in Figure 3.

Figure 3: The sales structure of companies in the sample



Source: Author's Preview

According to this criterion, the three groups of companies in the sample are defined:

- The first group named "EU market oriented companies",
- The second group named "Domestic market oriented companies",
- The third group named "Other companies".

The structure of the defined groups according to branches is presented on the Table 1. Further analysis will be based on the first two groups of countries, i.e. EU market oriented companies versus Domestic market oriented companies.

Table 1: The structure of the sample according to the defined groups and branches

Sales market orientation	Branches			Total
	Construction	Industry	Service	
EU market oriented	4(40%)	56(32%)	12(18%)	72(30%)
Domestic market oriented	6(60%)	66(43%)	54(82%)	126(52.5%)
Other companies	0(0%)	42(25%)	0 (0%)	42(17.5%)
Total	10(100%)	164(100%)	66(100%)	240(100%)

Source: Author's calculation in SPSS (*Statistical Package for the Social Sciences*), 17.0

The basic hypothesis in this research is the following:

H_0 : There is no statistically significant difference in respondent's opinion about key factors and priority issues related to the process of Serbian integration into European Union depending on:

- Sales market orientation or
- Their branche.

In the purpose of testing these hypotheses it was necessary to:

- Classify all enterprises in the sample into three groups according to their branches and in addition in two groups, according to sales market orientation;

- Explore the structure of the sample according to previous classifications;
- Test the significance of attitude differences between defined groups of enterprises.

The methods which are used in order to conduct analyses listed above are: descriptive statistics, proportion difference testing, chi square test and factor analysis.

3. RESEARCH RESULTS

The first topic in which we analyze the differences in perceptions between the two groups, defined above, refers to factors that have the most negative impact on current / future product and service development. Respondents were offered 15 factors and they selected three which, in their opinion, have the most negative impact on their business activities.

According to the data from the Table 3, the factors that have the most negative impact on current / future product and service development in the first group are:

1. Macroeconomic conditions,
2. National legislation,
3. Foreign competition, Costs of materials or components.

The managers of the observed companies which are oriented on domestic markets have similar perception about this task. Namely, the top three factors according to their opinion are:

1. Macroeconomic conditions,
2. Interest rates,
3. National legislation.

By detailed analysis of data concerning the most important factors it is evident that there is a significant difference in the number of respondents who ranked factor Macroeconomic conditions as the most important. The data presented in the Table 2 suggest that participation of companies that have defined this factor as one of the most negative for current / future product and service development in the EU market oriented companies is 29.4%, while in the second group is 30.5%. That means that companies which are oriented strictly on domestic market are more affected by the difficult economic conditions in the country.

Table 2: Relative frequencies of factors that have the most negative impact on current/future product and service development according to the market orientation

	Factor	EU market oriented	Domestic market oriented
1	Foreign competition	9.8%	4.3%
2	Domestic competition	6.9%	8.5%
3	Macroeconomic conditions	29.4%	30.5%
4	Energy costs	8.8%	6.7%
5	Costs of materials or components	9.8%	7.9%
6	Inadequate capacity	2.0%	1.8%
7	National legislation	13.7%	9.1%
8	Attitude of local government	4.9%	6.1%
9	Interest rates	7.8%	9.8%
10	Finance unavailability	4.9%	4.9%
11	Labour costs	0%	4.3%
12	Lack of qualified labour	0%	0.6%
13	Environmental constrains	2.0%	1.2%
14	Market distance	0%	2.4%
15	The loss of former Yugoslav market	0%	1.8%
	Total	100%	100%

Source: Author's calculation in SPSS

According to the results obtained by Chi-square test, the conclusion is that there is no dependence between market orientation and factors that have the most negative impact on current / future product and service development (p-value = 0.373).

According to the data from the Table 3, one third of surveyed companies from all branches are affected by General economic condition. Although the application of the Chi-square resulted that there is no correlation between the branch and the respondents' perceptions about factors that have the most negative impact on current / future product and service development (p-value=0.542), difference between perceptions could be noticed. For example, construction companies are, beside general economic condition, affected by the Attitude of local government, while service companies are affected by National legislation.

Table 3 Relative frequencies of factors that have the most negative impact on current / future product and service development according to the branch

	Factor	Construction	Industry	Service
1	Foreign competition	5.6%	8.4%	3.3%
2	Domestic competition	5.6%	6.3%	10%
3	Macroeconomic conditions	33.3%	31.5%	27.8%
4	Energy costs	5.6%	7%	7.8%
5	Costs of materials or components	11.1%	9.1%	6.7%
6	Inadequate capacity	0%	3.5%	0%
7	National legislation	5.6%	9.1%	14.4%
8	Attitude of local government	16.7%	2.8%	8.9%
9	Interest rates	11.1%	8.4%	10%
10	Finance unavailability	5.6%	6.3%	3.3%
11	Labour costs	0%	0.7%	6.7%
12	Lack of qualified labour	0%	0.7%	0%
13	Environmental constrains	0%	2.1%	0%
14	Market distance	0%	2.1%	1.1%
15	The loss of former Yugoslav market	0%	2.1%	0%
	Total	100%	100%	100%

Source: Author's calculation in SPSS.

Statistical method for data reduction, named factor analysis, was performed in order to discover new common factors, which will include all existing, grouped according to common characteristics. After the application of factor analysis, it was concluded that all these factors can be explained or grouped into 5 new factors whose structure was as follows.

Table 4: The structure of the new factors

New factors	Factor
I	Foreign competition
	Costs of materials or components
	Inadequate capacity
	National legislation
II	Domestic competition
	Lack of qualified labour
	Environmental constrains
III	Macroeconomic conditions
	Energy costs
	Labour costs
IV	Attitude of local government
	Interest rates
	Finance unavailability
V	Market distance
	The loss of former Yugoslav market

Source: Author's calculation in SPSS

The next task that was the subject of the analysis was factors which are most important for the company if Serbia joins the EU. These factors were classified into two groups: positive and negative. Each group consists of eight factors and respondents were able to choose three which are, according to their opinion, most significant among them.

The comparative analysis of number of respondents and their proportion within the group is presented on the Table 5. According to the data from this table the top three factor which are the most important for the company if Serbia joins the EU in the first group are:

1. Access to the large market without tariffs and other barriers,
2. A stable business climate,
3. The unique currency.

The managers from the group of domestic market oriented companies have different expectations. Namely, the most important positive factors according to their opinion are:

1. A stable business climate,
2. Access to the large market without tariffs and other barriers,
3. Easier implementation of the law.

Table 5: The relative frequencies of positive factors which are the most important for the company if Serbia joins the EU – comparative preview

	Factor	Sales market orientation	
		EU market	Domestic market
1	A stable business climate	18.3%	27.0%
2	Easier implementation of the law	7.5%	14.1%
3	Access to the large market without tariffs and other barriers	26.9%	16.1%
4	Stable capital market	12.9%	13.5%
5	Better labour force supply	1.1%	2.5%
6	The unique currency	15.1%	12.3%
7	Participation in EU programs	14.0%	9.2%
8	A higher level of protection of economic competition	4.3%	5.5%
	Total	100%	100%

Source: Author's calculation in SPSS

The dependence between respondents' opinion about most important positive effect of Serbia accession to the EU and market orientation isn't statistically significant (Sig. 0.190), but there are differences in perceptions within these two groups.

Table 6: The relative frequencies of positive factors which are the most important for the company if Serbia joins the EU – comparative preview

	Factor	Branch		
		Construction	Industry	Service
1	A stable business climate	11.1%	23.6%	28.2%
2	Easier implementation of the law	0%	10.7%	15.3%
3	Access to the large market without tariffs and other barriers	16.7%	25.7%	10.6%
4	Stable capital market	16.7%	12.9%	12.9%
5	Better labour force supply	5.6%	1.4%	2.4%
6	The unique currency	16.7%	12.1%	12.9%
7	Participation in EU programs	22.2%	10.7%	9.4%
8	A higher level of protection of economic competition	11.1%	2.9%	8.2%
	Total	100%	100%	100%

Source: Author's calculation in SPSS.

As it can be seen from the table above, the expectations are different according to the branches. Construction companies mostly are hoping to Participation to EU programs, while industry and service companies are mostly expect a stable business climate. Besides that, difference between branches isn't statistically significant (p-value=0.376),

so the conclusion is that there is no dependence between branches and respondents expectations.

Comparative previews of relative frequencies for the negative factors between groups are presented in the Table 7.

Table 7: The relative frequencies of negative factors which are most important for the company if Serbia joins the EU – comparative preview

	Factor	Orientation	
		EU market	Domestic market
1	Strong competition	26.3%	31.9%
2	Limited capabilities for a competitive price	15.8%	11%
3	Stricter consumer protection	10.5%	12.1%
4	Stricter environmental legislation	10.5%	11%
5	Investment in adaptation to new conditions	22.8%	16.5%
6	Higher ethical requirements	5.3%	6.6%
7	Stricter state rules for companies	3.5%	2.2%
8	Higher labour costs	5.3%	8.8%
	Total	100%	100%

Source: Author's calculation in SPSS.

According to the data presented in the table above, it is possible to extract top three negative factors in the each group. The negative factors that have the highest frequencies in the group of enterprises oriented to the EU market are:

1. Strong competition,
2. Investment in adaptation to new conditions,
3. Limited capabilities for a competitive price.

In the group of domestic market oriented companies, the concerns are similar. On the first place, there is a Strong competition, and then goes Investment in adaptation to new conditions, while on the third place there is a stricter consumer protection. Such results tell us that the managers from the both groups are almost equally concerned at their business in the future, and their concerns are not dependent on market orientation (p-value=0.909).

According to the data from the Table 8 the most important negative factor or consequence of Serbian integration into EU in all branches is the stronger competition. Besides that, construction companies are also afraid of stricter consumer protection, companies from the industry and service branches are afraid of Investment in adaptation to new conditions.

Table 8: The relative frequencies of negative factors which are most important for the company if Serbia joins the EU – comparative preview

	Factor	Branch		
		Construction	Industry	Services
1	Strong competition	27.3%	32.5%	27.7%
2	Limited capabilities for a competitive price	18.2%	10.8%	10.6%
3	Stricter consumer protection	18.2%	9.6%	12.8%
4	Stricter environmental legislation	9.1%	9.6%	14.9%
5	Investment in adaptation to new conditions	9.1%	16.9%	23.4%
6	Higher ethical requirements	9.1%	4.8%	8.5%
7	Stricter state rules for companies	0%	4.8%	0%
8	Higher labour costs	9.1%	10.8%	2.1%
	Total	100%	100%	100%

Source: Author's calculation in SPSS

The last task which will be analysed is respondents' opinion about treatment and role of foreign investors on domestic market. Respondents were asked to rank (1-the most important, 5- the least important) the importance of following claims:

1. The arrival of foreign investors had a positive impact on attracting new investors
2. Foreign investors contribute to the market expansion,
3. Local Self Government has same attitude towards domestic and foreign investors

The obtained results are presented in the Table 9.

Table 9: Relative frequencies of ranks related to the offered claims

Claim	1	2	3	4	5
The arrival of foreign investors had a positive impact on attracting new investors	33.3%	12.7%	29.4%	7.8%	16.7%
Foreign investors contribute to the market expansion	28.6%	18.4%	28.6%	9.2%	15.3%
Local Self Government has same attitude towards domestic and foreign investors	26.5%	12.2%	23.5%	12.2%	25.5%

Source: Author's calculation in SPSS.

According to data presented in Table 9, respondents' opinion about treatment and role of foreign investors on domestic market is harmonized. One third of the total number of respondents has awarded the highest rank to these issues.

There is no statistically significant difference in respondent's opinion between groups. Based on that fact, it is possible to conclude that, regardless of the market placement, interviewed managers have similar, even the same perception about the business requirements in the Republic of Serbia.

4. CONCLUSION

Economic relations between Serbia and the European Union have intensified in the past 10 years. This is particularly evident after the signing of the Stabilization and Association Agreement (SAA) and the Interim Trade Agreement in 2008. The agreement creates a free trade area between the EU and Serbia in a transitional period of six years. Serbia's obligation consists in the gradual abolition of tariffs on imports from the European Union in the interim period. On the other hand, the European Union this contract confirms free access to goods from Serbia to the EU market.

However, this intensified cooperation impact on series of business factors and has direct influence on enterprises in Serbia. The results of the opinion of business community of Serbia are presented in this paper. These opinions are related to the positive and negative factors of business when it comes to the impact of EU integration.

The results show that most of the enterprises in the sample are oriented toward the domestic market, and that only 30% has experience in dealing with the European Union. According to the obtained results, the general conclusion is that difference in the perception of opportunities and threats brought by the opening of the EU market for Serbia is evident, but isn't statistically significant.

REFERENCES

- Chakrapani, C. (2004) *Statistics in Marketing Research*. London: Hodder Arnold.
- Cohen, J. (1998) *Statistical power analysis for the behavioral sciences* (2nd ed.). New Jersey: Lawrence Erlbaum
- European Orientation of Serbian Citizens (2010). Trends, European Integration Office of Republic of Serbia European Union Delegation in Serbia, <http://www.europa.rs/srbijaEu.html> (access date August 22nd, 2012).
- Hallett, A.H., Svend, E.H.J., Christian, R., 2005. The European economy at the cross roads: Structural reforms, fiscal constraints and the Lisbon Agenda. *Res. Int. Business Finance* 19, 229–250.
- Hardle, W., Simar L. (2003) *Applied Multivariate Statistical Analysis*. <http://www.stat.wvu.edu/~jharner/courses/stat541/mva.pdf> (21.05.2011.)
- International Labour Office (2010) *Women in labour markets: Measuring progress and identifying challenges* (Geneva), http://www.ilo.org/wcmsp5/groups/public/edemp/empelm/trends/documents/publication/wcms_123835.pdf, (access date March 7th, 2012).
- International Labour Office (2010) *Women in labour markets: Measuring progress and indentifying challenges* (Geneva), downloaded March, 02nd 2012 http://www.ilo.org/wcmsp5/groups/public/ed_emp/empelm/trends/documents/publication/wcms_123835.pdf
- Katic A., Raletic S., Jokanovic B., Abramovic G., The importance of competitiveness measuring in the light of Serbia's accession to European Union, *Procedia Social and Behavioral Sciences* 24 (2011) 677–686.
- Leskiewicz Sandwik I., Sandwik K., The impact of market orientation on
- Mockaitis A.I., The race to the EU integration: How many and how high are the hurdles? *Research in International Business and Finance* 19 (2005) 195–199

Plikynas, D., Leonidas, S., Alina, P., 2005. Analysis of foreign investment impact on the dynamics of national capitalization structure: Computational intelligence approach. *Res. Int. Business Finance* 19, 304–332.

Serbia 2020: Concept of development of Republic of Serbia until year 2020, <http://www.predsednik.rs>

Statistical Office of Serbia (2012) Municipalities and Regions in Serbia in 2011, http://webrzs.stat.gov.rs/WebSite/repository/documents/00/00/54/08/Opstinski_godisnjak_Republike_Srbije_2011.zip, (access date February 16th, 2012).

Bogdana Vujnović-Gligorić

Pan-European University Apeiron, Banja Luka, Bosnia and Herzegovina

Sanel Jakupović

Pan-European University Apeiron, Banja Luka, Bosnia and Herzegovina

Nataša Zrilić

Fund for Environmental Protection of the Republic of Srpska, Banja Luka, Bosnia and Herzegovina

BOSNIA AND HERZEGOVINA IN THE PROCESS OF FINANCIAL LIBERALIZATION

ABSTRACT

In the process of accession to the European Union financial liberalization is imposed as a necessity. Financial liberalization is particularly more attractive to developing countries that have a need for external sources of funding, to help fill the gap between low domestic savings and accumulation, on the one hand and the need for investment, on the other hand. Such a need was expressed in Bosnia and Herzegovina, where the ravages of war destroyed the economy, and the need for development is big. Opening to import foreign capital should, also, contribute to a better allocative efficiency and competitive discipline, which would in the final optimize the management of aggregate saving and investment. These were the expectations of developing countries, not knowing that financial liberalization, in addition to the visual benefits, also brings dangers that threaten the country's economic development. With imports of capital increases the level of imported interventionism; imported capital determines the direction of development of the economy, which can often be in contrast with the economic development policies of the country. The big problem is if imported capital finances consumption, imports and trade, which become the basic economic activities, and lacking domestic production and exports as the main generator of sustainable development. Despite the fact that financial liberalization across the world economy turns into a unity system, it increases the economic, social, developmental and other differences between countries with different degrees of development. To understand the essence of financial liberalization, it should be considered as part of the broader economic liberalization. Therefore, in the first part of this paper we analyze the importance of structural reforms and institutional building. The second part will be devoted to the globalization of the international financial system and the importance of capital flows to developing countries. The third part is about controversies about financial liberalization.

Keywords: financial liberalization, foreign capital, the risks, benefits.

JEL classification: G15, G18

1. INTRODUCTION

A significant component of the overall process of globalization makes financial liberalization. Financial liberalization is a process of integration of the financial system of a country in international financial markets and institutions. For financial liberalization at the global level it is necessary prior implementation of liberalization of the domestic financial sector, and rise of the flow of capital in such a liberalized economies. Interest in financial liberalization is expressed in all countries, regardless of their degree of development. Developed countries see their chances of placing surplus funds, and developing countries and underdeveloped countries see only chance to raise capital, which could run its economy.

However, financial liberalization has its side effects which can reflect differently in different countries since, depending on their level of development, speed of acceptance, the development of legislation and financial institutions, etc. The goal is that each country through its financial integration with the global market, uses all the benefits that this can provide. However, different integration strategies brought different results. Some countries have applied a strategy of gradual liberalization, while others pursued rapid deployment, so the consequences are different.

2. THE IMPORTANCE OF STRUCTURAL REFORMS AND INSTITUTION BUILDING FOR FINANCIAL LIBERALIZATION

Crossing of the Bosnian-Herzegovinian economy to a market economy comes at a time of instability and inflationary exit from war-torn economy. In order to expedite the transition of activities the state has decided for "shock therapy" and quickly opening up to global capital flows. However, financial liberalization emphasizes the importance of past structural reforms and institutional building.

Structural reforms are related to the change of the economic structure, ie, a change in ownership, management structure, then the regulation and supervision of the financial sector, restructure of large enterprises, strengthening competition, the establishment of standards in the field of accounting, audit and control, improving transparency, etc.

When it comes to institutional building, it is applicable not only to changes in flats but also "profit institute, Institute of shareholding and corporatist, bankruptcy, institute financial system (banks, non-bank financial institutions, stock exchanges, the Securities Institute of hard budgetary constraints) and the Institute of the competition. "

Foreign capital is seeking owners of the property, which required acceleration of the privatization process. Ownership transformation is largely conducted through bad models, which were justified by constitutional and statutory provisions. Privatization has created such an ownership structure in which only interest is a capital-profits. Such interest will in parallel with the rapid expansion, demolish existing and build new systems of values: the sharp competition with foreign goods, the banking system in private (and foreign) owned financial-market, instruments unadjusted to market scheming, bad system of controls and supervision, etc. With poor Institutional building was expressed and bad management process. Instead that competing forces lead to the

construction of an efficient institutional and management framework, which will improve the quality of privatization, in Bosnia and Herzegovina the privatization was not accompanied by the establishment of an adequate framework. So, the big institutional underdevelopment and structural distortions couldn't present ownership transformation in favor of the state. Financial liberalization, instead of "shock therapy", demanded gradualism, with previous improvement of the institutional infrastructure, with strict financial discipline and competition. The international financial community has agreed in stand "on the desirability of a comprehensive approach to work simultaneously on liberalization, stabilization and structural reform of the economy..."

Accordingly, financial liberalization was intended to be an integral component of a comprehensive macroeconomic stabilization and structural reform and institutional building. In-torn Bosnia they could not be achieved neither macroeconomic stabilization nor structural reforms, without influence of foreign capital.

3. THE GLOBALIZATION OF THE INTERNATIONAL FINANCIAL SYSTEM

To be able to make certain decisions regarding the improvement of financial liberalization, it is necessary to evaluate the previously achieved level of liberalization and financial freedom in a country. Financial liberalization can be viewed through several indicators, such as the index of financial freedom, global competitiveness index, index of business conditions, etc.

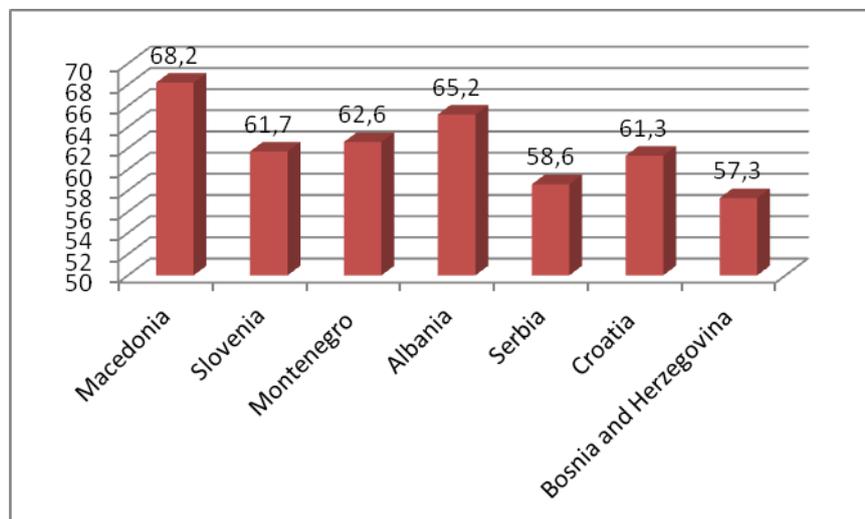
Index of financial freedom will be seen through the index compiled by well-known American Foundation-The foundation Haritage, normally consisting of ten indicators (freedoms). Criteria for financial freedom are:

- Rule of law, or, achieved level of regulation in the area of control of the financial sector,
- Regulatory Effectiveness (frequency of government intervention in the banking sector),
- The limitations of the government (in the ease of opening and managing companies in the financial sector),
- Openness (influence of government to allocate credit).

In the following picture you can see the achieved level of financial freedom at a global level. Grades are given ranging from 0 to 100, with the following characteristics:

- 80-100 - countries are financially free,
- 70 -79.9 - countries are mostly free,
- 60-69.9 - moderately free countries,
- 50-59.9 - countries usually not free,
- 0-49.9 - countries are under pressure.

Figure 1: The achieved level of financial freedom in the environment in 2012



Source: Index of economic freedom 2013, The Heritage Foundation, Washington D.C, 2013

Global Competitiveness Index, established by The Heritage Foundation, was released in January 2013 shows that the economic freedom increased in 32 European countries, while nine countries lost economic freedom (Cyprus and Ireland have the worst indicators). The biggest impact of the economic freedoms recorded Sweden, Germany, Georgia, Czech Republic, Norway, Poland, Romania and Bulgaria, while declining trends are present in France, Greece, Italy, Portugal and Great Britain. Bosnia and Herzegovina is a country with a predominantly low freedom, although in 2009 it had a level of freedom 60 and belonged to countries with moderate freedom.

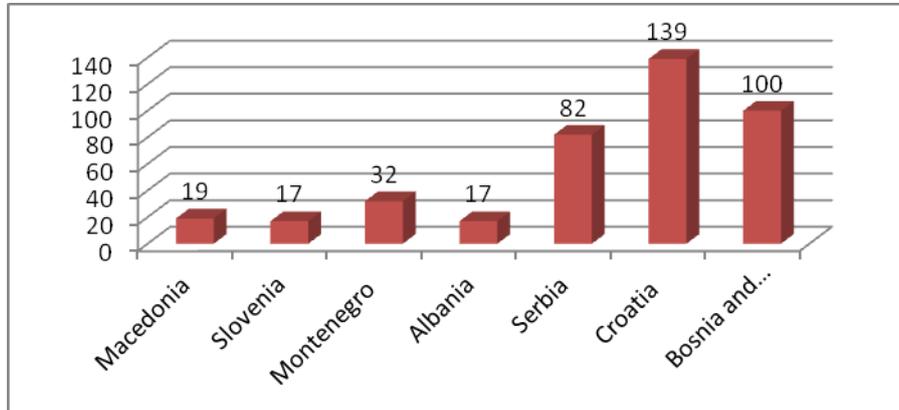
The authors cautioned that the index's criteria in Europe undermined the rule of law, and that corruption and poor protection of property rights have provoked slow growth and increase the debt crisis. What is worrying is that Europe remained the last ranking, stroll among the six regions, the two indicators of government restrictions, such as fiscal freedom and government spending.

Tendencies of Bosnia and Herzegovina towards financial freedom can best be seen in three key indicators:

- The protection of investors,
- Ease of obtaining credit,
- Competitiveness.

Indicator of investor protection, talks about the availability of information to the public and shareholders related to operations, in order to prevent problematic transactions. Also, this index shows the possibilities of compensation to investors, resolving disputes, and the effectiveness of sanctions for damages. On the following chart the indicators that evaluate the protection of investors in the region are outlined.

Figure 2: Protection of investors - global grade of countries in the region in 2012

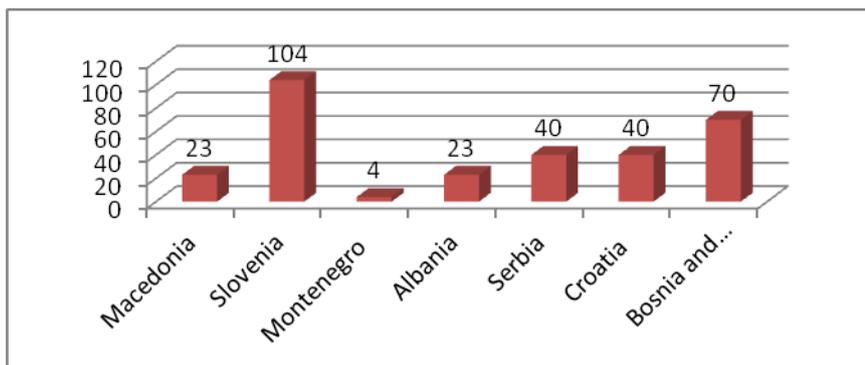


Source: Federalni zavod za programiranje razvoja, Lakoća poslovanja 2013 B&H, www.fzzpr.gov.ba (05.02.2013.)

From the standpoint of protecting the investors Bosnia and Herzegovina occupies a bad position (in 100th place in the world), which indicates the reason for the decreased interest of foreign investors to invest in Bosnia and Herzegovina.

With figure 2 it is presented assessment is the ease of getting credit in the region. Possibility of obtaining a loan is essential for business firms. Rating of functioning of credit market was based on two sets of indicators: the loans received and returned, as well as the legal rights and obligations of the debtor and the creditor. For each credit is important to have sufficient credit information when assessing risk and thus allocate credit more efficiently. This indicator includes the evaluation of credit in the event of non-repayment of loans.

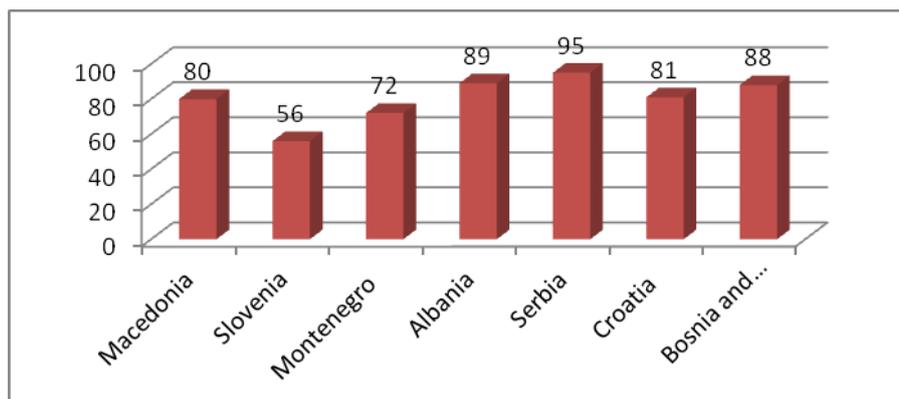
Figure 3: Getting a loan - a global rating of surrounding countries in 2012



Source: Federalni zavod za programiranje razvoja, Lakoća poslovanja 2013 B&H, www.fzzpr.gov.ba (05.02.2013.)

The ease of getting credit in Bosnia and Herzegovina has also been slowed in relation to the region, so that the 70th place in the world occupies Bosnia and Herzegovina. According to the index of competitiveness, Bosnia and Herzegovina occupies 88th place in the world and can be seen in Figure 3.

Figure 3: Evaluation of the competitiveness of the neighboring countries in 2012



Source: Federalni zavod za programiranje razvoja, Konkurentnost 2012-2013 B&H, <http://www.fzzpr.gov.ba> (05.02.2013.)

Based on achieved indicators, which can assess the financial freedom in Bosnia and Herzegovina, it is evident that Bosnia and Herzegovina has a lot of work on the liberalization of the financial markets. Greater liberalization requires effective supervision of the financial institutions, primarily banks. Supervision is necessary to ensure the safety and stability of the financial system, and the safety of investors and citizens through respect for legal norms of the institutions that offer financial services. Protection of citizens can be provided through market activities of financial institutions, the strengthening of institutions such as independent audits and medias. Entanglement of the state in the work of banks must be reduced because the state intervention distorts competition, discourages work and increases the cost of financing. However, with market operations it increases the risks, so that in addition to strengthening the contractual obligations and preventing illegal activities in the business, and increases the need for government intervention, which again restricts economic freedom and the ability of non-bank financial institutions to contribute to economic growth and development of the country. For example, if the government intervenes in the stock market then it faces interference in the price of capital. The market action, and general securities, measures gains and losses of public companies, which is the benchmark for allocating capital to the most profitable projects. Also, in the area of state intervention in insurance sector, it prevents the offer of this service on market conditions and with corresponding risks.

4. CONTROVERSIES ON FINANCIAL LIBERALIZATION

Financial globalization in developing countries can bring certain benefits, most of which are reflected in the development of the financial system. Development of the financial system implies a more comprehensive, more stable and better regulated financial market. A well-developed financial system is the basis of development of the economy of each country.

Besides, financial liberalization brings other advantages, such as:

- Easier access to a wider range of funding sources,
- Efficient allocation (diversification) risk (between domestic and foreign investors),
- Allocation of risk encourages companies to invest more, which impacts on economic growth,
- Financially liberalized countries attract foreign investment, followed by transfer of technology and knowledge, crucial for the growth of labor productivity,
- Entry of foreign financial institutions, encourages competition that improves the quality of services in the domestic financial sector,
- Financial liberalization fosters greater discipline and adopts strategies for creating a favorable investment climate.

Financial policy makers must as far as possible take advantage of the opportunities provided by financial liberalization, while minimizing its risks. Process of liberalization of Bosnia and Herzegovina will be deepened in the future, because of lack of capital needed for economic development of the country. However, the risk of rising interest rates due to the strong demand for loans, and limited interest of investors to invest in low credit ratings, especially in the conditions of financial crisis.

In order that the developing countries would have long-term economic benefits of the liberalization process, it is essential that this process is lighter and aligned with the development of key assumptions necessary for the freer movement of capital. Underdeveloped financial institutions, inadequate economic policy, poor regulation and supervision of banks, large budget deficits lead to high short-term borrowing by companies and banks. At the same time, a fixed exchange rate and state guarantees for deposits of banks, foreign investors are attracted by interests above average earnings. Growth in lending, due to weak banking supervision, leading to large losses on loans and reduce the value of the balance sheet of banks, the insolvency of the banking system, etc. In the case of devaluation of the domestic currency increases the burden on banks and debit of the companies that has been borrowed in foreign currency. Given that companies are not able to settle obligations of banking eroded bank capital (so called, losses on the substances of banking capital).

Besides, the instability comes from the international financial markets. In this market appears speculative bubble, irrational investor behavior, etc., which may cause the financial crisis and healthy economies.

In the absence of information, foreign investors are randomly entering the country mostly because others invested in it, so that in case of the first inkling of disorder they rapidly retreat equity provoking a crisis of major proportions. Asymmetric information

arising from the lack of transparency in financial institutions could lead to "inefficient allocation of financial flows, generate inconsistencies of due date, and result in costly crises." (Stiglitz, 2004:57)

Bosnia and Herzegovina in the process of financial liberalization, was faced with numerous problems. Problems related to the process of liberalization are mainly caused due to blindly following of an ideology, no regulated legal, institutional and managerial infrastructure. In addition, structural reforms misfired, which requires liberalism. In Bosnia and Herzegovina liberalization occurs in the postwar period, but ignoring all the important conditions for the functioning of markets and the economy. In an effort to liberalize the market as soon as possible and meet the criteria for joining the European Union liberalization hurried, so it's hard to expect benefits for which it access to liberalization. Instead of creating fair conditions for business, it appeared on the markets through anarchy that led to social stratification. The benefit of such a market structure had a small group, while most of the financial situation remains the same or is worse. Anarchism on the market was reflected mainly in the absence of rules of corporate conduct, which would define permissible and impermissible activities. Big winners in the process of liberalization have become the owners of larger capital. Besides legalization suspiciously acquired capital, were given an extra chance in the international diversification, through the liberalization of capital movements. Because of these developments, it was necessary to bring in big red capital, so that it began to behave in a strictly defined rules and regulations.

Consequently, it can be concluded that the state is "flown" in the liberalization process of the blind effort to change the administration as soon as the previous political system, and the sooner it makes up the lost time of development. In such a hurry state has used radical measures considering that the financial system has a better credit rating. The privatization of state companies, the budget extenders, was the basis for the excessive growth of government administration costs. Introduction of VAT Act in the state, through mandatory taxes, credited to importers by paying advance tax on imported goods. Such a system of calculation of VAT filled budget and encouraged imports, while simultaneously it discouraged domestic production in which tax collection is done by the sale. Due to the rising cost of financing, technological obsolescence and inadequate human resources, most of the domestic cost of production has become uncompetitive compared to the equivalent foreign goods.

In terms of credit market liberalization population resorted to buying outside of real purchasing power, which is further aggravated by a personal budget with high interest rates. High indebtedness of the population and the state, which has at times exceeded the value of money in circulation had consequently lead to a financial crisis. Given that the market is globalized financial crisis in one country spreads to the economies of other countries, that it is globalized.

5. CONCLUSION

Financial liberalization brings certain advantages and risks that could threaten the sustainable development of the economy. Financial liberalization in Bosnia, due to low

productivity, contributed to the loss of domestic production and jobs. Liberalization has brought effective realization of profits for private capital, which may not be a function of the economy development. Interest of private capital can be a cause of deviant phenomena, such as moving to countries with more favorable investment climate.

The inflow of foreign capital in Bosnia and Herzegovina has achieved some positive effects in the development of the domestic sector and better financial deals, but has not achieved progress in technological development, competitiveness and exports. Through the influx of foreign capital has been increased indebtedness of the economy and population, and that are not initiated activities that would facilitate repayment of loans. What can happen as a reflection of the growth of the listed activities of the government deficit, which will eventually increase the pressure on taxpayers?

Market liberalization is a concept that does not need to be left, but to eliminate any omissions. Small and underdeveloped countries have no alternative to their financial liberalization as a necessity. One must efficiently take advantage of financial liberalization and avoid its negative consequences if they want to become an EU member, to avoid stagnation and isolation, and also preserve their authentic values.

In the future, it is necessary to work on improving the investment climate, creating an environment that encourages savings, stimulates the flow of foreign capital, and build credibility, transparency and consistency of a comprehensive national policy, with the purpose of encouraging production, investment and exports. The current economic growth, determined by the growth of imports, trade and consumption, is short-lived. If you ignore the production, investment and exports it may be difficult to ensure long-term sustainability of the country.

REFERENCES

- Federalni zavod za programiranje razvoja, Konkurentnost 2012-2013 B&H, <http://www.fzzpr.gov.ba> (05.02.2013.)
- Izvor: Federalni zavod za programiranje razvoja, Lakoća poslovanja 2013 B&H, www.fzzpr.gov.ba (05.02.2013.)
- Radmilović, S., *Finansijska liberalizacija ali i drugi suštinski (non-technical) kriterijumi za pristupanje EU.* (<http://www.scribd.com/doc/29027204/FINANSIJSKA-LIBERALIZACIJA-ALI-I-DRUGI-SU%C5%A0TINSKI-NON-TECHNICAL-KRITERIJUMI-ZA-PRISTUPANJE-EU>), str.6
- Stiglitz, J., *Capital-Market Liberalization, Globalization, and the IMF*, Oxford Review of Economic Policy, Vol 20, No.1, 2004.
- World Economic Outlook, *Focus on Transition Economies*, October, 2000, International Monetary Fund, str. 90-91

SESSION 4

EU ENLARGEMENTS
IN BUSINESS
PERSPECTIVE

Anita Radman Peša

University of Zadar, Department of Economics, Zadar, Croatia

Sanjin Stanković

University of Zadar, Department of Economics, Zadar, Croatia

THE ROLE OF MoU AND ITS INSTRUMENTS BETWEEN CENTRAL BANKS OF TRANSITIONAL COUNTRIES AND INTERNATIONAL BANKS IN THE LIGHT OF FINANCIAL INTEGRATION

ABSTRACT

The aim of this study is to investigate the role of multilateral MoU (memorandum of understanding) between Central Banks of transitional countries and international banks (supervisors) in the light of strengthening financial supervision, cooperation and exchange of financial information in the process of EU financial integration. The main research question is based on the relevance of the MoU instruments such as macroeconomic and financial sector information. Also we want to check the adaptability of MoU instruments which should help to inspect and create operational steps (e. g. stress testing) in transitional countries in the light of actual global financial instability. In the scope of our interest is Croatian National Bank (CNB) and as a representative of transition financial bank of the country on their imminent entry in EU. We will research different MoU's which CNB signed on its way to EU financial integration as an example. Results of research give us evidence of the dependence between Croatian financial system and financial systems of some specific EU countries such as Germany, Italy and Austria. Reason for closer financial dependence between those EU countries and Croatia, authors find in the strong presence of German, Austrian and Italian affiliate banks in Croatia.

Keywords: financial integration, banking supervision, memorandum of understanding

JEL classification: E44, F33, G21

1. INTRODUCTION

The aim of this study is to investigate the role of multilateral MoU (memorandum of understanding) between Central Banks of transitional and international banks (supervisors) in the light of strengthening financial supervision, cooperation and exchange of financial information in the process of EU financial integration. The main research question is based on the relevance of the MoU instrument. Transitional countries on their way to EU have concluded many bilateral MoU with their main

partners in the European Union as well as with the other countries regarding of cooperation and exchange of information in the field of banking supervision across south-eastern Europe. This MoU foresees regular meetings of Heads of Supervision Departments and Governors, annual information exchanges on macroeconomic and financial sector indicators, joint on-site inspections and the creation of task forces on specific issues to be tackled (stress-testing).

Many authors agreed that this approach has limitations in the practice. The MoU lacks legal enforceability and as a result no penalties are envisaged in case the contract is breached. Also, in the absence of full regulatory harmonization, differences in accounting rules leave room for a lax interpretation of a bank's financial condition.

Also, MoU is confidential, which could limit accountability for the institutions involved. The lack of access to information regarding supervisory standards is another problem and EU candidate countries should be more involved in the meetings of supervisory institutions such as Basel Committee. Many authors doubt can the current agreements prevent unilateral actions by home or host supervisors/institutions to the detriment of the banking group because neither instruments can guarantee a coordinate approach to crisis resolution in the event of banking failure, as this requires a consensus between supervisors and financial sector regulations (ECB, 2010).

Results of research give us evidence of the dependence between Croatian financial system and financial systems of some specific EU countries such as Germany, Italy, France and Austria. Reason for closer financial dependence between those EU countries and Croatia, authors find in the strong presence of German, French, Austrian and Italian affiliate banks in Croatia.

The following chapters are structured thusly: In chapter 2 theoretical background of financial supervision is given, in chapter 3 the role of MoU's is explained and the implications are revisited in the conclusion.

2. FINANCIAL SUPERVISION

2.1. Financial supervision in general

Financial globalization got started in the mid of 1980s with rising cross-border financial flows among industrial economies and between industrial and developing economies. The liberalization of capital controls in many countries led to the better global allocation of capital and improved international risk-sharing possibilities. But the crises showed that developing countries have been more vulnerable than big industrial ones and has led to a debate on the costs and benefits of financial globalization.

Some economists view increasing capital account liberalization and unfettered capital flows as a serious impediment to global financial stability (Rodrik 1998, Bhagwati 1998, Stiglitz 2002) leading to the necessity for capital controls and the imposition of restrictions. Others (e.g. Summers 1998) argue that increased openness to capital flows

has proven essential for countries striving to upgrade from lower to middle-income status, while significantly enhancing stability among industrialized ones.

(Kose et al. 2006) agreed about the positive role of financial globalization, but they pointed out that there are many unanswered questions about how a country should organize and pace its growth. Kenen (2007) states it is almost impossible to conceive of a world without a global financial system. Large numbers of low-income developing countries have little access to that system but most middle-income developing countries are increasingly integrated into a global system and all of the major developed countries are fully integrated. Kose et al. (2006) suggested that the main gains from integration do not derive directly from the transfer of capital from rich to poor countries; they derive from 'potential collateral benefits' - the contribution of financial integration to the quality of institutions in the capital-importing countries, including improvements in corporate governance, the quality of banking supervision, and the deepening of financial markets. The conclusion is that the countries that would benefit the most from the indirect effects of financial integration may not be able to attract much foreign capital precisely because their institutions are far too weak to attract foreign investors.

The risks of financial globalization are more likely to be home-grown, not imported from international markets, but several emerging-market countries are in far better shape today than they were a decade ago. The monetary operations are conducted by the national central banks and other agencies that are directly responsible for bank supervision. Some emerging-market countries have adopted more flexible exchange rates and many have accumulated far greater reserves than they held a decade ago: the same have also reduced their government's foreign-currency debts and their banks are far less heavily reliant on short-term foreign currency borrowing to fund domestic lending (Kenen 2007). However, financial integration has produced a new form of vulnerability – the foreign purchases of equities and domestic-currency debt have grown rapidly in the last few years, and foreign portfolio investments exceed direct investments in some emerging-market countries. Any loss of confidence by holders of these claims could lead to mass selling. The effect of an exodus of foreign investors could lead to a fall in the domestic-currency prices of the country's stocks and bonds, and depreciation of the country's currency, which could, in turn, reduce the country's reserves.

The global financial system is a source of strength but simultaneously a source of risk, and thus calls for close cooperation among the world's major countries through the International Monetary Fund. The most developed countries are also the most responsible for the international financial system.

The most simple benchmark one-sector neoclassical framework suggests that financial globalization should lead to flows of capital from capital-rich economies into capital-poor ones since, in the latter; the returns on capital should be higher. In fact, the actual volume of such flows do not come anywhere near those predicted by neoclassical growth models (Lucas 1990) These flows should complement limited domestic savings in capital-poor economies and, by reducing the cost of capital, allow for increased investments. A certain type of financial flow could also generate technology spillovers and serve as a conduit for absorbing managerial and other forms of organizational expertise, from more advanced economies. Kose et al. (2006) also mention a number of

indirect channels through which financial globalization could enhance growth. It could help promote specialization by allowing for the sharing of income risk, which could in turn increase productivity and growth. Financial flows could foster the development of the domestic financial sector and, by imposing discipline on macroeconomic policies, lead to more stable policies.

With regard to volatility: financial integration allows capital-poor countries to diversify away from their narrow production bases that are often agriculture or natural-resource dependent, which could reduce macroeconomic volatility. At a more advanced stage of development, trade and financial integration could simultaneously allow for enhanced specialization based on comparative advantage considerations, which could make countries more vulnerable to industry-specific shocks.

In theory, the effect of increased financial integration in cross-country correlations of output growth is uncertain, since it depends on the nature of shocks and specialization patterns. Financial integration should, in theory, help countries diversify away country-specific risks and should result in stronger comovements of consumption growth across countries, but there is no evidence for correlations in output or income.

2.2. Regulations and 'safety net'

The financial system is considered to be one of the most regulated branches of the economy, with a special emphasis on the supervision of banks. Financial embezzlement has often led to a serious world crisis in the past. A crisis is often based on asymmetric information, negative selection, moral hazards and irrational crowd behavior, but also often on the irresponsible behavior of individuals, and has resulted in the regulatory system that we have today. However, even such a strictly regulated system is, in times of world financial and economic crisis, subject to shocks, which, many theoreticians believe, points to the need for even stricter regulations which should be implemented at a global and/or regional level.

The discussion on the need for stricter regulations stems from basic economic theories which, on the one hand, advocate a free market with little state involvement and on the other hand, warn about the need to have a certain level of state surveillance, which also includes a stricter regulation of the financial system. The discussion became heated during the 2007 world financial crisis, which many believe would not have happened if there had been adequate banking regulations.

When depositors know that they are insured against risk, a moral hazard occurs and the disciplinary effect for the market and banks is lost. Therefore, banks that are insured by the state often expose themselves to greater risks than they would otherwise. There is also negative selection: people most likely to create a negative effect (collapse of banks) are at the same time people who wish to use the insurance opportunity. This opens the way to numerous embezzlers who see the banking industry as a good medium for embezzlement and making a lot of money.

Horwitz (1992) drew attention to 'moral-hazard' problem. He argued that a loss of capital led these institutions to increase their asset risks (the opposite of prudent banking

practice) because their low capital levels imply little risk for further losses and significant upside gains for bank stockholders.

The period from 1988 to 1993 witnessed unprecedented international actions to limit the safety net protection of banks. The Basel international bank capital standards were the first steps followed by FIRREA¹ in 1989 and FDICIA² in 1991.

Despite the progress that has been made in the risk regulation, the question is whether these new and better government rules, implemented by government regulators and supervisors, are really a promising approach to resolving incentive problems attendant to the financial safety net. The government supervisors and regulators sometimes do not know a bank's true deposit risk or, if they do know, face political incentives to ignore it. This tendency is particularly compelling during recession-induced bank 'capital crunches' when politicians and regulators face strong incentives to 'forbear from strict enforcement of bank regulations to promote a larger supply of bank credit in the economy.' Standard minimum capital requirements through provide an inadequate solution to safety-net incentive problems for two reasons: book capital standards constrain risks only as long as regulators and supervisors ensure that book capital bears a close relationship to true capital (the market value of capital) and even if regulators enforce capital requirements by fully recognizing capital losses whenever they occur, capital standards alone do not obviate safety net subsidies for risk taking (Calomiris 1997).

Two of the most popular reforms that have been considered are 'narrow banking' ('safe bank') and 'market discipline'. The narrow-banking approach would restrict government insurance to a separately chartered narrow bank within the bank holding company, which would hold transparently low-risk, market-priced assets and would issue insured deposits. Narrow banking effectively eliminates any risk to the government from insuring deposits and is thus simply another name for the suggestions that deposit insurance be repealed.

The second reform is known as 'market discipline.' In order to counteract this loss of market discipline, governments have introduced regulations aimed at preventing bank managers from taking excessive risks.

2.3. Financial supervision in the SEE countries

The central banks of SEE countries are the leading financial institutions in every individual country, and their main task is to maintain monetary stability by issuing domestic currency and to coordinate the activities of the banking's agencies, which are in charge of bank licensing and supervision. Security commissions in all SEE countries regulates the issue and trade of securities, authorities and responsibilities of capital markets participants, and the protection of investors' interests on the securities market. Some of the countries are members of the European System of Central Banks and joined the euro zone (Slovenia from 2007 onwards) while others have not (Bulgaria,

¹ Financial Institutions Reform, Recovery and Enforcement Act

² Federal Deposit Insurance Corporation Improvement Act

Romania, Croatia, Bosnia and Herzegovina, Serbia and Montenegro). The financial systems of Southeastern European countries have been developing during recent years through processes such as privatization in the banking sector, a drop in interest rates, inflow of deposits during 2000 and 2001 (which peaked prior to the introduction of the Euro) and a general increase of competitiveness in the banking industry. The establishment of institutional investors was followed by the creation of the second pillar of a pension insurance scheme and the creation of investment funds. However, capital market activities are still relatively low. The transition process in SEE countries also includes financial development through the reconstruction of existing banking intermediaries in line with the needs of the market economy. This includes the development of those parts of the financial system that did not exist before, and of some banking intermediaries. The financial system in more advanced transition countries, including Croatia, is extremely bank-centric, meaning that banks are dominant, unlike the market-centric systems dominated by the capital market (Dalić 2002).

EU member states that have introduced the euro, such as Slovenia, have transferred the authority to conduct monetary policy to a new institution. A principle of centralized decision-making and decentralized implementation via national central banks applies to defining and implementing single monetary policy.

At the national level, the institutional structures for the supervision of financial intermediaries are diverse in the EU. Some countries have centralized supervision across banking, securities and insurance. Sometimes the central bank has taken this responsibility, as in the Netherlands. In other instances, the combined authority has been transferred to a separate supervisory agency, as in the United Kingdom. Other countries retain separate sectoral supervisors. Masciandaro (2007) shows an inverse correlation between the central bank involvement in prudential supervision and the degree of consolidation of the sectoral supervisors in a sample of sixty-eight countries. However, the separation of prudential supervision and central banking does not necessarily imply that regulators and central bankers will not share costly information. All central banks of the EU countries with the exception of Luxembourg and Denmark have, in principle, some mechanism to access to supervisory information. However, this raises the question of how effective are those mechanisms for sharing information on the financial condition of banks.

3. THE ROLE OF MoU's

With the re-intensified process of monetary integration in the European monetary union, theories of cyclical movement in financial markets multiplied. The interest of many discussions was increasingly based on examinations of the financial momentum transfer from developed markets to emerging markets that were, in general, less developed financial markets. The discussion was further fanned by recent financial crises that spread beyond national borders, creating a 'contagion effect'. Forbes (1993) and Forbes and Rigobon (2002) distinguished between interdependence (existing cross-market linkages) and contagion, which in their definition only occurs if such linkages become stronger in a crisis period (Caporale et al. 2005).

Smaller transitional countries such as Southeastern European countries with the significant presence of foreign banks (mostly from Germany, Italy, Austria and France) should take care not only about the bank subsidiary but also about the parent banks because of the possible negative spillover effect in the time of crisis. Many authors worry what should happen when safety net does not exist at the international level. They focused mainly on the problem of domestic financial institutions of the individual EU member states and asked if those institutions have incentives to cooperate sufficiently and promptly to avoid a financial crisis. From another point of view, more developed countries and parent banks in EU should have more responsibility regarding possible financial contagion on the less developed countries where they have affiliates.

This problem is actually known as information asymmetry. To reduce this asymmetry, the ECB (European Central Bank), the central banks and the supervisory agencies have signed a Memorandum of Understanding (MoU) on the exchange of information on the financial condition of distressed banks. The MoU consists of a set of principles and procedures that deal specifically with the identification of the authorities responsible with the crisis and the required flows of information between all authorities and the practical conditions for sharing information at the cross-border level.

This tool is particularly attractive for smaller countries given that the participation of host supervisors in a supervisory college is often limited to those overseeing subsidiaries that are significant or systemically relevant to the banking group, which tends to favor larger host countries (ESCB, 2010).

Authors agreed that this approach has limitations in the practice. The MoU lacks legal enforceability and as a result no penalties are envisaged in case the contract is breached. Also, in the absence of full regulatory harmonization, differences in accounting rules leave room for a lax interpretation of a bank's financial condition.

Also, the MoU is confidential, which could limit accountability for the institutions involved. Introducing the Euro is encouraging the development of markets and financial institutions. Once European institutions have emerged, the existing arrangements, based on the MoU and on Committee decisions, may prove too complex to manage effectively (Garcia and Nieto, 2010). The problem is also in effective information sharing under MoU because it should be reciprocal, but may take the form of predominantly one-way communication (from the host to the home supervisor) (ECB, 2010). The lack of access to information regarding supervisory standards is another problem and EU candidate countries should be more involved in the meetings of supervisory institutions such as Basel Committee. Also 'know how' should be transferred to candidate countries via extensive trainings (ECB, 2010). Finally, authors doubt can the current agreements prevent unilateral actions by home or host supervisors/institutions to the detriment of the banking group because neither instruments can guarantee a coordinate approach to crisis resolution in the event of banking failure, as this requires a consensus between supervisors and financial sector regulations (ECB, 2010).

ESCB Statute leaves open the possibility that the ECB might gain responsibility for the prudential supervision of credit institutions and other financial entities, with the exception of insurance companies.

3.1. The role of multilateral MoU between central banks of transitional countries and international banks

Financial globalization has strong impact on development of the financial regulation and supervision in transitional countries. Information sharing and closer cooperation between different national bank and strong regional institutions such as Basel Committee of Banking Supervisors, the Financial Stability Board (FSB) and the Committee of European Banking Supervisors (CEBS).

The strong presence of foreign banks in those countries in the last decade did not seriously help in reducing interest rates, but helped in the supply of different financial products and services to the government, companies and households. Foreign banks saw transition countries as a new market for applying their different financial products and services. The privatizations boosted confidence in banks, which in turn led to increasing monetization with rapid deposit growth. Together with enhanced access to foreign loans by the new private banks, this has helped fuel a boom in lending in most of the region (see: Fratzscher 2002, Poghossian 2008).

Transitional countries on their way to EU have concluded many bilateral MoU with their main partners in the European Union as well as with the other countries regarding of cooperation and exchange of information in the field of banking supervision across south-eastern Europe. This MoU foresees regular meetings of Heads of Supervision Departments and Governors, annual information exchanges on macroeconomic and financial sector indicators, joint on-site inspections and the creation of task forces on specific issues to be tackled (stress-testing).

This multilateral MoU was signed in 2007 by the central banks of Albania, Bosnia and Herzegovina, Bulgaria, Cyprus, Greece, the Former Yugoslav Republic of Macedonia, Montenegro, Romania and Serbia (ECB, 2010).

3.1.1. MoU's of Croatian National Bank

Croatian economical and political transitional process until '90 includes also financial integration and developing of financial supervision lead mainly by the CNB. Croatian EU accession accelerated financial integration. Foreign banks continuously formed subsidiaries in Croatia in last decade. Those banks were mostly from Austria, Italy, Germany and Austria which is obvious in the structure of the foreign direct investments in Croatia. Croatian banking sector has been practically completely privatized by banks from EU member countries, predominantly Italy and Austria (Žiković, 2010).

Accordingly, CNB signed MoU's with different financial supervisory institutions from EU member states such as Germany, France, Hungary, Italy and Austria (see Table 1), with some other financial institutions of the neighbouring countries such as Bosnia and

Herzegovina and Republic of Srpska and with some countries such as Turkey and San Marino.

Table 1: Co-operation of the CNB with financial authorities of the Member states and with the third country competent authorities

Type of agreement	Date	Institutions
MoU	19/11/2008	The Federal Financial Supervisory Authority Germany
Cooperation Agreement	8/12/2008	The Banking Commission France
MoU	8/6/2005	The Austrian Federal Ministry of Finance and Austrian Financial Market Authority Austria
MoU	29/3/2006	The Banca D'Italia Italy
MoU	20/12/2005	The Hungarian Financial Supervisory Authority Hungary
MoU	?	Banking Regulations and Supervision Agency of Turkey
Cooperation Agreement	?	The Central Bank of the Republic of San Marino
MoU	5/11/2003	The Central Bank of Bosnia and Herzegovina and Banking Agency of Republic of Srpska
MoU	29/3/2006	The Banca D'Italia

Source: www.cnb.hr (10/2/2013)

Božina Beroš (2012) highlights - even authors agreed that foreign financial subsidiaries are the most appropriate legal form of their presence in some national financial system, success of the supervision depends mostly of cooperation between supervisors of host country and supervisors of foreign country. This co-operation is formalized on same level just through those MoU's. But, as we can see in the Table 1, formal MoU's are signed mostly with those EU countries which have their subsidiaries in Croatia.

Does it mean that there is no need for cooperation and supervision with other EU member countries and non-EU members as well? Available data on the CNB official web site regarding MoU's give the picture of the non-systematic approach to this problem or the answer on this question lie in confidentiality (which could improve negative effect of information asymmetry). Maybe there are some more MoU's signed, but they are possible confidential.

If the success of supervision lie in cooperation between supervisors of the host country and supervisors of foreign country, those cooperation depend on accuracy, reliability timeliness of information. And information could flow in both directions, which is crucial form macro prudential regulation.

The recent financial crisis has questioned the effectiveness of the single supervisor model. As a result countries around the world are (re)considering their regulatory and supervisory arrangements. (Božina Beroš, 2012). Croatia on their way to EU should accept EU models of financial supervision and should cooperate with every EU

member country and their relevant financial institutions. EU candidate countries such as Croatia should be more involved in the meetings of EU supervisory institutions.

4. CONCLUSION

In this study, we demonstrated that the role of MoU's between financial institutions of transitional countries and EU financial institutions is not definitely effective and systematically approached. The MoU lacks legal enforceability and as a result no penalties are envisaged in case the contract is breached. Also, in the absence of full regulatory harmonization, differences in accounting rules leave room for a lack of interpretation of a bank's financial condition. The MoU's are mainly confidential, which could limit accountability for the institutions involved. The problem is also in effective information sharing under MoU because it should be reciprocal, but may take the form of predominantly one-way communication. The lack of access to information regarding supervisory standards is obvious. EU candidate countries should be more involved in the meetings of supervisory institutions. Finally, authors doubt can the current agreements prevent unilateral actions by home or host supervisors/institutions to the detriment of the banking group because neither instruments can guarantee a coordinate approach to crisis resolution in the event of banking failure.

REFERENCES

- Bhagwati, J. (1988), *Poverty and Public Policy*, Vikram Sarabhai Lecture. World Development. Vol. 16(5),539-555.
- Božina Beroš, M. (2012), *Financijska supervizija u Hrvatskoj — između dvije institucije i jednog europskog trenda (Financial Supervision in Croatia between two Institutions and One European Trend)*, Ekonomski pregled, 63 (5-6) 352-371.
- Calomiris, Ch.W. (1997), *The Postmoder Bank Safety Net: Lessons from Developed and Developing Economies*, The AEI Press, Washington D.C. 2.
- Dalić, M. (2002), *Usporedna analiza hrvatskog financijskog sustava i financijskih sustava naprednih tranzicijskih zemalja (Comparative Analysis of the Croatian Financial System and the Financial Systems of Advanced Transition Countries)*, Privredna kretanja i ekonomska politika (Economic Movements and Economic Policy) 92/2002, 27-28.
- ECB (2010), *Financial stability challenges in EU candidate countries financial systems in the aftermath of the global crisis*, Ocasional Paper No.115. July, 2010.
- Forbes, W. (1993), *The Integration of European Stock Markets: The Case of the Banks*, Journal of Business Finance & Accounting 20(3), 0306-686x.
- Forbes, K. and Rigobon, R. (2002), *No Contagion, Only Independence: Measuring Stock Market Co-Movements*. The Journal of Finance 57(5), 2223-2261.
- Fratzscher, M. (2001), *Financial Market Integration in Europe: on the Effects of EMU on Stock Markets*. ECB Working Paper no. 48.
- Garcia, G. H. and Nieto, M. J. (2010), *Banking crisis management in the European Union: Multiple regulators and resolution authorities*, Palgrave.
- Horvitz, P. (1992), *The Causes of Texas Bank and Thrift Failures. If Texas Were Chile: A Primer on Banking Reform*, edited by Philip Brock. San Francisco: ICS Press,131–60.

- Kenen, P. B. (2007), *The Benefits and Risks of Financial Globalization*. Cato Journal 27(2) Spring/Summer 2007. Cato Institute, 179.
- Kose, M.A, Prasad, E., Rogoff, K. and Wei. S.J. (2006), *Financial Globalization: A Reappraisal*, IMF Working Paper 06/179, 7.
- Lucas, R. (1990), *Why doesn't Capital Flow from Rich to Poor Countries?* American Economic Review 80, 92-96.
- Masciandaro, D. (2007): *Divide et impera: Financial supervision unification and central bank fragmentation effect*. European Journal of Political Economy, (23), 2: 285-315
- Poghossian, T. (2008), *Are "New" and "Old" EU Members Becoming More Financially Integrated? A Threshold Cointegration Analysis*. International Economics and Economic Policy. 6(3), 259 – 281.
- Rodrik, D. (1998), *Why Do More Open Economies Have Bigger Governments?* Forthcoming, Journal of Political Economy 106 (5), 997-1032.
- Summers, L. H. (1998), *Capital-Account Liberalization and the Role of the IMF, Should the IMF Pursue Capital-Account Convertibility?*, Princeton: Princeton University, Essays in International Finance 207, 1-10.
- Stiglitz, J. (2003), *Globalization and Its Discontents*, Penguin, London.
- Žiković, S. (2006), *Implications of Measuring VaR Using Historical Simulation; An Example of Zagreb Stock Exchange Index – CROBEX*. In J. Roufagalas (Ed.), Resource allocation and institutions: Explorations in economics, finance and law, 367-389. Athens: Athens Institute for Education and Research.

Edita Bečić

University of Ljubljana, Faculty of Economics, Ljubljana, Slovenia

Matej Lahovnik

University of Ljubljana, Faculty of Economics, Ljubljana, Slovenia

AGENCY THEORY AND FRANCHISING: A LITERATURE REVIEW

ABSTRACT

This article tries to understand the business phenomenon of franchising using the framework of agency theory. Even though many research studies have sought to understand franchising through agency theory, a proper understanding of this business opportunity still entails certain challenges. We review related past research and present the underlying ideas that allow an understanding of the concept. We believe that intangible assets taken from transaction cost theory play a crucial role by creating additional value for every potential franchisee as they are ready to invest in and participate in the franchise system for a long period of time. Finding different previous researches with inconsistent results, we propose a model of the relationship between risk and incentives in franchise contracts by using additionally new framework to explain the franchise relationship.

Keywords: *franchising, strategy, agency theory, risk, incentives*

JEL classification: *M10, M16*

1. INTRODUCTION

Franchising as the internationalisation strategy has been increasing throughout the world since 1950. It provides an opportunity for a firm to establish a presence in countries where the population or per capita spending is not sufficient for a major expansion effort. The franchising has become one of the most popular growth strategies also in the post-transition economies. Considering the trends in the most developed economies we may expect further growth in the near future. For example, franchising accounts close to 40 percent of US retail sale. Business format franchising enables franchisors to take advantage of the resources, capabilities and entrepreneurial spirit of a franchisee when establishing new franchise units. Consequently, this gives a franchisor a good opportunity to minimise the risk of running its foreign operations. Therefore, this strategy could be win-win situation to both parties involved in a transaction especially in the period of the current economic crisis. Franchising is particular attractive strategy in fragmented industries.

In the EU, France is the franchising leader with 1,369 brands and 51,600 franchise outlets (franchise units). Because some franchisors have more brands, the brand number is not the same as the number of franchisors. The UK used to be in second place, but in 2010 it was overtaken by Germany, which has 960 brands with 58,000 franchise outlets (franchise units). The biggest franchising business growth was observed in Poland, with the number of its brands rising by 47.5% from 2007 to 2009. Altogether, we can find 11,731 brands in the EU. This figure should in fact be reduced as some brands exist simultaneously in several countries; regarding this, a 15% reduction is appropriate, leaving a total number of brands of 9,971 for 20 countries. European franchises employ around 10 million people with revenue amounting almost 500 billion EUR (www.eff-franchise.com/IMG/pdf/Stats). Most Slovenian firms need strategic partners in order to compete in global market. Therefore, the strategy of franchising has become very popular growth strategy for small and medium firms. European entrepreneurs have recognised the growing economic sense of franchising their businesses. Business format franchise has proved to be the best option. We argue that in the near future franchising is set to become one of the most popular growth strategies in the post-transition economies.

This study focuses on the agency relationship between the franchisor and franchisees. The agency model has its origins in the 1960s and 1970s (Arrow, 1971; Wilson, 1968). It explains the contractual relationship between a principal and an agent under information asymmetry. Specifically, it deals with the relations between monitoring, incentives and uncertainty (Eisenhardt, 1989). Agency theory is the theoretical framework frequently used to address questions concerning how firms choose between franchised and company-owned units and how they select the terms of their contracts, such as royalties and fees (Lafontaine, Blair, 2005; Lafontaine, Oxley, 2004; Brickley, Dark, Weisbach, 1987).

The aim of this paper is to explain the relationship between risk and incentives in franchise relationships. Agency theory argues that incentives and risk are negatively correlated; however, several empirical studies show a positive relationship. As a result of our literature review, we propose a model of the relationship between risk and incentives in franchise contracts which will be empirically evaluated in future research. We argue that the relationship between risk and incentives depends on the contractibility of assets and the underlying governance mechanism. If a franchisor has entered into an employment contract with an outlet manager we expect a negative relationship, whereas if they have entered into a franchise contract we expect a positive relationship between risk and incentives.

The paper is structured as follows: Section two discusses the relevant literature. Section three develops hypotheses about the relationship between risk and incentives in franchise contracting. Section four concludes with a trial of explanation how the relationship between the risk and incentives changes, using past research suggestions.

2. LITERATURE REVIEW

Franchising is typically defined as a contractual arrangement between two legally independent firms. This form of organisation is a well-established business phenomenon and, consequently, given its economic importance, one can find in the literature a number of theoretical explanations for the existence of franchising and for the structure of franchise contracts (Lafontaine, Blair, 2005). The majority of studies analyse the franchise contract within the framework of a principal-agent model. It is a dominant theoretical framework in organisational economics focusing on the study of contracts, organisations, incentives, the theory of the firm, corporate control, labour, law and economics etc. However, there are some unresolved problems associated with agency theory, especially the problem of risk-sharing and incentives (Lafontaine, Slade, 1997). Researchers have found negative and positive relationships between risk and incentives (Wulf, 2007; Oyer, 2004; Foss, Laursen, 2005). Still others have found no statistically significant relationship at all (Bushman, Indjejikian, and Smith 1996; Ittner, Larcker and Rajan 1997; Garen 1994; Nagar 2002).

Opportunism and control problems in agency relationships arise from the delegation of tasks to an agent with private information. The basic agency model investigates the contract design as a tool to set up an efficient relationship between risk sharing and incentives in franchising because the level of effort expended by franchisees is not directly observable by the franchisor. Empirical work has proposed a negative relationship between risk and incentives, yet the empirical results suggest a positive relationship. The franchisor is typically responsible for providing training and general support to its franchisees. It is also the one in charge of promoting and advertising the chain globally, and (more generally) of developing and maintaining the value of the trade name. The franchisee, in contrast, is responsible for managing the outlet on a day-to-day basis. Its responsibilities include human resource management activities and keeping track of local needs together with taking care of local advertising. The franchisee's and franchisor's inputs impact on how the outlet performs. However, the intensity of efforts devoted to such activities is not easily monitored by the parties other than the individual providers of such efforts. In a franchising-type relationship both the franchisor and the franchisee share the risk and incentives, as opposed to an employment relationship where a manager is tasked to run a company-owned outlet.

The central idea behind the principal and agent model is that the franchisor as the principal has high monitoring costs to control the outcome and behaviour of the franchisees in the presence of asymmetric information. According to agency theory, managers of company-owned units have less incentive to perform efficiently because a substantial proportion of their compensation is fixed income. Due to moral hazard which arises through a lack of effort on the part of the agent and the principal's inability to adequately monitor the agent's performance, this form of compensation encourages managers to shirk or perform suboptimal. In this situation, the principal introduces a performance-based contract to motivate the agents. Based on agency theory, there is a trade-off between transferring risk to the franchisees and the incentives (Lafontaine, Slade, 2001). This key characteristic of the principal-agent model has received a great deal of scholarly attention since the original papers

published by Holmstrom (1979) and Shavell (1979), yet the empirical results do not confirm the negative relationship between risk and incentives in franchising.

To conclude, the research gap results from the inconsistency between the theoretical and empirical patterns regarding the allocation of residual income rights (royalties) and risk. According to the standard prediction of agency theory, royalties (as performance-based incentives) and risk should be positively related. The empirical results do not confirm this relationship (Lafontaine, Slade, 2007). In addition, recent theoretical results in organisational economics also question the risk-incentive trade-off (Shi, 2005). In the following section, we develop hypotheses which may explain the positive relationship between risk and incentives.

Franchising as a business phenomenon has been researched and analysed many times. As part of agency theory, quantitative methodologies were initially used to analyse the propensity to franchise (Caves and 1976; Brickley and Dark 1987; Martin 1988; Norton 1988b; Brickley, Dark et al. 1991). As franchising was becoming a more and more interesting phenomenon to analyse, we later find 28% of research studies examining this relationship. At first, only agency theory was applied, but later almost half of the studies started to additionally use resource scarcity theory or transaction cost theory to explain franchising.

Table 1: Classification of the agency theory and franchising literature

Research stream	Number of studies	%	Theoretical background	Number of studies	%	Method	Number of studies	%
Propensity to franchise	9	50	Agency theory applied	10	56	Quantitative	12	67
Franchisor-franchisee relationship	5	28	Agency theory with another theory applied	8	44	Quantitative and Qualitative	1	6
Asset specificity influence	4	22				Qualitative	5	27
Total	18	100		18	100		18	100

3. RELATIONSHIP BETWEEN RISK AND INCENTIVES IN FRANCHISING

3.1. Delegation view of incentives

Prendergast (2002) argues that the principal assigns a task to the agent or allows the agent unrestricted choice over its actions. In addition, he argues that under high uncertainty the relationship between incentives and risk might be positive. An uncertain environment requires the delegation of responsibilities which, in turn, results in incentive pay based on output. Companies (principals) offer high pay-for-performance arrangements in more uncertain markets as they have high costs of controlling the employees (agents). Simultaneously, to lower the costs of control, companies delegate authority and transfer more residual income rights to the agents in riskier environments. In this situation, employees with more authority and incentives react more flexibly to the dynamics and complexity of the task environment. Consequently, Prendergast can provide an explanation of the positive relationship between risk and incentives in agency relationships.

However, since Prendergast only focuses on incentive contracts in employment relationships he cannot explain the varying roles of incentive contracts under different governance mechanisms. On one hand, employment contracts are used in hierarchical relationships. On the other, franchise contracts are concluded between the franchisor (as principal) and franchisee (as agent), the latter being an entrepreneur. This fundamentally different relationship may influence the design of incentive contracts. Franchisees as entrepreneurs gain profits due to uncertainty and risk, but employees (with risk aversion) prefer contracts with less incentive under high uncertainty.

3.2. Property rights theory

According to property rights theory, the structure of residual income and ownership rights depends on the distribution of non-contractible assets (intangible assets) that generate the firm's residual surplus. In franchising, this means it involves a relationship of sharing the intangible assets between the franchisor and franchisee. For the franchisor, the intangible assets refer to the brand name assets and the system-specific know-how. These assets represent proprietary knowledge that is not easy to transfer because the investments in such assets are costly and not easily controlled (Teece, 1980). The intangible assets of the franchisee are outlet-specific know-how, know-how about local advertising, customer service, human resource management and administrative capabilities.

The franchisor faces a problem of how to maximise its returns when they depend on the local intangible assets of the franchisee. In franchising, this intangibility of assets plays an important role in determining the allocation of residual income and ownership rights (Windsperger, 2002). If one of the agents is the holder of intangible assets and the other of tangible assets then, according to property rights theory, the first should receive a bigger proportion of the residual income and ownership rights. Specifically, if we assume that the franchisor's system-specific assets are more important than the franchisees' local market assets for the generation of residual income, it should receive

a higher proportion of residual income rights such as higher royalties and/or a greater proportion of company-owned outlets. Therefore, incentives in franchise relationships are provided by ownership and residual income rights – the payment of royalties.

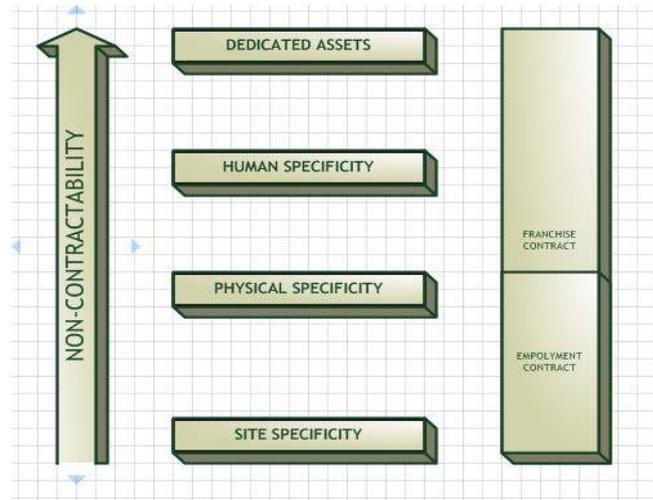
So what solution does property rights theory offer to the problem of the relationship between risk and incentive in the franchising context? The relationship between risk and incentives in contractual relations depends on the underlying governance mechanism (i.e. internal governance versus market or network governance). Under an employment contract between headquarters and outlet managers with more contractible assets, it is more likely that the relationship between risk and performance-based incentives is negative. In this case, the franchisor can more easily monitor the behaviour and the outcomes, resulting in more monitoring and fewer incentives under increasing risk due to environmental uncertainty.

In contrast, under a franchise contract with more non-contractible assets of franchisees it is likely that the relationship between risk and incentives is positive. This means that if the franchisees' local market assets are very important for generating the residual income, the franchisee should receive a higher proportion of the residual income and hence pay lower royalties. In addition, we expect that the importance of the local market assets increases with local outlets operating amid higher uncertainty.

According to agency theory, the high information asymmetry and moral hazard risk in foreign markets made the application of coercive sources of power, exercised through stipulated franchise contract terms, inevitable. However, a necessary requirement for franchisors to exercise coercive control was the existence of sector-specific intangible assets such as a strong brand name and franchise concept (Quinn, Doherty, 2000).

We hypothesise that the relationship between risk and incentives in franchise contracting depends on the contractibility of the assets (Figure 1). If the assets are contractible, as assumed in agency theory, the relationship is negative; if the assets are non-contractible, as assumed in property rights theory, the relationship is positive.

Figure 1: How non-contractibility rises



From this proposition we derive the following hypotheses:

H1: If the assets are highly contractible, the relationship between risk and incentives in franchise contracting is negative. This refers to incentive contracts between a franchisor and managers of company-owned outlets.

H2: If the assets are highly non-contractible, the relationship between risk and incentive is positive. This refers to incentive contracts between a franchisor and franchisees as outlet managers. It implies that the relationship between royalties and risk is negative.

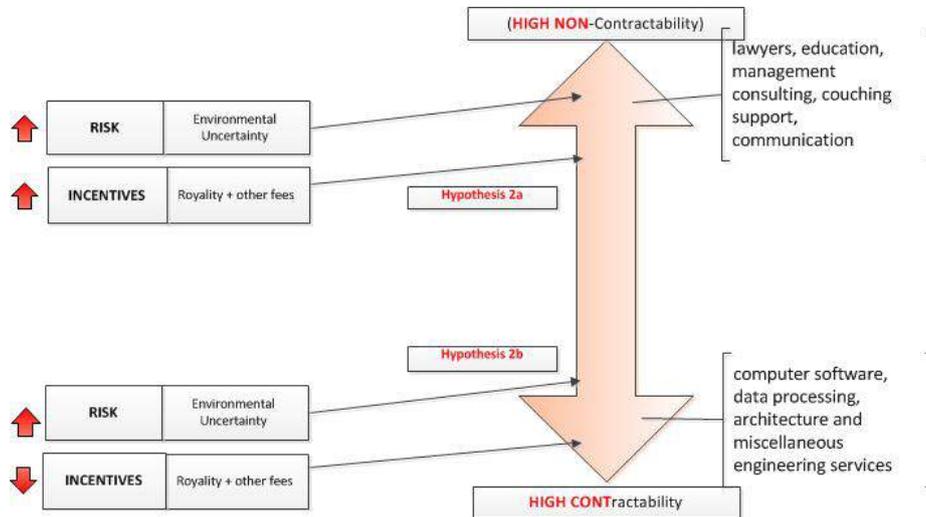
The second hypothesis can be specified for empirical testing as follows: If we differentiate the franchise systems according to the intangibility of the assets involved, we can expect that the positive (negative) relationship between risk and incentive (royalties) is stronger for franchise systems with more intangible assets compared to franchise systems with less intangible assets.

H2a: The negative relationship between risk and royalties is stronger for franchise systems with more intangible assets.

H2b: The negative relationship between risk and royalties is weaker for franchise systems with less intangible assets.

Overall, we can summarise our research model that focuses on the relationship between risk and incentives under two franchise systems: (a) systems with a higher degree of contractibility (less intangibility); and (b) systems with a lower degree of contractibility (high intangibility) (see Figure 2).

Figure 2: Intangibility and the relationship between risk and incentives



If we apply this framework to international franchise relationships, the franchisor is less able to evaluate the environmental uncertainty than under domestic franchising. Therefore, in an international setting environmental uncertainty and hence monitoring costs are increased due to the geographical and cultural distance involved (Fladmoe-Lindquist, Jacque, 1995). In particular, exchange rate fluctuations, political instability, legal uncertainty and high cultural distance increase the uncertainty for the franchisor which will impact the relationship between risk and incentives.

4. CONCLUSION

This research paper develops a new framework to explain the relationship between risk and incentives in franchise relationships. Specifically, it is argued that the relationship between risk and incentives depends on the contractability of assets and the underlying governance mechanism of the contractual relationship. If the assets are easily contractible, the franchisor may establish an employment relationship with the managers of company-owned outlets. These employment contracts are characterised by a negative relationship between incentive and risk. If the assets are highly non-contractible, the franchisor transfers the residual income and ownership rights to the franchisees. Specifically, it will introduce franchise contracts characterised by a negative relationship between royalties and risk/uncertainty. In addition, the negative relationship between uncertainty and royalties will be higher for franchise systems with highly intangible local market assets.

However, each study has its shortcomings and is confronted with some limitations. Hence, qualitative methodology may not fully capture all quality criteria of validity and reliability. With successful replication and comparison between cases the findings shall

not be considered as the ultimate answers to our research model. Our proposed model refers to theory-testing research. We decided to use the case study approach which tests a probabilistic relation. This exploratory study with proposed hypotheses does not give us the possibility to collect data from a large sample. The reason lies within time demanding access to bigger retail and services companies in order to get appropriate non-contractibility in franchise companies with minimum ten years of franchise experience. Additionally, all necessary costs are too expensive. Academic theories in business and management are in fact deterministic with their conditions and relations, we use the probabilistic relation as we believe this relation in our cases enable us more insight into description of reality (Dul, Hak, 2008). In order to achieve comparative case study, we use interviews as the source of data. This gives us the possibility to use measurement technique called pattern matching (Yin, 2009). It seems to be particularly important when the subject addresses a complex phenomenon, such as risk and incentive issues of the international franchise companies that request the comprehension of an interrelated set of environmental and non-contractible factors.

Overall, our theoretical model contributes to the franchise and organisational economics literature by arguing that incentive contracts cannot be evaluated without considering the impact of the underlying governance mechanism on the contract design. In other words, the design of an incentive contract depends on the governance mechanism under which an incentive contract is introduced. For risk-averse employees the relationship between risk and incentives may be negative, but for entrepreneurs (such as franchisees) as network partners the entrepreneurial profit orientation results in a positive relationship. Consequently, future research has to differentiate incentive contracts according to the underlying governance mechanisms.

REFERENCES

- Arrow, K. J. (1971), *Essays in the Theory of Risk-Bearing*, Markham Pub. Co., Chicago.
- Brickley, J. A., Dark, F. H. & Weisbach, M. S. (1987), *The Choice of Organizational Form: The Case of Franchising*, *Journal of Financial Economics*, Vol. 18 (2), 401-420.
- Brickley, J. A., Linck, J. S. & Coles, J. L. (1999), *What happens to CEOs after realize retire? New evidence on career concerns, horizon problems, and CEO incentives*, *Journal of Financial Economics*, Vol. 52(3), 341-377.
- Bushman, R., Indjejikian, R. J. & Smith, A. (1996), *CEO Compensation: The Role of Individual Performance Evaluation*, *Journal of Accounting and Economics*, Vol. 21(2), 161-193.
- Dul, J. & Hak, T. (2008), *Case Study Research Methodology in Business Research*, Butterworth-Heinemann/Elsevier, Oxford.
- Eisenhardt, K. M. (1989), *Agency theory: An Assessment and Review*, *The Academy of Management Review*, Vol. 14(1), 57-74.
- Fladmoe-Lindquist, K. & Jacque, L. L. (1995), *Control Modes in International Service Operations: The Propensity to Franchise*, *Management Science*, Vol. 7(4), 1238-1249.
- Foss, N. J. & Laursen, K. (2005). *Performance Pay, Delegation and Multitasking Under Uncertainty and Innovativeness: An Empirical Investigation*, *Journal of Economic Behaviour and Organization*, Vol. 58(2), 246-276.
- Garen, J. E. (1994), *Executive Compensation and Principal-Agent Theory*, *Journal of Political Economy*, Vol. 102(6), 1175-1199.

- Holmstrom, B. (1979), *Moral Hazard and Observability*, The Bell Journal of Economics, Vol. 10(1), 74-91.
<http://www.eff-franchise.com>, 18.08.2010.
http://www.efffranchise.com/IMG/pdf/Stats_Franchise_Europe_10092010-2.pdf, 21.04.2011)
- Ittner, C. D., Larcker, D. F., & Rajan, M. V. (1997), *The Choice of Performance Measures in Annual Bonus Contracts*, The Accounting Review, Vol. 72(2), 231–255.
- Lafontaine, F. & Slade, M. E. (2007), *Vertical Integration and the Firm Boundaries: The Evidence*, Journal of Economic Literature, Vol. 45(3), 629-685.
- Lafontaine, F. & Blair, R. D. (2005), *The Economics of Franchising*, Cambridge University Press, New York.
- Lafontaine, F. & Oxley, J. E. (2004), *International Franchising Practices in Mexico: Do Franchisors Customize Their Contracts?* Journal of Economics & Management Strategy, Vol. 13(1), 95-123.
- Lafontaine, F. & Slade, M. E. (2001), *Incentive Contracting and the Franchise Decision*. Published in Advances in Business Applications of Game Theory, K. Chatterjee and W. Samuelson (eds.), Kluwer Academic Press.
- Lafontaine, F. & Slade, M. E. (1997), *Retail Contracting: Theory and Practice*, The Journal of Industrial Economics, Vol. 45(1), 1-25.
- Lafontaine, F. (1992), *Agency Theory and Franchising: Some Empirical Results*, RAND Journal of Economics, Vol. 23(2), 263-283.
- Nagar, V. (2002), *Delegation and Incentive Compensation*, The Accounting Review, Vol. 77(2), 379–395.
- Oyer, P. (2004), *Why Do Firms Use Incentives That Have No Incentive Effects?* Journal of Finance, Vol. 59(4), 1619–1650.
- Prendergast, C. (2002), *The Tenuous Trade-off between Risk and Incentives*, Journal of political economy, Vol. 110(5), 1071-1102.
- Quinn, B., Doherty, A. M. (2000), *Power and control in international retail franchising – Evidence from theory and practice*, International Marketing Review, Vol. 17 (4), pp. 354-372.
- Shavell, S. (1979), *On Moral Hazard and Insurance*, The Quarterly Journal of Economics, Vol. 93(4), 541-562.
- Shi, L. (2005), *Responsible Risk and Incentives for CEOs: the Role of Information-collection and Decision-making*, Working Paper, University of Washington, Washington.
- Teece, D. J. (1980), *Economies of scope and the scope of the enterprise*, Journal of Economic Behavior and Organization, Vol. 61(1), 223-247.
- Wilson, R. (1968), *On the Theory of Syndicates*. Econometrica, Vol. 36(1), 119-132.
- Windsperger, J. (2002), *The Structure of Ownership Rights in Franchising: An Incomplete Contracting View*, European Journal of Law and Economics, Vol. 13(2), 129-142.
- Wulf, J. (2007), *Authority, Risk, and Performance Incentives: Evidence from Division Manager Positions Inside Firms*, Journal of Industrial Economics, Vol. 55(1), 169–196.
- Yin, R.K. (2009), *Case Study Research Design and Methods*. Sage Publications, Inc.

Dragan Mišetić

University of "Vitez" Travnik, Vitez, Bosnia & Herzegovina

Marko Tomljanović

University of Rijeka, Faculty of Economics, Rijeka, Croatia

Tomislav Kandžija

Primorsko-goranska County, Rijeka, Croatia

THE ROLE OF MANAGEMENT IN THE ACCESSION PROCESS OF B&H TO THE EU

ABSTRACT

The main goal of B&H in the near future is accession to the EU. An economic system of B&H is characterized by a low competitiveness, the low share of people with higher education, low education of the labour force, low technological competitiveness, and generally bad governance and economy. All these factors make the accession process difficult. In order to make the mentioned process easier, it is necessary to gradually establish institutions that guarantee democracy and the rule of law and provide other fundamental freedoms. It is also necessary to establish functional market economy capable to fairly compete with competition in the Internal European market and to adapt administrative structures and make them able to implement the EU acquis.

The whole process is emphasized by role of management. Critical characteristics of management in B&H are lack of clearly defined activities and disorganized management structure. Each level of management functions needs further increase by engaging the additional forces and finding new sources of knowledge. These procedures are necessary in order to analyse external and internal environment, to define coordinated plans and goals, and strategies for easier problem counteracting. Changes in the implementation of management functions and raising them to a higher level, contribute the success of each company, and further to success and development of the whole B&H economy.

The main objectives of the Medium Term Development Strategy are complemented by the need for development of export-oriented private sector, which will demand the Institutions to: improve the business climate for domestic and foreign investment and support for entrepreneurship, accelerate the privatization process, reduce corruption in the society and carry out judiciary reform, preserve the stability of the financial sector and rapid development of capital markets, carry out the reform of the labour market, further trade liberalization in the region, support exports, public administration reform and the establishment of an adequate system of social protection.

Using systematic research of companies characteristics in B&H, and characteristics of enterprise owners, it is possible to determine the direction of development of

management as a key tool in achieving the set goal. Without quality management development and systematic management development, Bosnia and Herzegovina would not reach effective integration in the economic system of the European Union. After Croatian accession, European Union could be closed for new members for a long time because of the intention to change its internal structure. Despite the statements of European leaders on the prolongation of further enlargement, managers of public and private enterprises and other institutions in B&H must work systematically to increase their knowledge of Management, which will contribute to the growth and development of the country.

Keywords: EU, B&H, management, accession, institutions, enterprise

JEL classification: E 20; F 15; F 36; O 11; O 52

1. INTRODUCTION

B&H is a country with the most severe consequences of the war in the region and as such faces a difficult economic and social transition, which results in poor economic and social conditions. Economic condition implies weak growth in national per capita income, insufficient market potential, slow economic growth, which results in a large number of poor and unemployed. To improve economic situation it is necessary to engage all of the factors of social life in the development strategy and the national strategic plan. Overcoming of these problems involves the help of the international community, particularly in education and the acquisition of new knowledge. As the main long-term goal of B&H, where she weighs based on historical, cultural and economic characteristics, according to the inclusion in the EU. On the way to full membership in the EU emphasizes the role of management, whose characteristics and development need to focus and adapt to EU requirements.

The basic objective of management development of Bosnia and Herzegovina is to achieve high efficiency and innovation to integrate the economy of Bosnia and Herzegovina in the economic area of the European Union. Areas such as investment management, investment project management, strategic planning, the development of innovation, the process of managing investment teams, methods of investment planning, leadership and management, human resource development, etc. are the basic guidelines for systematic model development management of economy of Bosnia and Herzegovina as a basic requirement effective integration of the economy. Modern business practice requires monitoring discontinuous changes through a continuous process of learning and the development of management tools and techniques in order to achieve the opportunity to gain competitive advantage. The degree of economic development of Bosnia and Herzegovina is a challenge for the application of modern management solutions.

Systematic investigation of the companies in B&H, and the peculiarities of business owners, it is possible to determine the direction of development of management as a key tool in achieving the set goal. Without quality and without systematic management

development in Bosnia and Herzegovina there won't be effective integration of the economy of Bosnia and Herzegovina in the economic system of the European Union. Notwithstanding the statements of European leaders on prolongation of expansion, managers of public and private companies and other institutions in B&H must work systematically to increase their knowledge of Management, which will contribute to the growth and development of the country.

2. MANAGEMENT AND ENVIRONMENT IMPACT

Management can be defined as the process of planning objectives, organization of resources and activities, and human resource management and control, which continual achieves an effective combination of limited resources and human resources to effectively achieve organizational goals in a changing environment. Holder of process of management is management as an organizational system of people – managers which is organizational structured in accordance with the organizational structure of enterprises implement this process.

Management is also defined as a collection of different roles grouped into three basic groups:

- Role in the field of human relations;
- Role in the field of information;
- Role in the field of decision-making.

Management consists of three subsystems: strategic, coordination and operation, which correspond to different levels of the hierarchical structure of the organization: supreme, middle and lower management. Top management presented the organization and provides support for the environment, and is subject to the greatest uncertainty. This is the level at which defines the strategy, establish long-term plans and goals and policies for achieving the goals. This level requires specific strategic skills, including ability to see companies as a system, interdependence of different functions and activities of the company and its environment.

Middle level management is oriented towards long-term goals and their conversion into concrete goals and specific tasks of organizational units. This level is focused on the implementation of strategies and policies, and the internal integration activities and provision of inputs to the operational level, which enables stable operation of the organization. For middle management the most important are social skills. Lower level management is focused on solving of direct task, ie, control of resources at the lowest level of the organization.

3. CHARACTERISTICS OF B&H ECONOMIC SYSTEM

The disintegration of the socialist system and the transition to a market system has enabled the economy in Bosnia and Herzegovina to entrepreneurs, as important factor of development of their own economies the opportunity that based of free will and of their own risk can initiate appropriate jobs. Among a large number of people who are

oriented to establish his own company only a small number of them can succeed because of: incompetent management company, little or no managerial experience and lack of knowledge about business functions. Primarily, succeeded those managers who are innovative, willing to reasonable risk-taking, self-confident, persistent workers and responsible leaders, and most succeed are those who largely understand management and need to pursue a management functions in practice.

Bosnia and Herzegovina is unlike many of European countries, which have entered the transition process from a relatively stable and economically developed secondary economic situation, had a much harder way to achieve a main goal: accession to the European Union. An international institution requires from Bosnia and Herzegovina faster changes, along with the already existing poor economy situation as well as the liberalism which imposes and which threatens to big social shocks. Current high unemployment could result in even higher unemployment that could easily lead to a complete collapse of the economy.

B&H also belongs to a group of European countries with the lowest number of population which are covered by secondary and tertiary education. Fact that only 7.1 of the population older than 15 years have after a high school education (college, university, master's or doctorate) shows that B&H has inadequately educated workforce. Also, the country is lagging behind in area of technological readiness, particularly in relation to information and communication technologies. Research and analysis of social infrastructure and political institutions identify their importance in explaining long-term difference in the progress of the country.

The rule of law (existence of property rights and ability to protect legal rights) is not sufficiently established. There is also a high rate of corruption which reduces economic value and has harmful economic effects, increase in operating costs and reducing investment incentives. Previously mentioned characteristics have a direct effect on low rate of competitiveness of the economy of Bosnia and Herzegovina.

Following figure shows the position of B&H to Global Competitiveness Index (GCI) and the assessment of the competitiveness of the Bosnia and Herzegovina economy in the period of year 2007 – 2012.

Table 1: Rank and rating of Bosnia and Herzegovina economy

Basic indicators Year 2010		Rank	View
Population (million, 2012) -3,8	GCI 2011-2012 (total from 142)	100	3,8
GDP (in billions US\$) – 16,8	GCI 2010-2011 (total from 139)	102	3,7
GDP per capita (US\$) – 4.319	GCI 2009-2010 (total from 133)	109	3,5
	GCI 2008-2009 (total from 134)	107	3,6
	GCI 2007-2008 (total from 131)	106	3,6

	Rank 2010- 2011 (139)	View 2010- 2011 (1-7)	Rank 2011- 2012 (142)	View 2011- 2012 (1-7)	Change in rank
Global Competitiveness Indeks (GCI)	102	3,7	100	3,8	2
Basic conditions	98	4,1	92	4,2	6
I pillar					
Institutions	126	3,1	109	3,3	17
II pillar					
Infrastructure	98	3,2	99	3,2	-1
III pillar					
Macroeconomic stability	81	4,5	78	4,6	3
IV pillar					
Human health and basic education	89	5,4	58	5,8	31
Increase efficiency	100	3,6	102	3,6	2
V pillar					
Higher education & vocation training	88	3,8	86	3,9	2
VI pillar					
Efficiency of commodity markets	127	3,6	115	3,8	12
VII pillar					
Labor market efficiency	94	4,2	85	4,2	9
VIII pillar					
Development of financial market	113	3,5	124	3,3	-11
IX pillar					
Technological readiness	85	3,4	73	3,6	12
X pillar					
market size	93	3,1	97	3,0	-4
Innovation and sophistication factors	120	2,9	108	3,1	12
XI pillar					
Business sophistication	115	3,3	108	3,4	7
XII pillar					
Innovation	120	2,6	104	2,8	16

Source : EU Forum, 2012

According to World Bank classification, B&H is a country with lower medium income. In a global competitiveness report for 2011-2012, Bosnia and Herzegovina was rated 3.8 of the possible score of 7, and ranked 100th place according to economy

competitiveness, which represents an improvement of two places compared with previous report.

Biggest improvement was achieved in the assessment of quality of institutions. Also, the growth was recorded in area of innovation. Facts about areas that are in decline must concern us: namely, biggest drop was recorded in the areas of financial market development and market size. Area of financial market development was poorly rated because of poor availability of financial services, availability of venture capital and authorization by funds. In the area of efficiency of commodity markets, bad score is result low intensity of local competition, degree of market dominance, number of days required to start a business, the degree of the level of taxation, the cost of agricultural policy and the number of procedures required to start a business. Reports also suggest on the most problematic factors for the successful conduct of business operations in Bosnia and Herzegovina: a) access to financial resources, b) high tax rates and c) inefficient administration.

It is interesting to determinate the extent to which managers are introduced with the concepts / reasons for the economic crisis and to determine their views on how economic issues have to be represented by politicians. According to the research, 26% of managers are aware of the current situation and feel that the country needs a radical economic reform. Also, almost the same percentage of managers believe that B&H passes through economic crisis, lagging behind other countries in transition, and they believe that without successful reforms, B&H will still lag behind. Although 79% of respondents are aware of the crisis, they believe that economic issues are very important in politicians attitudes but important problem is the lack of knowledge about current economic situation among political leaders.

Furthermore, according to research, 85% of managers believe that economy in B&H is weaker than other developing countries, while only 12% considered that B&H economy is approximately equal. Such an attitude is to some extent correct, with respect to Global Competitiveness Index, according to which other developing countries are in front of B&H. Also, 70% of respondents believe that living standard in B&H is weaker than in other developing countries.

In addition to the above facts, it is necessary to determine whether managers are ready to make personal sacrifices in order to achieve the development European countries. Results showed that 39% are ready for new victims, and 36% of them emphasized that they are tired of sacrificing. Also, 25% of managers have noted that they were waived in the last 5 years.

Leading institutions in Bosnia and Herzegovina have been making efforts to improve the coordination of economic and fiscal policy, and the Office of the High Representative (OHR) plays a significant role in establishing of normal conditions which is characteristic of the most of the countries in transition and achieve integration into the European Union with a stable economic development.

For achievement of the goals there was set six key tasks in several programs: a) establishment the rule of law, b) ensure that extreme nationalists, war criminals and

organized criminal networks can not stop the Peace Implementation Council, c) to reform the economy, d) strengthen the capacity of authorities B&H authorities, especially at the state level, e) to establish a civil administration and control of the armed forces at the national level, f) to reform the security sector and pave the way for integration into Euro-Atlantic structures, the sustainable return of refugees and displaced persons.

Given the need to establish normal state and later integration into the EU, it was necessary to determine opinion of managers about person or groups that should determine future of Bosnia and Herzegovina: greatest hopes and expectations are given to leading entrepreneurs (30%), the B&H Council of Ministers (19 %) and to university professors and scientists (17%). Minimum expectations were given to the entity governments and religious leaders. In addition to determining who should determine future of Bosnia and Herzegovina, it is necessary to determine opinion of managers about the expertise of persons conducting business, government and unions. Results shows that 40% of respondents believe that people who lead B&H economy are expert, and 18% recognized expertise of Council of Ministers. Symptomatic response is that managers slightest believe in expertise of unions. Also, 30% of respondents believe that Bosnia and Herzegovina leaders have vision and how they will make the best decisions for the country, while 25% believe that state is going in the right direction. Only 10% of managers believe that leaders of B&H care about personal interests of the citizens.

Accession to the European Union means for Bosnian and Herzegovina taking positions which has always belonged in the political, cultural and economic terms. Citizens are determined to be an integral part of modern European political, economic and security structures with a clear indication of the lack of expertise of people who lead Bosnia and Herzegovina as well as the lack of competence of the top people. Therefore, sharing the goals, values and principles, which has the European Union, Bosnia and Herzegovina must take the necessary steps to be ready to assume the obligations of membership in the European Union. In this direction it is necessary to develop a complete system on the values and achievements of European democracies, with goals that include the preservation and strengthening of peace on the European continent, economic advancement and growth based on the free market, and to strengthen and improve the social security and welfare as well as cultural cooperation. Prospect of EU membership is a powerful incentive to continue the reforms already under way in Bosnia, and a driver of the process, which should allow the creation of economic, legal, organizational and social structures capable of acting in accordance with EU rules.

Bosnia and Herzegovina had 1.054 million employees in the year of 1990 and in 2007 total employment was estimated at 999,500 people, of whom 638,000 (63.8%) were in real sector. A large number of young people (3/4) work in the informal sector of the economy (gray economy). In employing process discrimination is present on several grounds: ethnicity, age and sex. Unemployment rate in B&H is almost 41%, according to a World Bank study, and people wait for the job for more than 3 years. The older generation is waiting to work for more than 5 years. Employment in the informal economy has enabled many people to stay above the poverty line.

Existence of informal sector in the further development of the B&H Association and the European Union is not desirable because: a) the adverse impact on the efficiency and equity, b) a large number of workers without the right to social and pension insurance, c) an adverse effect on the budget and the state pension and health insurance. Large public sector employment is explained by the slow recovery of the industrial sector and the development of the administrative apparatus after the war. In the post-war period the number of employees in state administration has almost doubled from 5.9% to 11.6%, while the share of employees in the retail sector increased by more than 30%, i.e. from 9.1% to 14%, and the share of education sector from 5.8% to 8.5%. For the economy of Bosnia and Herzegovina is indicative and high employment in the service sector. Table 1 shows number of employees in enterprises of the Republic of Serbian in 2010th year.

Table 1: Number of employees in Republic of Serbian enterprises

		Employed persons
Total		126.000
Industrial activities (B, C, D, E)		66.000
B	Mining and quarrying	4.000
C	Manufacturing	49.000
D	Manufacturing and supplying with electricity, gas	8.000
E	Water supply, sewerage, waste management and remediation environment activities	5.000
F	Construction	13.000
G	Wholesale and retail trade, repair of motor vehicles and motorcycles	33.000
H	Transport and storage	11.000
I	Accommodation providers, preparing and serving food, hotels and catering	2.000
L	Real estate	1.000

Source: Data from Institute of Statistics of Republic of Serbian

In the Republic of Serbian companies a total of 126,000 workers are employed. The structure of employment accounted for the largest share of industrial activities (66,000) and retail and wholesale trade, repair of motor vehicles and motorcycles.

Table 2 shows number of employees in B&H companies and crafts.

Table 2: Number of employees in B&H companies and crafts

Activity	2009	2010	2011
Agriculture, hunting and forestry	9320	9010	8811
Fishing	179	180	172
Mining and quarrying	15049	14649	14294
Manufacturing	84275	84064	84700
Electricity, gas and water supply	13208	13451	13488
Construction	26832	26024	24975
Trade; repair of vehicles, motorcycles and personal and household goods	80438	80969	81140
Accommodation and food services activities	18078	17084	17135
Transport, storage, communication	29627	29756	29406
Financial intermediation	10711	11040	10879
Real estate, renting, business activities	17905	18232	19194
Public administration and defence; compulsory social security	38138	46873	47532
Education	36453	37324	38653
Human health and social work activities	28850	29235	29830
Other community, social, personal activities	16999	17199	17150
Total	437501	438949	440747

Source: Federal Bureau of Statistics

In enterprises in B&H in the year of 2011th were employed 440.747 workers and this represent increase compared to the year 2009 and 2010.

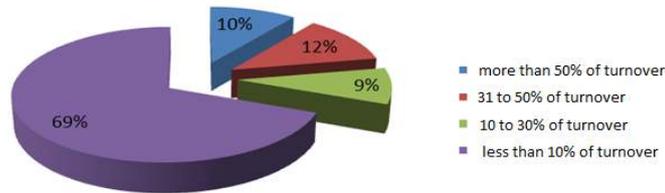
In the employment structure, largest amount of employees were among highly educated and highly skilled workforce and it is quite certain that increase in employment can be expected mainly in the private sector, and that the promotion of entrepreneurship is best solution for reducing unemployment.

Studies conducted among entrepreneurs point on a great distrust of business partners, which is a serious impediment to private sector growth. Level of interpersonal trust and confidence in the B&H system is among the lowest in the region.

Opinion research among manager about economic objectives B&H shows that majority of them believe that in the future there will not happen any significant changes, regardless of which political option is on rule, because they believe that no one has clearly laid out economic goals. As the most important economic goals B&H, managers have identified: reducing unemployment, economic development, the growth of production, GDP growth, increase exports and the inclusion in the EU.

From the data on export companies from Bosnia and Herzegovina to the EU market and neighbouring countries in the study was examined the amount of traffic that individual companies realized on the EU market. Results of the survey about export to the EU shows Figure 1.

Figure 1: Export to the EU

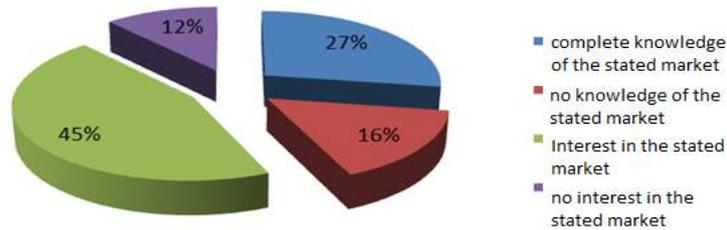


Source: authors calculation

Even 69% of managers surveyed ranking that exports to the EU market acquires less than 10% of their total turnover, 10% of respondents that in the EU market gets more than 50% of turnover, and for them it can be said that they are export-oriented enterprises.

Reasons for bad condition of exports to EU countries arising from insufficient knowledge about EU market.

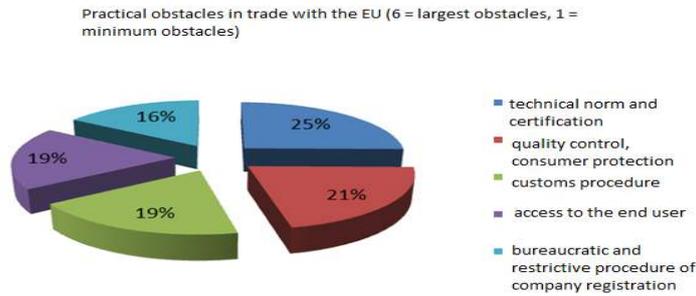
Figure 2: Knowledge about EU market



Source: authors calculation

Results show that 16% of managers are not even familiar with EU market, 12% have no interest for that market, 45% of managers are interested to do business on EU market, 27% of managers have full knowledge about EU market. Managers who are familiar with EU market and have interest to do business on it faced with various barriers to trade.

Figure 3: EU trade barriers

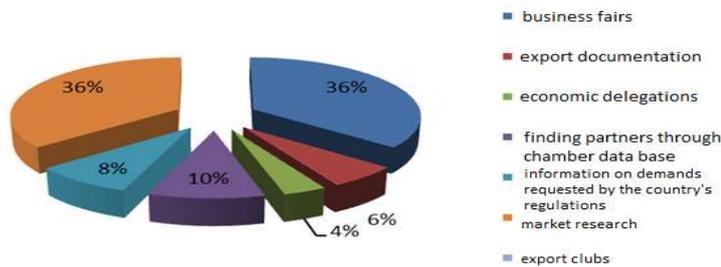


Source: authors calculation

Most important trade barriers for managers: technical standards and certification (25%); quality control and consumer protection (21%). Customs problems in trading are obstacle mainly due to bureaucracy and lengthy and costly customs clearance procedure.

In promoting exports, different countries are using different activities and therefore is need to determine which services organizations and in which in the extent are used to promote exports.

Figure 4: Organization services used to promote exports



Source: authors calculation

36% of companies most commonly use economic fairs, and the same percentage are also carried out market research activities. 10% of companies find partners through Chamber of Commerce databases, 4% of companies are using contacts with the business delegation in promoting exports. Also, 20% of the company managers considered market research activities as the most important for the promotion of exports, followed by economic fairs (17%) and economic delegation (15%).

Foreign trade in the year of 2011 was mainly focused on the EU and neighbouring countries. On these two groups of countries (EU27 and SEE) refers to 92.6% of total

exports, while their share in total imports is 73.3%. Among them are extracted Croatia and Germany as the leading partners in export and import.

Table 3: B&H export and import

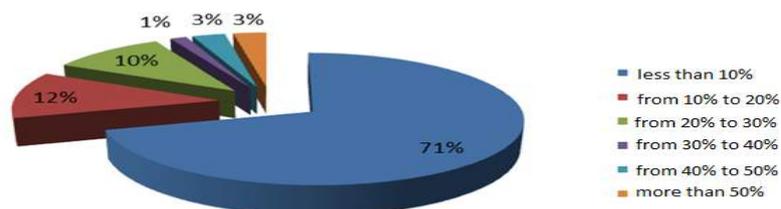
	Export (%)					Import (%)				
	2007	2008	2009	2010	2011	2007	2008	2009	2010	2011
EU 27	57,3	55,2	54,2	54,5	55,8	47,8	48,0	49,1	45,9	45,4
Eurozone	48,5	46,6	47,4	48,1	49,1	38,3	37,5	38,4	36,0	35,8
Italy	13,1	12,6	12,7	12,1	11,7	9,0	9,3	10,1	10,5	10,6
Germany	12,8	13,6	14,7	15,3	14,8	12,5	11,8	11,3	8,9	8,9
Slovenia	10,9	9,2	8,4	8,6	8,6	6,4	5,9	6,1	5,9	5,3
JIE *	35,8	37,1	38,1	37	36,8	29,1	28,9	26,8	29,8	27,9
Croatia	18,4	17,2	17,1	15,1	14,6	17,6	17,1	15,0	15,1	14,3
Serbia	11,7	14,0	13,4	12,6	12,2	9,4	10,6	10,4	10,5	9,4
Other countries	6,9	7,7	7,7	8,4	7,4	23,1	23,1	24,1	24,3	26,7
Russia	0,1	0,2	0,5	0,5	0,6	2,0	2,1	7,0	8,7	10,5

Source: Annual Report of the Central Bank of Bosnia and Herzegovina in the year of 2011

Note: *Southeastern Europe (Albania, Croatia, B&H, Macedonia, Serbia, Montenegro)

In the context of economic growth in Bosnia and Herzegovina and the assessment of its further growth is important to determinate how much of total income company realized by export to South Eastern Europe markets.

Figure 5: Export to South Eastern Europe markets

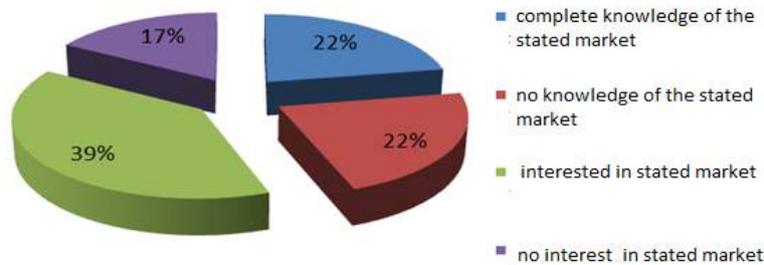


Source: authors calculation

The results in Figure 5 show that in 71% of the surveyed companies value of exports to Southeast Europe markets in the total turnover is less than 10%. The fact that 22% of companies is having 10% to 30% of exports to these markets indicates that one can expect an increase in revenue realization from exports.

It is necessary to determine the level of managers knowledge about Southeast Europe markets.

Figure 6: Knowledge about Southern Europe markets

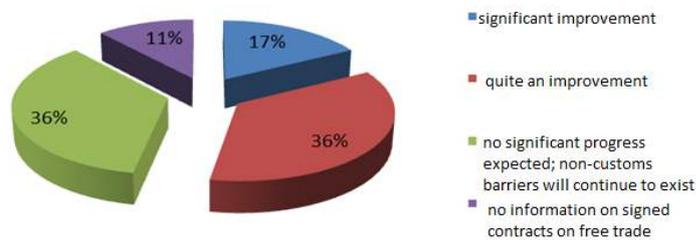


Source: authors calculation

According to Figure 6, 22% of managers of enterprises are not familiar with South Eastern Europe markets, and 17% have no interest in that market. A ratio of 39% of companies that are interested in doing business in South-Eastern Europe markets shows that the same through time in the future need to acquire knowledge and skills that will enable them to better marketing of its own products and services and better positioning in these markets.

Expectations of managers of trade liberalization in Southeast Europe shows Figure 7.

Figure 7: Expectations of trade liberalization



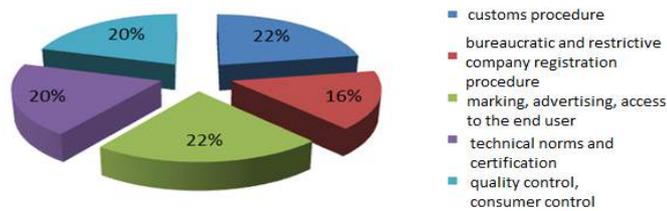
Source: authors calculation

In addition 17% of managers who expect a significant improvement in economic activity and 36% of managers expect change for the better, which indicates that the majority of them expect the positive aspects of liberalization. However, 36% of companies believe that liberalization will not significantly improve the business because they believe that non-tariff barriers continue to be a constraint for entry into these markets.

Managers have identified the most significant trade barriers with the South Eastern Europe countries.

Figure 8: Trade barriers with South Eastern Europe countries

Obstacles in trade with southeast European countries (evaluate from 1 to 6)



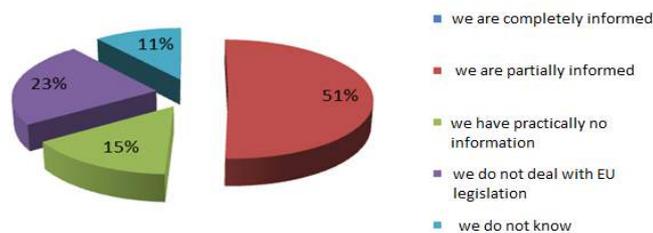
Source: authors calculation

As the most important obstacles were identified customs procedure and labelling, advertising and access to the end user. Obstacle for companies too often encounter are bureaucratic and restrictive registration procedure and the biggest problems are related to technical standards and certification of enterprises are lack of mutually recognized certification bodies, and the deficiencies of national certification of compliance with standards.

B&H achieved some progress in privatization and restructuring of enterprises. However, there is still a certain, a big part of companies that are owned by the state, and the privatization of strategic enterprises is still slow.

Managers and companies should actively participate in reform of the legal framework and actively cooperate with agencies. In this regard, it is necessary to determinate the awareness of managers on EU legislation.

Figure 9: Awareness of managers on EU legislation



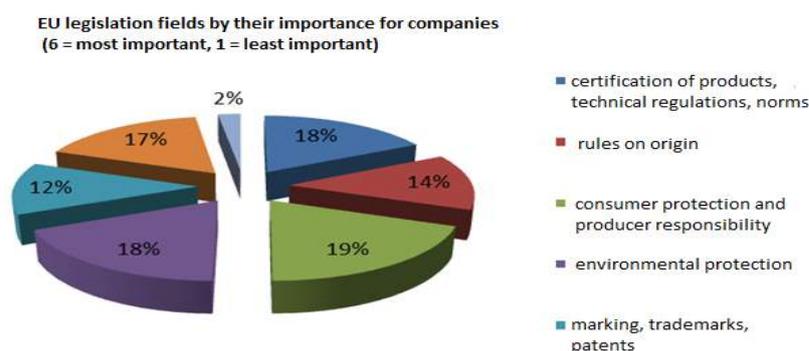
Source: authors calculation

About EU legislation fully is informed only 11% of companies, while 15% said that virtually has no information on the question. It is significant that most of that 51% of managers stated that are partially informed on EU legislation which indicates that the Agency should continue to work intensively on supplementary education of managers

in interested companies. The results showed that disinterested in EU legislation 23%, which is in accordance with the number of companies who expressed disinterest in markets outside Bosnia and Herzegovina.

It is important to ascertain the opinion of managers of the importance of certain areas of EU legislation for companies.

Figure 10: Importance of certain areas of EU legislation for companies.



Source: authors calculation

Most important areas of legislation for relating Companies from Bosnia & Herzegovina are those relating to the protection of the consumer and producer responsibility, environmental protection and product certification, technical regulations and standards, and followed the rules of origin.

For accession to the European Union, where Bosnia and Herzegovina aims, it is important that she meet the Copenhagen economic criteria.

The time required for Bosnia and Herzegovina to reached at least competitive EU member states is the minimum 8-10 years, because the country's on level of development at which is B&H on average improve their position for 2-4 places in the competitiveness rankings. Therefore, it is interesting to determinate the relationship or knowledge of managers in companies from Bosnia and Herzegovina about key aspects of the European Union.

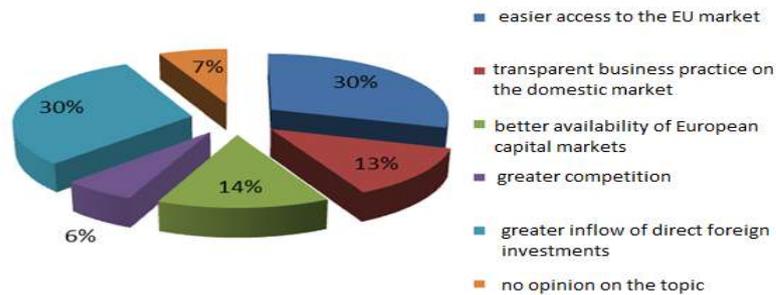
5. EXPECTED EFFECTS OF B&H INTEGRATION TO THE EU

Accession process is one of the most important political instrument of EU. Desire to join the EU helped the countries of Central and Eastern Europe to transform into a modern and functional democracy. The EU has initiated significant reforms in Turkey, Croatia and the Western Balkans countries. All European citizens have benefit from the fact that their neighbors have governments with stable democracies and prosperous market economies. Expansion is the process that leads carefully, and that helps countries that are involved in this process of transformation when it comes to

promoting peace, stability, prosperity, democracy, human rights and the rule of law across Europe.

Figure 11 shows managers attitudes about most important effects of the B&H accession to the EU

Figure 11: Most important effects of B&H accession to the EU

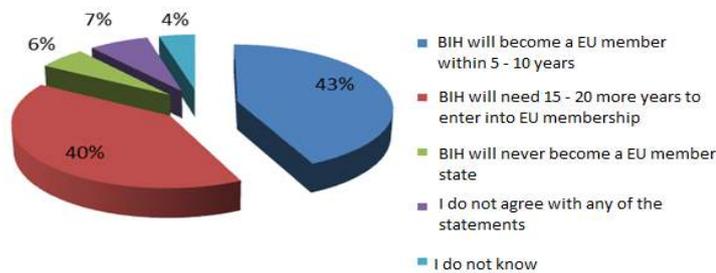


Source: authors calculation

As the most important effects of integration into EU, B&H managers have identified : easier access to the EU internal market and a large inflow of foreign direct investments (30%); better access to European capital markets (14%); strengthening of transparent business practices in the domestic market (13%).

When Accession Treaty is signed, a candidate country becomes "accession country" and is entitled to temporary privileges to access when it became the member state. Access State may comment drafts, notes, recommendations and initiatives of the EU, and given the status of "active observer" EU bodies and agencies, which gives her the right to take part in the discussions but not to vote. When ratification process is concluded, agreement will enter into force on the fixed date and accession countries will became the Member State.

Figure 12: expectations of managers about the time of B&H accession of to the EU



Source: authors calculation

Most of company managers from Bosnia and Herzegovina considers that B&H will enter to the EU in the next 15-20 years or it will never become a member state, while 43% of them think that country will become the full EU member in next 5-10 years.

Bosnia and Herzegovina is an example for the countries in the region in the field of free movement of goods, services, capital and people. In the application is a package of framework legislation on the free movement of goods, right of establishment of companies that do not discriminate against anyone, nor the Law on Foreign Direct Investment, and domestic and foreign companies can participate in the privatization of enterprises and banks. The greatest progress in B&H has achieved in the fiscal sector, in the modernization of the payment system, privatization of banks and maintaining a stable exchange rate. Policy reform of trade made B&H a country of the Western Balkans with the most liberal regime of free trade. Hydropower potential of B&H is 22 000 GWh of electricity production, as well as 4 billion tons of coal reserves present a priority for the EU, which is characterized by high energy dependence. The strategic goal of B&H is to become part of the Energy Community of South East Europe, and then part of the EU market.

Skilled labor force in B&H with developed work habits will be competitive in the EU, while at the same time will not pose a threat to workers from other countries, because the citizens of Bosnia and Herzegovina make 0.8% of the population of the Union. Under the biggest impact of Europe's competition there will be the agriculture and trade, in need of special protection and care. In the process of joining the EU, B&H must create a predictable economic environment, invest in infrastructure, encourage private savings, create an attractive environment for foreign investment and maximize investments in education.

Enterprise Technology Management is a factor of economic development of each country's market economy. Conducting organizational change management of Bosnia and Herzegovina should be directed towards bringing the features of European competitiveness. In this sense, it is necessary to develop the organization of work according to the principles of entrepreneurial organization, to develop a hierarchy of goals and strategies and to develop their respect of organizational structure. Given the current and future business expansion to the countries of the European Union, it is necessary to strengthen communication techniques to negotiate with the EU and to strengthen project manager managerial decision-making in order to internationalize the business. Economy of B&H will strengthen through integration process of the EU to become a destination for various types of resources in order to develop the economy of Bosnia and Herzegovina. In this connection, it is necessary to develop the technology of planning and organizing projects for investment from the EU, and in particular to develop skills needed for project organization and project management. The economy of Bosnia and Herzegovina, as well as its management, have to define long-term and strategic plans, and to develop techniques of financial planning and budgeting. Planning is a continuous process that accompany technical and technological, political, legal, economic and cultural changes, as well as real indicators of the key elements that create the socio-economic development. The planning process has to coordinate the development of contradiction of local and regional interest, operated by the criteria of optimal usage of natural and other resources of the region.

6. CONCLUSION

Including of the economy of Bosnia and Herzegovina in the EU economy will not be possible or is difficult, given the current low competitiveness of the economy which B&H currently has, and it is caused by a low level of competitiveness of application due to the low coverage of higher education and training of employees of enterprises, and because of to low technological competitiveness as well as because of poor quality of management of society and economy. In order to B&H to join the European Union economy is necessary to establish the stability of institutions guaranteeing democracy, the rule of law, human rights and protection of minorities and the existence of a functioning market economy, capable to cope with competitive pressure and market forces within the Union, and to gain ability to assume the obligations of membership including adherence to the objectives of political, economic and monetary union. It is certainly necessary to create the conditions for the integration of adapting administrative structures through the implementation of regulations with the support of appropriate administrative and judicial structures, which requires the full engagement of the state and entity institutions, NGOs and society at large.

Managers and sometimes business owners start from a concept usually by offering a product or service, or that which have, have expenses, seeking to regain equity and realizing sometimes even profits to a large extent. However, what they lack in most cases is clearly defined activity, determined, effective and organized the present where they know where to go and what to do in order to achieve satisfactory results. Although it is difficult to define the ingredients in the recipe of success, even more difficult to precisely define the importance of different elements, because for every company crucial is influence of its managers. Therefore, the fact that, regardless of the genius ideas, capital that attracts, and demands which are related to quality of products or services, the company difficult to survive in the modern market conditions if they don't defined activity and they don't ensure a quality realization functional management (planning, organization, personnel issues, management , controlling).

The last statement of the leading politicians of the European Union as well as the statements of local politicians certainly contributes to the research results which show that the majority of managers companies from Bosnia and Herzegovina believe that the state will enter the EU in the next 15-20 years or it will never become an EU member. It is therefore necessary that all the institutions of Bosnia and Herzegovina make further efforts to the number of managers (43%) who believes that for the entry into the EU Bosnia and Herzegovina need 5-10 years has increased significantly. In addition to the preceding, and regardless of political statements by the head of the European Union and the prolongation of the expected time of joining the European Union, it is essential that managers of companies (public and private) and other institutions of Bosnia and Herzegovina must work on increasing the knowledge of management, which will contribute to economic growth and development Bosnia and Herzegovina.

REFERENCES

- European Commission, Document: "SEC (2008)2693 final", Izvještaj o napretku Bosne i Hercegovine u 2008.godini, Brisel, 5.11.2008.
- Freser, R. 1991. „The World Trade System“, Longman, Harlow
- Fung, M. 1998. „A learning team approach for service organizations to achieve TQM and beat the competition“, *Managing Service Quality*, Volume 8, Number 5
- <http://www.europa.ba>
- <http://www.mvteo.gov.ba>
- <http://www.oma.uino.gov.ba>
- <http://www.uino.gov.ba>
- <http://www.bhas.ba>
- <http://www.wto.org>
- <http://www.eu.int>
- <http://www.fzs.ba>
- <http://www.rzs.rs.ba>
- Kandžija, V.; Bezić, H. 2001. „The EU commercial policy towards third countries“, *Economic System of European Union and Accession of the Republic of Croatia*, Rijeka
- Kandžija, V.; Host, A. 2001. „Debt Adjustment of the Republic of Croatia“, Brno Conference,
- Kandžija, V. 2003. „Gospodarski sustav Europske unije“, Rijeka: Ekonomski fakultet Rijeka
- Kordić D. 1990. „Organizacija i funkcioniranje poduzeća“, Mostar (Ekonomski fakultet)
- Kordić D. 1997. „Organizacija poduzeća“, Mostar (Narodni list)
- Kotler P. 1994. „Upravljanje marketingom“, Zagreb (Informator)
- Kovaček, S. 1999. „Novi carinski zakon – još jedan korak prema Europi!“ *Carinski vjesnik*, Zagreb,
- Masic, B. 1996. „Strategijski menadžment“, Univerzitet "Braća Karić", BK INSTITUT, Beograd
- Marušić, S. 2001. „Upravljanje ljudskim potencijalima“, Zagreb
- McAdam, R.; McCreedy, S. 1999. „A critical review of knowledge management models“, *The Learning Organization*, Volume 6, Number 3,
- McRtensson, M. 2000. „A critical review of knowledge management as a management tool“, *Journal of Knowledge Management*, Volume 4, Number 3,
- Meade, J. 1959. „The Theory of International Economic Policy Trade and Welfare“, vol. II, London
- Mencer, I. 2003. „Strateški menadžment i poslovna politika“, Vitagraf, Rijeka
- Mišetić, D. 1999. „Ostvarivanje funkcija managementa u malim poduzećima“ magistarski rad, Split
- Mišetić, D. 2001. „Management functions realization within small enterprises in transition“ *Enterprise in Transition: International Conference Proceedings*
- Mišetić, D. 2001. „Model of defining the level of implementation of the management functions in small enterprises“, *Management Journal of Contemporary Issues*, Vol. 6.

Vera Boronenko
Institute of Social Research of Daugavpils University
BA School of Business and Finance
Foundation "Cluster Experts Baltic Sea Region"
Jelena Lonska
Daugavpils University, Daugavpils, Latvia

WHY BUSINESS SUPPORT INSTRUMENTS ARE NOT WIDELY USED BY SMEs? CASE OF LATVIA

ABSTRACT

The application of business support instruments in EU countries has been studied within the European Commission (EC) project „Study on the Compilation of SME policy measures and assessment of the SBA implementation within the SME performance” (one of the authors was expert covering Latvia in this project during two years - 2011 and 2012). The result of study results show that there is a considerable number of SME policy measures taken in the European Union (EU) countries to comply with the Small Business Act (SBA) principles and apply them in practice. However, small and medium enterprises (SMEs) still are not satisfied with the state support policies and measures. The main aim of the research presented in this paper is to apply SBA policy measures in a case of a concrete enterprises (on Latvian case) to identify if this is possible to use these measures for SMEs and what are the main drawbacks limiting effects of the SMEs’ support system. Research results approved the hypothesis of the authors that there are four main reasons for a low efficiency from application of the SBA measures by European SMEs: cognitive, emotional, competence based and ecological, by assessing the significance of each factor. This paper was prepared with the support of the Lifelong Learning Programme’s Leonardo de Vinci co-financed TOI project “Transfer of the Best-Practice & Innovation in CAD for Logistics stakeholders” (Nr. 2012-ES1-LEO05-48228).

Keywords: SME, SBA, business support instruments.

JEL classification: E60, K20

1. INTRODUCTION

The idea of conducting this research appeared while one of the authors (V.Boronenko) worked as Latvia's expert of the EC co-funded project „Study on the Compilation of SME policy measures and assessment of the SBA implementation within the SME performance. Review 2010-2011”. The SBA has been created in the European Union (vs USA) to help better focus policies and policy measures of governments of the EU

countries towards supporting specific needs of SMEs. The SBA is based on 10 principles or areas of activities which were accordingly researched by the authors of this paper evaluating support policies and measures implemented by the government of Latvia in 2010 and 2011. The SBA principles are the following:

1. *Entrepreneurship* (for stimulating innovative and entrepreneurial mindsets among young people);
2. *Second chance* (for promoting a positive attitude in society towards giving entrepreneurs a fresh start);
3. *Think small first* (for ensuring that policy results are delivered while minimizing costs and burdens for starting business);
4. *Responsive administration* (for reducing the level of fees requested by the Member States' administrations for registering a business);
5. *Public procurement and State aid* (for setting up mechanisms to widen access to information on public procurement opportunities);
6. *Skills and innovation* (for implementing professional skills and innovative capacity of SMEs);
7. *Access to finance* (for increasing SMEs possibilities to access loans, guarantees and other funding instruments);
8. *Single market* (for encouraging efforts of SMEs to internationalize and become high growth enterprises);
9. *Environment* (for providing incentives for eco-efficient businesses and products);
10. *Internationalization* (for encouraging coaching of SMEs by large companies in order to bring them to international markets and others policy measures).

The analysis of the SMEs' support policy conducted by the Latvian government has shown that a considerable number of new business support instruments were adopted in Latvia during 2010-2011. Taking into consideration the fact that many of SMEs' support instruments were adopted already before 2010 and their application has been continued in a longer term, it can be concluded that Latvia has developed a good system of SMEs' support.

At the same time, working in the European Economic Area (EEA) and the Latvian government's co-funded project „Usage of the Potential of Universities for Regional Development” (2009-2011), one of the authors of this paper together with the team of researchers of the Institute of Social Research of the Daugavpils University found the following contradiction: according to the data of sociological surveys carried out by the above-mentioned Institute, entrepreneurs have a point of view that the support of their business activity from the side of local authorities and the state is minimal, even comparing it in their descriptions with a word “genocide”. Though, as it was mentioned before, there are enough business support instruments announced and implemented in Latvia, which entrepreneurs can use. By some unknown reasons all of these instruments do not achieve their main goal – to support SMEs. One of the results of this project was confirmation of the hypothesis that that business support instruments provided by the state do not correspond with real needs of Latvian SMEs (Boronenko V. et al., 2011).

Continuing working with projects related to the business support, one of the authors of this paper has taken part in the implementation of the EU Lifelong Learning

Programme's Leonardo da Vinci sub-programme's Transfer of Innovation project "LogiCAD: Transfer of Best-Practice & Innovation in CAD for Logistics Stakeholders" (2012-2014). Project's partners are six institutions from Spain, Latvia, Malta, Romania and Hungary) and it aims at facilitating transfer of best practices and innovation – IT solutions, i.e. 2D and 3D CAD - generated within the previous LdV project "euCAD" (<http://www.camis.pub.ro/eucad/>) to professionals and other stakeholders working in the sector of transport and logistics. A member of the project team, researcher of the Daugavpils University, S.Ignatyeva elaborated the methodological model of the empirical research of the process of practical application of new technologies which consists of four stages – cognitive (understanding the benefit from a new technology), emotional (psychological acceptance of a new technology), competence based (ability to use a new technology) and ecological (existence of an adequate technical and organizational conditions for applying a new technology) (Ignatyeva S., Boronenko V., 2013). All these stages must be applied successfully for a general success of a new technology which can make an enterprise and a country more competitive. The authors argue that this methodology can be also applied for evaluating the application of business support instruments as some kind of a "new technology" for doing business better and in a more effective way. In this research, the authors will try to prove their hypothesis that the Latvian SMEs do not exploit enough business support instruments provided by Latvian government. There are four main reasons for non-usage or low efficiency usage of the SBA measures by the SMEs: cognitive, emotional, competence based and ecological, - with an assessment of significance of each reason.

This assessment will be performed both, qualitatively and quantitatively, using the following methods:

1. Analysing the case of a Latvian enterprise which has tried to use some business support instruments provided by the Latvian government;
2. Performing the quantitative analysis of the data from sociological survey of the Latvian logistic companies about their application of CAD as supporting instrument for development of the performance of their businesses.

The paper is structured into two main chapters, which correspond to two research questions discussed within these chapters:

1. What are the business support instruments provided by Latvian government for SMEs? This information will be given in the next chapter and it is based on the research results of the „Study on the Compilation of SME policy measures and assessment of the SBA implementation within the SME performance. Review 2010-2011”;
2. What are the possibilities for SMEs to use business support instruments provided by the Latvian government as well as by other stakeholders? This research question will be discussed in the last chapter of the paper using the two above mentioned methods, and partly based on the data of the EU Lifelong Learning Programme LdV TOI project “LogiCAD: Transfer of Best-Practice & Innovation in CAD for Logistics Stakeholders”, as well as the authors' experience within the EU project “Erasmus for Young Entrepreneurs: The action EYE SEE P” (2013-2014, project's partners are five institutions from Germany, Latvia, Slovenia, Spain and Turkey).

In the result of this research some conceptual remarks and recommendations on how to improve the practice of adopting business support instruments in Latvia and the EU will be provided, taking into consideration the research findings and the authors' experience within abovementioned projects.

2. ANALYSIS OF SUPPORT INSTRUMENTS FOR THE LATVIAN SMEs

The Government of Latvia has not adopted any specific strategy for the “Small Business Act” (SBA) implementation. The implementation of different business support measures has followed the annual Action Plan for Improving Business Environment in Latvia. The business support policy is implemented through various legal acts and policy documents, such the Conception of Support Measures for Micro Enterprises and other. The body responsible for the overall implementation of SBA is the Ministry of Economics of Latvia which has nominated the SBA envoy for Latvia. However, there are a number of specific policy measures listed by the SBA which are under responsibility of respective ministries and government agencies.

The number of SMEs relative to Latvia's population is still lower than in other EU countries: 31 SMEs per 1000 inhabitants vis-à-vis 40 for the EU-average (Ministry of Economics of Latvia, 2010). Therefore, an important challenge for Latvia is to increase a number of economically active enterprises and commercial entities. Taking into account a very high level of unemployment in Latvia - 13.9 percent in 2010, 12.0 percent in 2011 and 11.3 percent in 2012 (Central Statistical Bureau of Latvia, 2013) - and acknowledging that SMEs in Latvia contribute significantly higher share to the overall employment as compared to the EU average, the challenge of increasing a number of SMEs and micro-enterprises becomes even more important. In this respect, the focus of SBA has addressed challenges of SMEs in Latvia to the great extent.

In 2010-2011, Latvia initiated actions in all SBA areas. Activities started in previous years were continued in different policy areas, such as Entrepreneurship, Environment and Internationalization. A number of policy measures for supporting Latvian SMEs were developed during this period. The following ones are the most significant (classified by the areas of activities mentioned in the introduction of this paper):

- 1. Entrepreneurship:** New study subject “Economics” for general secondary education (The Centre of State Education Content, 2011) was included in the mandatory study programme of 20% of Latvian secondary schools (Bikse V., 2009). Some informal initiatives of the entrepreneurship subjects' integration into general secondary education curricula were adopted: 1) methodological activities (seminars, manuals etc.) on the new study subject “Creativity and entrepreneurship skills” on the base of Edvard de Bono methodology (De Bono E., 1992) integration into general school education curricula (Truksane A., 2013; Websoft.lv, 2013); 2) promoting the creation of Scholars Training Enterprises (STE) for 5-12th classes in the secondary schools, including teachers and schoolchildren, initiated by the business education foundation “Junior Achievement – Latvia” (Junior Achievement – Latvia, 2013).
- 2. Second chance:** There has been a substantial and significant progress achieved in this SBA area due to amendments of the Insolvency Law adopted to decrease the

time of insolvency process from 3 years to one year and one month. The costs of the insolvency process have been reduced approximately twice - from 13% to 7% (Parliament of Latvia, 2010a). There has not been any progress achieved in implementing measures related to promoting a positive attitude in society towards giving entrepreneurs a fresh start; implementing the recommendation to promote second chances for entrepreneurs by limiting the discharge time and debt settlement for an honest entrepreneur after bankruptcy to a maximum of three years by 2013; and ensuring that re-starters are treated on an equal footing with new start-ups.

- 3. Think small first:** The implementation of the Conception of Support Measures for Micro Enterprises, adopted by the Government of Latvia in 2010, resulted in the set of following support measures: the state fee to be paid when registering an enterprise in the Register of Enterprises was reduced by 50% in order to decrease costs of business start-ups (Cabinet of Ministers of Latvia, 2009); the equity capital requirement of a newly established company was reduced permitting to start a company with a minimum equity capital (from €1,43) (Cabinet of Ministers of Latvia, 2010a); the special reduced overall tax for micro-enterprises (9%) was introduced; the application of a fixed patent fees for economically active persons was made possible, etc. (Parliament of Latvia, 2010c).

There has been a substantial and significant progress achieved by reducing a number of obligations to be reported by entrepreneurs; permitting entrepreneurs to use the Electronic Declaration System to submit VAT reports significantly reducing the time required to prepare the VAT report; allowing gradual increase of the threshold for VAT registration from LVL 10 000 (Euro 14 228.80) to LVL 35 000 (Euro 49 800.80); as well as planning to develop additional new e-services to simplify administrative procedures for entrepreneurs in 2012 and further on.

- 4. Responsive administration:** In order to provide communication with SMEs and hear the opinion of entrepreneurs, moreover, to achieve that this way of communication would be productive for all interested parties, the Ministry of Economics has established SMEs discussion platform. In this forum, the entrepreneurs are welcome to participate in solving issues relevant to development of SMEs and adopting recommending decisions regarding these issues, as well as to identify problems which impede development of SMEs in Latvia, jointly elaborate solutions for improving the situation, and discuss specific issues directly referring to small and micro-enterprises (Ministry of Economics of Latvia, 2010).

In addition, the Law “On the Free Provision of Services” and related Government regulations were adopted to ensure full and timely implementation of the Services Directive (Parliament of Latvia, 2010d), including setting up points of a single contact, through which businesses can obtain all relevant information and complete all necessary procedures and formalities by using integrated state information systems and unified government e-service portal (www.latvija.lv). Also, the Conception on the implementation of a principle of one-stop agency for better accessibility of public services has been worked out for improving quality and access to public services, reducing administrative burdens and time to receive services, as well as reducing burden placed on the State budget.

- 5. Public procurement and state aid:** In 2010, the Plan for Improving the Application of the Electronic Procurement System 2010-2012 was adopted to widen access to information on public procurement opportunities, as well as to

make the electronic procurement system more efficient and easily applicable (Cabinet of Ministers of Latvia, 2010b).

There has been some progress achieved by adopting the Guidelines for local government centralized procurement organization (Cabinet of Ministers of Latvia, 2010c) recommending the subdividing of procurement objects into lots to improve possibilities for SMEs to participate in sub-contracts. Also, since 2011 centralized guidelines for public services providers are published on-line in the Public Procurement Bureau home page.

6. **Access to finance:** In 2010, the State Loan Support Programme for SME's Growth and Development facilitating investment and business activities of SMEs became available for enterprises (Mortgage and Loan Bank of Latvia, 2010).

On August 10th, 2010, the amendments of the Law "On Company Income Tax" became effective providing that long term investment projects in nationally supported priority sectors can receive the tax reduction of 25% for investments from LVL 5 million (Euro 7.1 million) to LVL 35 million (Euro 49.8 million) and 15% if investments exceed LVL 35 million (Euro 49.9 million). Companies operating in special economic zones having special investment conditions can apply 80% reduction on their income tax payment related to investment. Also, companies can reduce the taxed income level by a sum of interest rate, which a company has to pay on its loan. According to the above mentioned amendments, since January 2010, companies buying new technological equipment can apply 1,5 coefficient on fixed assets, but companies working in special economic zones can apply a coefficient from 2 to 1.3 for new technological equipment (Parliament of Latvia, 2010e).

7. **Single market:** There has been a substantial progress achieved by organizing different public activities during 2011, including SOLVIT popularization and networking measures, as well information events on standardization. The new price policy of standardization has been worked out to achieve a compromise between possibilities of producers and the most important aspect of standardization - respecting copyrights, as well as prices for Latvian standards have been reduced by 50 percent on the average (Ministry of Economics of Latvia, 2010).

There has not been any progress achieved to ensure that the composition of the standardization committees is fair; and to provide SMEs with advisory services, including support to defend themselves against unfair commercial practices.

8. **Skills and innovation:** In 2010, a new Electronic Government Development Plan (2010-2013) was implemented by the Ministry of Regional Development and Local Government to facilitate the availability of public services for SMEs in the Internet (Cabinet of Ministers of Latvia, 2010d).

There has been a substantial and significant progress achieved by adopting the new government Regulations to promote the development of new products and technologies by micro, small and medium enterprises, as well as to attract high value investments to improve competences, technologies and innovation capacity of companies by providing necessary ERAF co-financing (Cabinet of Ministers of Latvia, 2010e).

9. **Environment: In 2010, a new Programme for the Development of Biological Agriculture (BLA 08) (2010-2014) was adopted by government and implemented by State Agency "Rural Support Service to stimulate biological agricultural production by providing funding for SMEs which apply biological agricultural**

production technologies (Latvian State Agency 'Rural Support Service', 2010). In the beginning of 2011, a new support programme "Climate Change Financial Instrument" was adopted by government to stimulate SMEs to create technologies which are limiting the emission of gas with strobe effects by providing funding for SMEs' technological projects.

There has been a substantial progress achieved by adopting support measures to promote participation of entrepreneurs in biological agriculture schemes through the micro financial support for rural commercial entities working in biological agriculture and support measure for increasing an efficiency of heating systems of enterprises. However, no other support measures were undertaken.

- 10. Internationalisation:** Since 2010, short term financial and political risk guarantees for SME's export activities became available to lower risks on export transaction. This export credit programme implemented by the Latvian Agency of Guarantees with total budget of LVL 20 million (EUR 28.5 million) will be available until July 30th, 2011. During 2010, 38 companies received credit guarantees for the total amount LVL 2 million (EUR 2.85 million) which is only 10% of total available amount (Golsts I., 2010).

Since 2010, SMEs can receive a support for activities related to the opening up of foreign markets to stimulate the integration of companies into international supply chains, as well as participating of entrepreneurs in international exhibitions. Within this programme a company can receive up to €200.000 for financing its activities during the period of three years. These support measures are designed for several years and they will continue also in 2011 (Ministry of Economics of Latvia, 2011).

The strengths of the SME Policy implementation in Latvia are related to SBA areas which have been tackled by the annual Action Plan for Improving Business Environment in Latvia and other related policy documents which ensure effective implementation, regular evaluation and improvement of SME support measures. In result of implementing of this Action Plan Latvia constantly has improved its ranking according to the World Bank ("Doing Business") indicators. The World Bank has ranked Latvia at 24th place out of 183 world countries in the indicators of the *Doing Business 2011*, which is 3 positions higher than in the survey of 2010; among the EU member states Latvia has been ranked at 9th place in 2011 (World Bank, 2011). Though, in 2012 Latvia's position was estimated even higher – with 21th rank, but then is started to decrease to 25th rank in 2013 (World Bank, 2013). As the indicators of Figure 1 show, number of a newly registered enterprises in Latvia which is one of the main indicators for measuring the efficiency of business support policy – started to increase since 2010, but not very significantly yet. (Register of Enterprises of Latvia, 2013).

The implemented SME support policy measures helped to make it much easier to start a business in Latvia, as well as considerably lowered the regulatory burden of SMEs. Still a lot remains to be done in areas related to closing a business (Second chance) and doing business - dealing with construction permits and improving tax administration and responsiveness to SMEs needs (Responsive administration), as well as in those areas not covered by the Action Plan for Improving Business Environment and other related policy documents, such as Entrepreneurship, Public procurement and state aid,

Internationalization. Also, Latvia has to develop policy measures for entrepreneurs-immigrants which currently do not exist.

3. HOW LATVIAN SMEs USE THE EXISTING BUSINESS SUPPORT INSTRUMENTS?

Based on the information provided in the previous chapter we can conclude that Latvia has introduced a system of business support instruments which could be successfully applied to improve the performance of Latvian SMEs and stimulate the development of entrepreneurship in Latvia. The next step in our analysis was to evaluate possibilities for a concrete Latvian SME to use business support instruments provided by the Latvian Government, as well as other stakeholders. For this purpose, the method of case study and quantitative analysis of data from the sociological survey of the Latvian logistic companies (The survey was performed to check the application of CAD as a supporting instrument for improving the performance of companies.) were applied. The results of this analysis are presented in this chapter.

Case study of the Latvian SME's possibilities to use business support instruments provided by the government. The enterprise chosen for the case study is located in the Latgale region (Eastern part of Latvia which is the most economically depressive region of Latvia), in the Daugavpils city (the largest big city in the Latgale region). It is registered in 2006 with a total number of employees – 16. The type of activity of this enterprise is the food production (oriental sweets) and its annual turnover is 86 000 LVL (~123 000 EUR).

First of all, real needs of the enterprise and available business support instruments were compared. Findings show that there are instruments which meet enterprise's real needs, but all of those instruments have not been used by this SME. For example, to save time spent on business administration, the enterprise has used the Electronic Declaration System to submit VAT reports and other financial declarations. However, another important requirement for any SME is to decrease the tax burden. In this respect, the only designed support instrument for companies is that they can receive tax reduction of 25% for investments from LVL 5 million (EUR 7.1 million) to LVL 35 million (EUR 49.8 million). Practically, there are no SMEs in Latvia which could make such investments and, thus, this support measure is applicable only in a case of large companies.

According to the results of the case study of the Latvian enterprise, the most problematic is the process of applying for state provided business support instruments. According to the interview: "to receive any financial support (loan, guarantee, grant), you have to prove that you do not need it, i.e. you have to show to the bank that you have no any debts and other financial weaknesses" (according to the accountant of the enterprise). In addition entrepreneurs complain that all available information is in Latvian or in English – nothing in Russian" (according to the manager of the enterprise).

The results of the case study, as well as the authors' work experience in other projects (for example, abovementioned EEA and the Latvian government's co-funded project „Usage of the Potential of Universities for Regional Development”), allow us to define the following main barriers for receiving the state support for SMEs:

- enterprises often do not need several kinds of support measures provided by the Latvian government (mentoring, seminars etc.);
- SMEs usually have insufficient capacity to write big applications for different projects or programs or have no administrative capacity to follow and apply for new instruments (free participation in international exhibitions etc.);
- enterprises often have a lot of financial problems which restrict them from the access of provided financial instruments;
- only few Latvian SMEs have innovations in their businesses which is especially supported.

Authors of this paper also have some experience working with the European Union (EU) program "Erasmus for Young Entrepreneurs" (EYE) (The action EYE SEE P" (2013-2014, project's partners are five institutions from Germany, Latvia, Slovenia, Spain and Turkey) which offers new Latvian entrepreneurs opportunities and financial support to go for an exchange in different European countries. The program also offers opportunities for experienced Latvian companies - to host young entrepreneurs from other European countries.

The EYE program has been started 3 months ago at the time of working on this research. However, the interest of new entrepreneurs and host entrepreneurs from Latvia has not been huge despite advertising campaigns in mass media, via social networks and personal channels. However, already in the beginning of implementation of this program some drawbacks of it have been identified. At the moment, according to our short-term observations, there are two main reasons which keep entrepreneurs away from registering: 1) entrepreneurs in Latvia do not see so much use if this support measure for their companies or they do not consider it for personal reasons, such as language difficulties, family or they can't leave their businesses for longer time (Entrepreneurs mainly argue that they need start capital, but not fellowship for exchange visits.); 2) procedure for receiving this support is long, unclear and administratively difficult (complicated registration process, unclear procedure of finding host enterprise, etc.). On the other hand, there are entrepreneurs who really want to participate in this exchange program and who have participated in it and found it very beneficial for their businesses. Nevertheless, the program just has started and we will be able to draw more solid, and hopefully positive, conclusions about it at the end of 2014 from our own experience, as well as from the experience of other participating countries.

Quantitative analysis of data of the sociological survey of Latvian logistics companies. The importance of creating a model, which would allow to measure systemically application of new technologies and business support instruments, as well as to describe possible identified difficulties of enterprises in these processes, arise when researchers of the Daugavpils University begun to work on the project „LogiCAD: Transfer of Best-Practice & Innovation in CAD for Logistics Stakeholders” (mentioned in the introduction of this paper). This project is aimed at

facilitating transfer of best practices and innovations – IT solutions, i.e. 2D and 3D CAD -generated within the previous LdV project "euCAD" (<http://www.camis.pub.ro/eucad/>) to professionals and other stakeholders working in the transport and logistics sector (ITA, 2013).

The authors argue that application of any new technology, as well as a new business support instrument in daily practice of enterprises is going through at least four mandatory stages:

1. **Cognitive stage** - during this stage potential users of any new technology or business support instrument become introduced with new technology or business supporting instrument and its ability to bring a desired result or to solve a concrete problem of the business/enterprise (for instance, improvement of the product's quality, increasing of business's profit, speeding of production processes etc.;
2. **Emotional stage** - during this stage potential users of a new technology or business support instrument accept it on an emotional level. i.e. within the categories "like – do not like";
3. **Competence stage** - during this stage potential users of a new technology or business support instrument mastering professional skills (if they have no enough skills for it) to be able to use this new technology or business support instrument in their daily work effectively;
4. **Ecological stage** - during this stage potential users of a new technology or business support instrument work at their enterprise with all requested technical, financial, psychological and other infrastructure (i.e. managers allow employees to use these new technologies or apply new business support measures providing him/her with above-mentioned infrastructure and other ecological conditions).

Resulting from the above mentioned classification of the stages of the implementation of new technologies the empirical interpretation of the model has been also worked out and is presented in the Table 1 as the survey instrument for interviewing employees of any searched economic sector and any new technology. In this case we are focusing on employees of the transport and logistics sector and a subject of interview is the application of CAD decisions.

Two wings of the Table 1 are for 1) measuring the degree of one or another barrier from a subjective point of view of the interviewed worker on the scale from 0 to 2 according to the module; 2) directions on the right or on the left are indicating the strength of perception of one or another declaration as the barrier for the implementation of a new technology (in this case - CAD) in practice (in this case - sector of transport and logistics). This model provides a possibility for investigating mutual relationships of certain barriers for practical application of new technologies. For instance, we can find out statistically significant evidence on what stage – cognitive, emotional, competence based or ecological - the implementation of a new technology will be the most difficult, what are the reservations of workers (for instance, workers are accepting a new technology on cognitive and emotional levels, and he/she is more or less ready for working with this technology even on the professional level, but there are no ecological means in the enterprise for application of this technology, i.e. software is missing, there are no premises, conditions, etc.)

As the data of Figure 2 show, all affiliations included in the empirical estimation model, are perceived by respondents not as barriers, but as positive elements of stimulating the application of a new technology or a new business support instrument at the enterprise. The main benefits from applying the CAD at their enterprises are the following: CAD will increase the efficiency of work (1.40 points by the scale from -2 to +2), CAD will increase the quality of work (1.33 points), CAD will make work more creative and interesting (1.33 points). All these affiliations can be included in cognitive stage of applying CAD as the new business support instrument. It means that this stage is passed through more successfully according to CAD technology applying it in transport and logistics sector.

At the same time, such affiliations as “CAD technology is provided with enthusiasm of employees” (0.27 points by the scale from -2 to +2), “CAD technology is provided by necessary knowledge and skills of employees” (0.20 points) and “CAD technology is topical for the enterprise” (0.13 points) – in spite of they have been estimated more than 0 – have worst positions in the hierarchy of an enterprise’s benefits from CAD solutions. These affiliations can be included in emotional and competence stage of applying CAD in transport and logistics sector, and are some evidence of so called cognitive dissonance, when employees understand benefits of new business support instruments by their mind, but do not approve it accordingly on emotional level and do not provide adequate professional skills.

4. CONCLUSIONS AND RECOMMENDATIONS

The declared objective of the Latvian Government related to the SME support policies is to develop an attractive business environment (Cabinet of Ministers of Latvia, 2010f, 2011). While measures corresponding to targets set by the SBA are implemented in the framework of the Action Plan for Improving Business Environment and other related political documents, national authorities of Latvia still have not adopted a general strategy to implement the “Small Business Act” (SBA) which is recommended by the European Commission.

Increase in a number of newly registered companies in 2010 and 2011 indicate that Latvian businesses have overcome the impact of financial and economic crisis which brought a considerable economic downturn in 2008 and 2009. Also, a positive growth rate of real GDP in 2011 (5.5%) shows that business activity in Latvia has been increasing. In comparison with 2010, there have been less policy measures adopted in 2011 which could be related to different factors, such as continuation of multiannual business support programmes started in previous years, extraordinary Parliamentary elections held in September, 2011, etc. In addition, a new Conception of Support Measures for Micro Enterprises was adopted in 2010 resulting in a lot of new business support activities which have continued also in 2011 and afterwards. However, in the result of implementation of the Annual Action Plan for Improving Business Environment in Latvia and other related policy documents effective and constant implementation, monitoring and improvement of SME support policy measures in Latvia has been ensured.

The problem is that entrepreneurs in Latvia often do not use business support instruments which are available which also provides less impact of SBA policy measures for the Latvian SMEs. The application of business support instruments was researched by using the qualitative analysis (case study of Latvian enterprise) and the quantitative analysis (factor analysis of the elements included in the empirical model for evaluating barriers of a successful implementation of any new technology or business support instrument which was conducted on the basis of a sample of 110 Latvian employees working at transport and logistics enterprises) methods.

The empirical findings of the research show that there are many barriers for Latvian SMEs for using business support instruments. These barriers are often related to a low administrative and/or innovative capacity, language skills, lack of competences, etc. of SMEs managers. Also, in SMEs managers often express the opinion that business support instruments provided by the state are not adequate (for instance, application procedures are too complicated or time consuming) and do not correspond with real needs and capabilities of Latvian entrepreneurs (for instance, training or exchange possibilities are provided instead of business financing). Another significant barrier – cognitive dissonance, which means that entrepreneurs generally perceive state's business support instruments as beneficial for them, but do not approve it accordingly on emotional level and do not provide adequate professional skills to apply them in their daily business practice.

Based on results of the research the authors suggest the following for implementation of EU business support policy: to research deeply economical, political, cultural, sociological and psychological aspects of entrepreneurship in order to elaborate more adequate business support instruments which could be used not just by ideal, but also by really existed entrepreneur with all his/her weaknesses, poor competence and misunderstandings. Business support policy has to have less bureaucratic procedures and technically more useful for such busy economic actors as entrepreneurs.

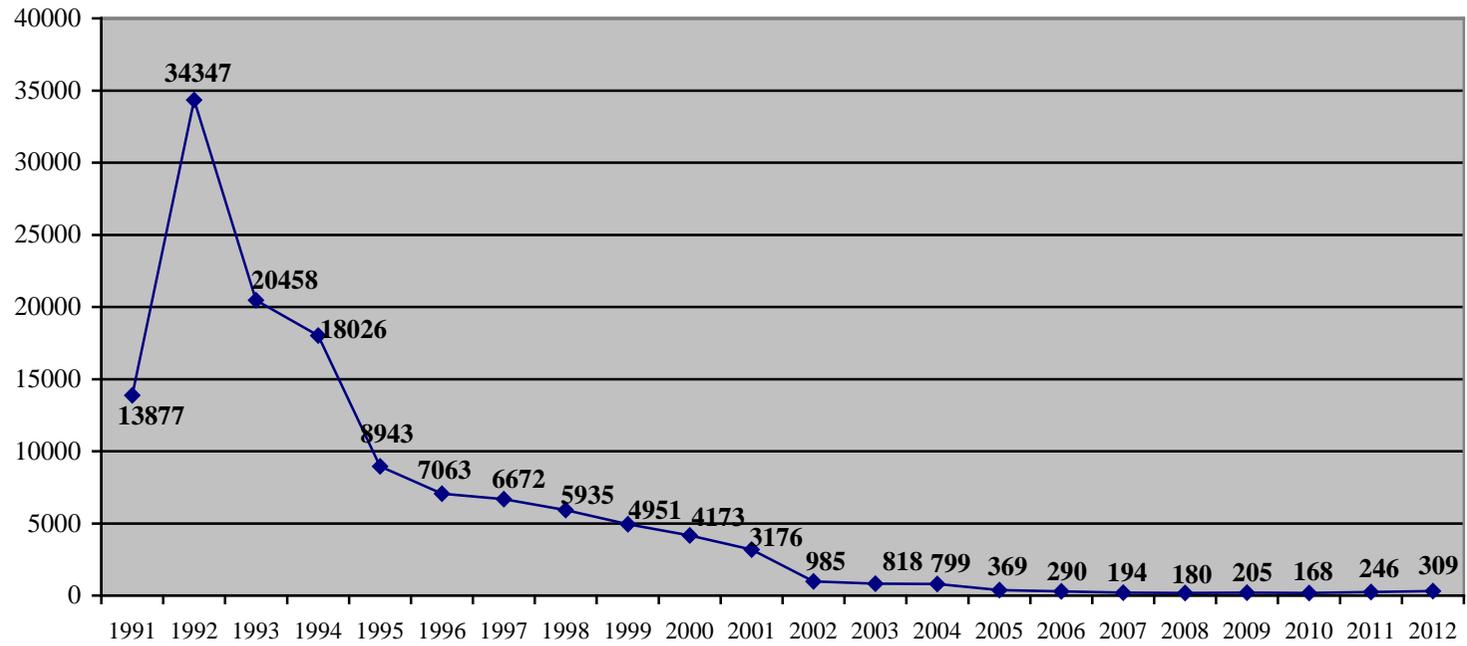
Table 1: Learning CAD and usage of this technology at your enterprise:

	+2	+1	0	-1	-2	
1) will increase an efficiency of the work	<input type="checkbox"/>	will decrease an efficiency of the work				
2) will increase a quality of the work	<input type="checkbox"/>	will decrease a quality of the work				
3) will make the work easier	<input type="checkbox"/>	will create additional difficulties for the work				
4) will make the work more creative and interesting	<input type="checkbox"/>	will not make the work more creative and interesting				
5) will stimulate professional development of the employees	<input type="checkbox"/>	it is not necessary for professional development of employees				
6) it is actually for our enterprise	<input type="checkbox"/>	it is not actually for our enterprise				
7) provided with requested equipment and software	<input type="checkbox"/>	not provided with requested equipment and software				
8) provided with adequate knowledge and skills of employees	<input type="checkbox"/>	not provided with adequate knowledge and skills of employees				
9) requests adequate material and time investments	<input type="checkbox"/>	requests non-adequate material and time investments				
10) supported by lead managers of the enterprise	<input type="checkbox"/>	rejected by lead managers of the enterprise				
11) employees perceive it with enthusiasm	<input type="checkbox"/>	employees perceive it without any trust				
12) it is necessary condition of a good performance of our enterprise	<input type="checkbox"/>	it is not necessary condition of a good performance of our enterprise				

Note: please, your answer in every line, by the scale: 0 – difficult to say, +/-1 – more agree than disagree, +/-2 – absolutely agree

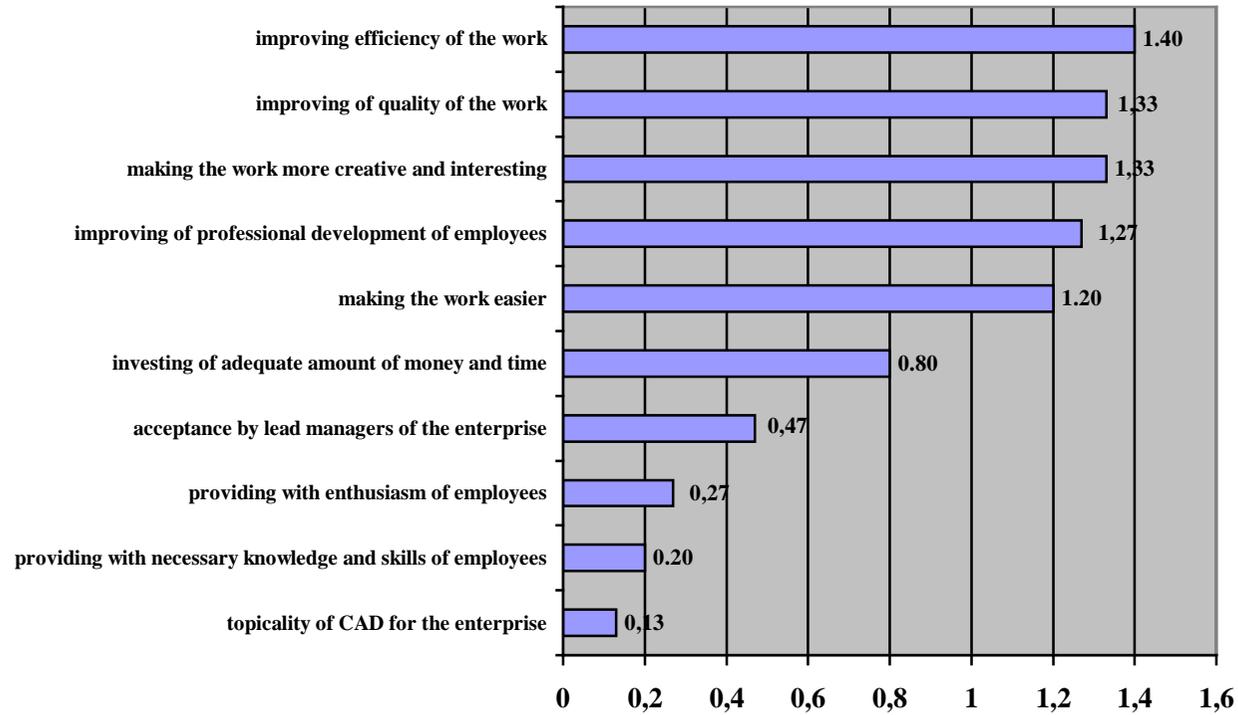
Source: elaborated by S. Ignatyeva (the researcher of the Daugavpils University (Latvia)) within the “LogiCAD: Transfer of Best-Practice & Innovation in CAD for Logistics Stakeholders”

Figure 1: Dynamics of the registration of new enterprises in Latvia, 1991-2012, in absolute numbers



Source: Register of Enterprises of Latvia, 2013

Figure 2: Estimations of possible benefits from a new technology – CAD – for an enterprise, by the scale from -2 – absolutely disagree to 2 – absolutely agree, employees of Latvian transport and logistic companies, n = 110, 2013



Source: elaborated by the authors

REFERENCES

- Bikse, V. (2009), *Latvian progress in the development of entrepreneurship education after joining EU (scientific research) [In Latvian]*, Riga: European Commission Representation in Latvia.
- Boronenko, V., Ohotina, A., Jarulevica, J., Ulpe, S. (2011), Research potential and capacity of the Daugavpils University for the development of Latgale region. [In Latvian] In Tisenkopfs, T., Bela, B., Kunda, I. (Eds.) *High schools in the regions: interconnection of knowledge and practice [In Latvian]*, Riga: LU publishing house „Zinatne”, 297-336.
- Cabinet of Ministers of Latvia. (2009), Amendments to the ‘*Regulations on state fee for confirming of signature at the Enterprise Register*’. Regulation No.1548 from 22.12.2009. Latvijas Vestnesis, No. 203 (4189), 28.12.
- Cabinet of Ministers of Latvia. (2010a), Amendments to the ‘*Regulations on introducing information in the Enterprise Register journal and commercial register, as well as on the state fee for registering submitted documents*’. Regulation No.443 from 12.05.2010. Latvijas Vestnesis, No. 83 (4275), 27.05.
- Cabinet of Ministers of Latvia. (2010b), *Plan for Improving the Application of the Electronic Procurement System 2010-2012*. Regulations No. 231 from 22.04.2010 (Policy planning document). Available: <http://polsis.mk.gov.lv/view.do?id=3369> (accessed 10.04.2013).
- Cabinet of Ministers of Latvia. (2010c), *Regulations on the Centralized Electronic Procurement*. Regulations No. 1241 from 28.12.2010. Latvijas Vestnesis, No. 5 (4403), 11.01.
- Cabinet of Ministers of Latvia. (2010d), *Procedures of the Single service portal information exchange*. Regulations No. 480 from 25.05.2010. Latvijas Vestnesis, No. 88 (4280), 03.06.
- Cabinet of Ministers of Latvia. (2010e), *Amendments to the Programme ‘Entrepreneurship and Innovation’*. Regulations No.132 from 8.03.2010. Latvijas Vestnesis, No. 39 (4231), 10.03.
- Cabinet of Ministers of Latvia. (2010f), *Action Plan for Improving the Business Environment in Latvia in 2010*. Latvijas Vestnesis, No. 49 (4241), 26.03.
- Cabinet of Ministers of Latvia. (2011), *Action Plan for Improving the Business Environment in Latvia in 2011*. [In Latvian] Latvijas Vestnesis, No. 25 (4423), 15.02.2011.
- Central Statistical Bureau of Latvia. (2013), Table NBG01: *Population by labour status and sex*. Statistics Database. Available: <http://data.csb.gov.lv/DATABASEEN/Iedzoc/Annual%20statistical%20data/05.%20Employment%20and%20unemployment/05.%20Employment%20and%20unemployment.asp> (accessed 10.04.2013).
- Centre of State Education Content. (2011), *Timetable of standards’ application*. [In Latvian]. Available: http://visc.gov.lv/saturs/vispizgl/standarti/standartu_iev_graf.pdf (accessed 10.04.2013).
- De Bono, E. (1992), *Serious Creativity Using the Power Lateral thinking to Create New Ideas*. The McQuaig Group.
- Golsts, I. (2010), *Latvian Agency of Guarantees begins to provide guarantees for export to all countries of the world* [In Latvian], Press releases of Latvian Agency of Guarantees, 1.07. Available: <http://www.buzzpodium.lv/latvijas-garantiju-agentura/latvijas-garantiju-agentura-sak-sniegt-garantijas-eksportam-uz-visu-pasauli> (accessed 10.04.2013).
- Ignatyeva, S., Boronenko, V. (2013), *Why new technologies are applied for practice with difficulties?* [In Russian], Partycki, S. (Ed.) *Economic and social strategies in times of financial crisis. The experience of Central and Eastern European countries*. Lublin: KUL, 246-252.
- ITA. (2013), *Transfer of Best-Practice & Innovation in CAD for Logistics Stakeholders (LogiCAD)*. Web-page of LdV TOI project. Available: www.logicadproject.eu (accessed 10.04.2013).
- Junior Achievement – Latvia. (2013), Web-page of the foundation. Available: <http://www.pirmaismiljons.lv/Lapas/Junior%20Achievement%20Latvia.aspx> (accessed 10.04. 2013).
- Latvian State Agency ‘Rural Support Service’. (2010), *The programme “Development of Biological Agriculture” (BLA 08)*. Available: www.lad.gov.lv (accessed 10.04.2013).

- Ministry of Economics of Latvia. (2010), *Report on Economic Development of Latvia*. Riga: Ministry of Economics.
- Ministry of Economics of Latvia. (2011), *Guarantees on export credits*. Available: <http://www.em.gov.lv/em/2nd/?cat=30146> (accessed 10.04.2013).
- Mortgage and Loan Bank of Latvia. (2010), *State loans support programme for SMEs growth and development*. Available: <http://www.kreditiem.lv/lv/zinas/hipoteku-banka-sak-mvu-izaugsmes-aizdevumu-programmu/> (accessed 10.04.2013).
- Parliament of Latvia. (2010a), *Law 'Amendments to the Law 'On Insolvency''*, 14.10.2010 (effective since 1.11.2010). Available: <http://www.likumi.lv/doc.php?id=220140> (accessed 10.04.2013).
- Parliament of Latvia. (2010b), *Law 'Amendments to the Commercial Law'*. Latvijas Vestnesis, No. 68 (4260), 29.04.
- Parliament of the Republic of Latvia. (2010c), *Law 'On Micro enterprise Tax'*. Latvijas Vestnesis, No. 131 (4323), 19.08.
- Parliament of Latvia. (2010d), *Law 'On the Free Provision of Services'*. Latvijas Vestnesis, No. 62 (4254), 20.04.
- Parliament of Latvia. (2010e), *Law 'Amendments of the Law 'On Company Income Tax'*. Latvijas Vestnesis, No. 200 (4186), 13.08.
- Register of Enterprises of Latvia. (2013), *Dynamics of the registration of enterprises*. [In Latvian]. Available: <http://www.ur.gov.lv/?a=1143> (accessed 10.04.2013).
- Truksane, A. (2013), *Latvian teachers are preparing for a new study subject's "Creativity and entrepreneurship ability" including in curricula of Latvian schools*. [In Latvian], EASYGET.lv. Available: <http://easyget.lv/latvija-un-pasaule/read/28760/> (accessed 10.04.2013).
- Websoft.lv. (2013), *Web-page of the foundation "Creativity Castle"*. Available: www.radosumapils.lv (accessed 10.04.2013).
- World Bank. (2011), *Latvia - Doing Business 2011: Making a Difference for Entrepreneurs*. Washington: World Bank.
- World Bank. (2013), *Doing Business in Latvia*. Available: <http://www.doingbusiness.org/data/exploreconomies/latvia/> (accessed 10.04.2013).

Mirko Palić

University of Zagreb, Faculty of Economics and Business, Zagreb, Croatia

Ivan Kovač

Croatian Bureau of Statistics, Zagreb, Croatia

Boris Sruk

Korlea Invest, d.o.o.

COOPERATIVE BUYING AS A SOURCE OF COMPETITIVE ADVANTAGE ON THE CROATIAN FMCG RETAIL MARKET

ABSTRACT

Main goal of this paper is to explore how the formation of contractual vertical marketing system such as retailer's co-ops can influence procurement and purchase efficiency of the companies involved in the contractual relationship. Due to the competitive market pressures retailers can not raise prices in order to improve profitability so they are constantly searching for different alternatives of cost reduction. Through formation of joint purchasing companies several smaller retailers can obtain economies of scales in purchasing and thus stay competitive on the marketplace. Qualitative research conducted with the main Croatian retailer's cooperative companies indentified key drawbacks and key benefits for such type of business organizations. Research results proved that retailer's cooperatives are vital component for ensuring medium time survival of the smaller, regional FMCG chains on the Croatian market. Drawing on the main conclusions of the research the guidelines for the managers working in the field have been provided.

Keywords: *purchasing, retail cooperatives, Croatia, competitive advantage*

JEL classification: *L81*

1. INTRODUCTION

Retail cooperatives originated in Germany with the Edeka group of grocers. The term refers to the companies, usually in the same industry that create an organization in which each member becomes a shareholder. The organization uses the combined strength of the shareholders to get economies of scale in any number of areas of its business, such as purchasing, advertising, or private label manufacturing. This format is generally designed to allow small companies to compete more effectively with large companies. (Coughlan et al., 2006, p.37)

Retailer owned cooperative groups have been present on a developed markets for a long time and played a significant roles in retailing. Such cooperatives are created

when a group of independent retailers join together and create a wholesale – purchasing company in order to benefit all of the participating retailers. The joint wholesale company unifies purchases of the group members in order to achieve purchasing economies of scale from the suppliers (Lang, 1994). In addition, coop might receive better terms of sales and promotional support from suppliers than independent retailers acting alone would due to their smaller size. Thus, the rationale behind joining the coop is to obtain the efficiencies that will allow them to compete more effectively against large chain stores.

Often, the result of the standardization and coordination efforts allows the cooperatives to appear to consumers like a wholly owned retail organization and achieve a strong market presence. As a form of organization, retailer-sponsored cooperative groups are an interesting topic of research due to the voluntary nature of the membership that ties individual members to the group. Although they are contractual, vertical relationships, lines of authority and power are not well defined in a cooperative group. This is particularly true for a retailer-sponsored cooperative group, where a large number of members participate in the ownership and operation of the wholesale unit to satisfy the need of the collective. Therefore, each entity must give up some power and autonomy in order to achieve efficiencies of operation gained by being a member of the group (Stoel, 2002).

Although professionally managed, grocery cooperatives are controlled through the one-member, one-vote principle and have the unique challenge of serving the need both of the members and of the business. This can be difficult in large supply cooperatives where the membership is heterogeneous. Lang (1994) suggests that supply cooperatives are particularly susceptible of conflict between market and member interests. The conflict is between maximizing patronage rebates while adequately funding long-term investment in the business, resulting in horizon problems (Burkink, 2002).

So, while the relationship is voluntary and there are no sanctions for non-compliance, groups have been successful in creating and maintaining systems that promote loyalty and discourage exit from the group. Examples of these enticements include stock ownership, store identity programs, and end-of-year rebates on purchases. Different researches pointed that success of the cooperative relationship effectiveness rests on behaviors exhibited by both the cooperative members and cooperative management organization. Coughlan et al. (2006, p.248) describe cooperative relationships as “noisy and contentious” and this is inevitable. The resulting conflict should be tolerated, even welcomed as normal. Although cooperative management organizations have traditionally interacted with and provided services to members, there is increased emphasis on communication and interaction between retailers and the cooperative management personnel, through store visits, consultations, and educational program, regular joint meetings and teambuilding.

2. RETAIL TRENDS IN CROATIA

The entry of foreign competition has forced Croatian retailers to change their way of conducting business in order to survive on the market. For the past 20 years retail has

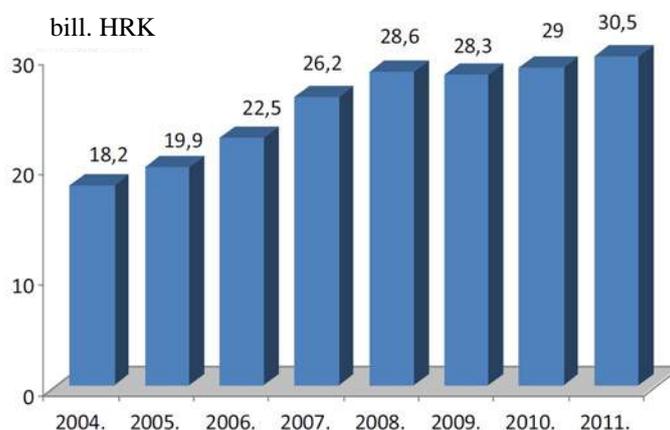
been one of the most developed, most competitive and fastest growing economic branches. According to Anić (2001), there were two periods in the growth and development of the Croatian retail:

- period of fragmentation of retail from 1990 to 1998
- period of concentration of retail after 1998 to present.

In the first phase the growth was result of the growth in the number of small private shops. According to this source, in the year 1989 there were 2.246 retail stores and 20.942 in 1996. Since 1999, the number of employees has grown and the number of stores has oscillated, so the number of employees per store has grown, which indicated that the selling area increased while number of stores decreased. With the concentration of the sector including changes in the market structure based on the size type and the entry of foreign retail chains, a new phase in the development and growth of Croatian retail begun (Palić et al. 2011).

In Croatia, the retail trade is statistically monitored as a part of the distributive trade. Distributive trade is defined as a set of all types of trading activities, from supplying goods from the producer to distributing them to the final consumer. It comprises wholesale trade on one's own account, wholesale on a fee or a contract basis, retail trade and repair of motor vehicles and motorcycles (Statistical Yearbook, 2010). Distributive trade holds a significant place in Croatian economy since 35% of economic agents operate in this business, it employs about 18% of workforce and its share of GDP amounted to 9.5% in 2009. Also, distributive trade is the second largest employer in Croatia after the processing industry, as well as the biggest generator of new jobs. In 2009, there were 223.872 employed persons, of which 185.244 were in companies and 38.628 in craft businesses. Retail trade had the largest number of employed 55.08%. Distributive trade in 2009 generated a turnover of HRK 252.05 billion, of which the companies have generated HRK 241.75 billion, and craftsmen HRK 10.30 billion. A dominant role in the structure of the total achieved distributive trade turnover is wholesale and intermediation trade with 43.13% share, followed by retail with 38.12% (CCE, 2010).

Chart 1: FMCG retail trade turnover in Croatia (in bill. HRK)



Source: AZTN 2012

Retail trade is the sale of goods to final consumers for personal consumption or use in households (Statistical Yearbook, 2010). According to changes on the Croatian retail market in the past decade retailers are faced with challenges, such as globalization, stronger competition in the local market, introduction of new technology, new forms of retail trade, e-commerce. The main characteristics of the Croatian FMCG retail market are concentration, internationalization and consolidation. The share of the top 10 retailers amounted to 16.6% seven years ago, while in the year 2011 top 10 retailers achieved 78% of the market (AZTN, 2012). However, concentration is not specific only to Croatian retail market as globally top 10 retailers held over 30% market share in 2008 (Deloitte, 2010). Also, in the majority of European countries the top 10 retailers hold from 60% to 80%, even 90% of the market share. In Slovakia, for example, the leading 10 hold 70% of the market; Hungary is similar to Croatia with 67% while the Slovenian top 5 retailers hold 90% of the market (CCE, 2010). Internationalization is also not characteristic exclusively to Croatian FMCG retail market. This process has sped up in transition countries with the fall of Berlin Wall. The entry of foreign competitors resulted in increased market consolidation from takeovers and strategic alliances of some retailers.

In the past decade the market structure based on the size types on the Croatian retail market has changed as well. The largest share is still held by small shops but their share decreased from 53% in 2001 to 32% in 2009 (CCE, 2010) and it is still decreasing. So, retail network is still fragmented. The FMCG retailers are trying to develop large retail establishments (supermarkets and hypermarkets) prominently due to changes in the way of life and new customer needs. The hypermarkets and supermarkets are steadily increasing their retail market share; their share in 2009 was 21%. The share of supermarkets in 2009 was 28%, cash & carry 5% and discount shops 5%, as well as other sales channels 8%. The latest development trend is moving toward the construction of modern shopping centres that provide various shopping services and entertainment in one place. Based on the estimate of the CCE Trade Department, over 2.000.000 m² of large retail facilities with more than 1.000 m² of selling space have

been built in Croatia over the past 15 years. But, the construction of trade facilities in Croatia is a process characterized by territorial concentration of large outlets in larger county hubs – Zagreb, Split, Rijeka, Zadar and Osijek. However, shopping centers are extending their business activities to other county centers (CCE, 2010).

According to consumers' preferences on the Croatian FMCG retail market, consumers generally choose supermarkets (47%), small shops (23%), hypermarkets (15%), discounts (2%), and other retail formats (GfK, 2009). It is therefore of no surprise that smaller regional Croatian chains in order to survive and stay competitive formed a joint cooperative purchasing groups. Presently there are two main retail coops operating on the Croatian market. Ultragros has been formed under name Ultra grupa in the year 2001 as a reaction to the changing retail environment and increasing competition due to the foreign retailers entrance to the market. In year 2005 Ultra grupa merged with Uigross to form Ultra gross. Members (owners) of the Ultragros are Djelo, Duravit, Jadranka trgovina, Jeruzalem, Kvarner Punat trgovine, La-vor trade, Lonia, Mlin i pekare, PPK, Prehrana, Puljanka, Ribola, Sonik, Strahinjčica, TP Varaždin, Trgocentar, Trgonom, Union, Valalta, Victa and Vrutak. Owners operate over 900 retail stores with 4.800 employees. Ultragros negotiate terms and purchase different products from over 260 suppliers for its members. The company introduced a private label under name Ultra plus which has more than 450 different products and accounts for 5.2% of overall retail sales. Estimated turnover in year 2011 was around 3 bill. kn. The second significant coop in Croatian market is NTL grupa. NTL members (owners) are: Bakmaz, Diona, Studenac, Boso, Metss, Pemo, Trgovina Krk, TS Trgostil, Gavranović. It was also founded in year 2001 as CBA International which has been merged with NTL founded in year 2004. NTL group has over 1.200 stores with over 250.000 m2 of sales area and 8.000 employees (Suvremena.hr, 2013). Estimated turnover in year 2012 amounts to 5.1 bill. HRK. The group has several private label brands.

3. RESEARCH GOALS AND METHODOLOGY

Main goal of this paper was to explore how the formation of contractual vertical marketing system such as retailer's co-ops can influence procurement and purchase efficiency of the companies involved in the contractual relationship. What are the cost reductions due to the economies of scales in purchasing and how it helps coop's members to stay competitive on the marketplace? What are benefits and drawbacks of coop organization compared to corporate retail chains? In order to answer research questions qualitative exploratory research has been conducted during the period of April 2013. The sample included managers from both Croatian retailer's owned coops Ultragros and NTL group. In depth interviews have been conducted and its duration varied from 75-90 minutes. Respondent's answers have been recorded and data have been analysed using content analysis method.

4. RESEARCH RESULTS

The main purpose of coops formation on the Croatian market represents the urging need of smaller, regional retail chains – ranging from as little as two stores to more

than hundred stores – to stay competitive in comparison with large corporate retail chains present on the market. By using such channel structure smaller chains, regarding of their size have improved their purchasing terms from 10% - 30% depending on their previous size and product category observed.

Management of the coops is responsible for the tactical operations but strategic decisions are usually made by the Board of directors made up from the retail owners or their top managers. When voting on the “less important” decisions one-member-one-vote principle is applied. However, when strategically important decisions are made then larger members, in terms of turnover, have appropriately more influence, or more votes. Since many of the small regional chains have different suppliers the joint coop negotiates purchase terms only for suppliers or producers that are listed in the assortment of, for example, three or more members.

It is found that the main roles or services provided by coops to their members on Croatian market are:

- Negotiating joint purchase conditions from the suppliers/manufacturers. This proved to be most important function of the coops. Such joint purchasing was, during the time extended to all possible areas such as negotiating better telecom rates, IT services, marketing services and so on.
- Developing and managing private labels in order to differentiate the value offer of its members and boost consumer loyalty
- National visibility. Joint promotion and appearance on national level what would be impossible for smaller members and much less cost effective for larger ones. Creation of catalogs with special offers, organization of sweepstakes, coupons, and other different sales promotion actions.
- Import of selected products and their logistics for members.
- Development and management of joint retail brand and visual identity for members.
- Dissemination of market research data and monitoring of competitor's prices.

However, research data showed that there are several shortfalls to coop organization and operation comparing to the corporate owned retail chain. There are communication obstacles between different members/owners of the coops. Slower communication usually translates to slower decision making. Different retailers/owners among themselves have different goals and sometimes they try to push for the actions of the coop that they consider to be a priority. It is therefore often hard for the management of coop to try to fulfill different expectations form owners and it may cause distraction from the focus on strategic goals of the coop.

Improvements in coop operation on Croatian market should be made in area of IT where members are not well connected with the coop and do not automatically share expected sort of information regarding sales data. Further improvements might be made on improving joint visual identity and branding in order to raise consumer awareness and improve consumer loyalty. Order processing and joint logistics might also prove to be beneficial to the members in the future.

5. CONCLUSION

Research results indeed proved that retail owned cooperative formation on the Croatian market increased competitiveness of small, domestic regional retail chains. From the ad hoc solution to get better purchasing terms, Croatian coops evolved toward organizations that lead and apply new standards and innovations among its members. Coordinating joint promotion and building single joint brand and visibility for its final consumers are just some of the examples of it. However, in comparison to corporate retail chains, coops appear to be more inert. That is due to the more complex ownership and decision making procedure where different interests and priorities come to play. From the past experience it might be concluded that coops in the recent years have played an important role for the market survival of its members. But as competitive pressures increases coops need to move to the next phase of its evolution. They have to become the strong integrator of the local retail chains offering them more marketing services than ever before. Under single brand, standardization of retail service and value offer becomes *condito sine qua non*. However, because of different goals and priorities of its members it is hard to enforce common rules and procedures. That is why the idea of unification of a coop and its members in a single retail company is so popular among the management of the coops. It would provide them with much more control and power to act. At the same time the idea is not, at this time, acceptable for the members – owners of the small local retail chains as they would lose control over their daily operations and over the identity of their companies. As retail concentration of the Croatian market increases the coops will have to decide on actions to take in order to stay competitive over a longer period of time. Retail cooperatives in some markets displayed extreme adaptability and hold large or even leading market share (Schwitzerland) while at the same time they are almost nonexistent on some other markets. Croatian coops are still significantly strong to proactively influence its future but the speed (or lack of it) and direction of change is their main drawback.

REFERENCE

- Agencija za zaštitu tržišnog natjecanja AZTN (2012): Prikaz stanja na tržištu distributivne trgovine mješovitom robom, pretežno hranom, pićima i higijenskim proizvodima za domaćinstvo u Republici Hrvatskoj u 2011. (http://www.aztn.hr/uploads/documents/istrazivanje_trzista/maloprodaja_2011.pdf)
- Anić, I.D. (2001), *Maloprodajna politika i razvoj maloprodaje u Republici Hrvatskoj*, doktorska disertacija, Ekonomski fakultet Zagreb, Zagreb.
- Burkink, T. (2002): „Cooperative and voluntary wholesale groups: channel coordination and interfirm knowledge transfer“, *Supply Chain Management: An International Journal*, Vol. 7, No. 2, MCB University Press, pp. 60-70
- Croatian Chamber of Commerce - CCE (2010), *Distributive trade*, Zagreb, http://www2.hgk.hr/en/depts/trade/distributivna_trgovina_2010_web.pdf
- Coughlan, A.T., Anderson, E., Stern, L.W., El-Ansary, A.I. (2006): *Marketing channels*, 7th edition, Pearson-Prentice Hall, Upper Saddle River, NJ
- Deloitte (2010), *Emerging from the downturn: Global Powers of Retailing 2010*, http://www.deloitte.com/assets/DcomGlobal/Local%20Assets/Documents/Consumer%20Business/dtt_globalpowersofretailing2010.pdf, 2010.

- GfK (2009): "Hrvati sve češće kupuju u hipermarketima", <http://www.seebiz.eu/hr/tvrtke/trgovina/gfk-hrvati-sve-cesce-kupuju-u-hipermarketima,39929.html>.
- Lang, M.G. (1994): "The role of management behavior in agricultural cooperatives: discussion", *Journal of Cooperatives*, Vol. 9, pp. 66-66.
- Palić, M., Maričić, M., Kovač, I. (2011): „Impact of personal service on customer satisfaction in FMCG retail in Croatia“, The 8th International CIRCLE Conference for Consumer Behaviour and Retailing Research, 27th - 29th April, University of Dubrovnik, Croatia. Cjelovit rad objavljen u *International Journal of Management Cases, Special Issue: 8th CIRCLE Conference 2011*, Vol. 13, Issue 3, str. 8-18, ISSN 1741-6264
- Suvremena.hr (2013): „NTL zapošljava najveći broj radnika društva Biljemer Kant – u stečaju“, *Suvremena.hr portal za trgovinu*, <http://www.suvremena.hr/25126.aspx>
- Stoel, L. (2002): „Retail cooperatives: group size, group identification, communication frequency and relationship effectiveness“, *International Journal of Retail & Distribution Management*, Vol. 30, No. 1, pp. 51-60.
- Weinstein, S. (1991): "Climate for co-ops: partly cloudy", *Progressive Grocer*, November, pp. 43-46.

Hrvoje Katunar, University of Rijeka, Faculty of Economics, Rijeka, Croatia
Dara Ljubić, University of Dubrovnik, Department of Economics and Business
Economics, Dubrovnik, Croatia

VALUE OF CAPITAL IN FAIR VALUE MEASUREMENT

ABSTRACT

Valuation of assets, liabilities and equity of the company stated in the financial statements at its fair value is not new measurement method and company evaluation system. International association of accountants and economic analysts encourage this method of valuation through a variety of international accounting standards. Necessity for apply fair value techniques derives from the fact that the valuation of assets, liabilities and equity with existing techniques adapted in the contemporary industrial conditions leads to an anomaly in today's presented results of operations, and is not adjusted to use in today's post informational age. Therefore, it is necessary to adjust the current reporting practices. Today's accounting is undergoing a revolutionary change, respecting valuation techniques of valuating assets, liabilities and equity. Accounting paradigm if industrial society is based on the measurement of historical cost, and today post informational and globalised society requires a measure of the current fair value of the reporting elements. Today's economy requires a paradigm shift and new evaluation methods.

Keywords: financial reporting, IFRS, fair value

JEL classification: M4

1. INTRODUCTION

Basic goal of fair value measurement system is to display the fair value of the business and the value of companies as accurately as possible and present more useful information for potential investors, creditors and investment decision-makers. In order to understand the environment in which the use of fair value measurement is required, it is necessary to draw attention to the key determinants, which are: financial statements are trying to provide information for making different types of decisions, and the objectives of financial reporting are influenced by economic, legal, political and social factors in the environment.

Objectivity in financial reporting is a fundamental objective of these changes in accounting practice. Providing relevant information about the assets, liabilities and equity, as well as the values of these segments is a fundamental purpose. According to international accounting standard 32 (IAS 32), and international financial reporting

standard 7,9 and 13 (IFRS 7,9 i 13), total assets and liabilities must be estimated and measured at fair value.

2. MEASURING THE FAIR VALUE

Starting from the assets or liabilities of the company, capital is calculated as the difference between these two elements, however, the question is how to determine the fair value of the total capital, starting from the capital as the basic element essential for investors.

When calculating the value of equity investors and others should take into account those elements that can be recognized as a liability by applying the principle that states economic substance-over-form, or those complex elements which consist of liability and of the elements of equity which is now valued at fair value and their total value is now determinate by combining different valuation methods, as it is prescribed in IAS 32 and IFRS 7.

Calculating equity also raises question of how to preserve the equity that was invested in the company in times of economic disruption due to the concept of capital maintenance, and how to protect fair value of equity for the owners, and how to measure the performance of the company on the basis of fair value of equity for equity owners.

International standards were formed during a very long period and their requirements for measuring fair value are scattered, and often do not show any clear manner or the purpose of measuring fair value.

Guidance on the application of the provisions of different standards is very limited or very detailed, and often do not complies with the standards to which they refer. Incapability of their claims about fair value measurement, even disclosure of information of the fair value, results in different measurement practice, and reduces the comparability of the information in the financial statements. Therefore, the publication of standards that would set uniform requirements and methodology for measuring fair value has become necessary. However, even after the publication of IFRS 13 remains an open question of fair value measurement for the total equity of a company.

Since 2009 the application of fair value accounting in the U.S. has become the standard method (SFAS 157, R141 and 160) for all public and private companies form year 2011. The IASB published International Financial Reporting Standard 13; Fair Value Measurement (IFRS 13), which applies to annual reports for the period beginning January 1, 2013.

With this standard Committee defines fair value, establishes a framework for fair value measurement, and determinate the required disclosures about fair value measurements. The provisions of IFRS 13 applies to all standards (IFRS) which requires or permits fair value measurement and setting out the required disclosures about fair value, such as disclosures of fair value less selling costs, values founded on fair value or

disclosures about its measurement. IFRS 13 also explains how to measure fair value disclosures in the financial statements. Standard does not set specific measurement requirements, does not set the standards of measurement values, and does not affect the evaluation of the effects beyond the financial reporting framework.

Some previously published IFRSs require or permit fair value measurement of assets, liabilities or equity instruments, but none of the standards defines measurement of the total equity, nor provide guidance on fair value measurement which starts from equity, and the values that owners hold after the settlement of all obligations under existing property. The fair value of the equity can be viewed through the value of companies in the capital market, but not with some corrections.

IFRS 13 defines fair value as the price that could be realized by selling property or pays a commitment to the common transaction between market participants at the measurement date (exit price). This definition emphasizes that the basis of fair value is market value, rather than a specific value for the company. When establishing fair value, company would assume it would be done by market participants when determining value of an asset or liability aligned with market conditions, including the risk. Therefore, for the purposes of measuring fair value, companies intention about use of an asset or settle the liability is irrelevant. The issue of specific values of the company can be placed when estimating the fair value of equity. Companies are required to determinate fair value of a specific asset or liability, most common use, and the fact that property is used in combination with other assets or independently. Companies are required to determine the most common market on which asset or liabilities are traded, and the appropriate valuation technique for measuring fair value. Valuation techniques should include the largest possible number of verifiable data, and exclude those who are not. That should be information that other market participants would use. The fair value is determinate for individual types of assets and liabilities. Therefore, in determining the fair value estimate characteristics of assets and liabilities company must take them into account if these characteristics are or should be taken into account by market participants when determination the value of an asset or liability at the date of valuation. Such features are, for example, conditions or location of the property, or restrictions on the sale or use of property.

From equity point of view, the question is whether the company and its total equity estimates, given its vault to the market participants, whether such a value less liabilities of the company is actually the value of equity for its owners, and is that the fair value of the company.

The definition of fair value presented in IFRS 13 is not a definition used by experts for evaluation purposes in the past, and probably it will not be used for any other purpose other than for financial reporting. Characteristics of fair value defined as in IFRS 13 are as follows:

- Exit price – the price that would be received for sold assets or paid to settle the obligation;
- Fair value is a measure of the value for a particular asset or liability - special characteristics of asset and liabilities shall be taken into account;

- This is a hypothetical value of the transaction, which includes a normal position in the market and implemented common marketing activities prior to the date of measurement;
- Fair value is the value on particular day. Estimated future cash flows for an item that was assumed on a particular day, the discount rate used to assess the time value of money risk premium, which is required in the market on a particular day are the basic components of fair value measurements. These components are changing over time therefore the fair value at some future time will be different from those found earlier.

In doing so, the fair value measurement system introduces the following features:

- This is the value that is in principle determined,
- Internally consistent,
- Internationally harmonized, and
- Leads to financial reporting relevant to the needs of investment, credit and similar decisions.

Fair value of net assets is based on market value, not on the specific conditions in the company who owns that asset. For some types of assets and liabilities, there are available information on market values, but for some there are not. For booth specified group of assets and liabilities assessment the objective of a fair value measurement is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions.

If prices for certain assets are not available on the market, the company will apply different valuation techniques, but will involve the largest possible number of verifiable market data, and reduce to a minimum the information that cannot be verified. Fair value measurement is based on the transactions that are assumed to occur at the main market for that particular assets and liabilities, and / or capital, from the perspective of objective market participants.

The main market is the market where it has its greatest volume and level of activity for a particular asset or liability. Best market is a market in which company would be able to achieve the highest price for its assets, and the smallest price for its liability, if there is no capital market. Thus, the main market has priority over the most competitive market. If there is a major market for assets and liabilities, fair value measurement will determine the price in that market (if the price can be read directly, or otherwise using certain valuation techniques to determine), even if company can obtain a much better price on the day of measurement on a different market. Can we apply specified rules to capital? Is the market price on the main or most favourable market sufficient measure of the fair value of equity?

The fair value of equity arises from the special features of each company, and when measuring the fair value of equity, especially taking into account the preservation of capital to investors, it is necessary to adjust the definition of fair value. The definition of fair value is based on the market, not the specifics of companies. Therefore, the fair value is based on assumptions which would do participants in the market, not what

would make particular company. This implies that market participants are customers and vendors on the main or the most favourable market for the asset or liability. Market participants are also persons who are independent of the company, the people who are informed (access to relevant information, including obtaining any additional information included in the concept of due diligence), persons that may enter into transactions, and people who want to make transactions (motivated but unforced). Measurement of fair value should be based on a hypothetical transaction at the measurement date from the perspective of all of these market participants. The biggest difference between this set of for fair value and the current practice assessment is as far appraisers took into consideration the expected manner of use of assets or settlement of the debt. The definition of fair value is based on quoted fair value, rather than fair value to be realized in a particular company. This does not take into criteria for measuring fair value in measuring the fair value of equity the fact that the market value of company is also determined with measured parameters as well as knowledge and ability to use certain assets in the specific environment of individual businesses, which is why the definition of fair value for measuring equity needs to be amended.

Measuring the fair value of assets assumes the most common and best use of the property from the perspective of market participants, regardless of the intent of the company to use method property. This will consider whether the way of use for specific assets is:

- Physically possible,
- Legally admissible, and
- Financially viable.

For the purposes of fair value measurement it is assumed that way of use will realize the greatest value. Basic assumptions for use of an asset are:

- In use, which means it will be combined with other assets, such as a group of fixed assets, in which company will achieved the highest value, and
- In exchange, which assumes a single asset, such as financial assets that can be individually and independently exchanged on the market?

The assumption of use an asset as part of a group of assets in determining fair value in use refers to all assets, regardless of whether it is part of the aggregate assets or not. Determination of a group of assets may or may not be the same group setting under the provisions of IAS 36, which is used in the analysis to determine the purpose of impairment. In determining the fair value of equity, and not taking into account the possible specific synergies, benefits or cost savings from mergers, there may occur part of the value that should be attributed to the synergistic effect. This value is also part of the fair value of the equity for the owners.

Fair value of liabilities is also based on the market. For liabilities, fair value measurement involves transferring liabilities to market participants, ie the acceptance of obligation of the market participants. When setting prices relating to the transfer of liabilities, one must take into account the risk of default, which must be the same before and after the supposed transfer. The risk of default is the risk of not honouring its obligations, which is measured, and included, but is not limited to credit risk of reporting company.

Input and output prices will be the same if the price is measured for the same items in the same market. However, input and output prices will not be the same if the transactions occurred between related companies, if the transaction occurs under duress, if the input transaction differ from specific assets or liabilities that are measured (transactions with multiple elements are included, transaction costs are included, transactions are associated with other transactions), and if the current input market is not the main (or most advantageous) market for the asset or liability.

Measuring the fair value of the company's equity includes determining the fair value of equity on the market, however, the equity holders do not have to have equal economic strength and equal negotiation options. Difference in the value that occurs in such transactions should be included in the fair value of the equity, but a party that is in a disadvantaged negotiating position will not realize the fair value of equity.

The fair value measurement stipulates that the technique of measurement is in compliance with market approach, profit and cost approach. The objective of measurement is to select those techniques (or combinations of techniques) that complies with the conditions in which for the most part use observable market inputs. It is a common transaction price for sale of assets or settlement of liabilities between market participants at the measurement date at current market conditions.

Common are three valuation techniques: the market approach the cost approach and the income approach. The company will select a valuation technique that is aligned with one of these approaches or its combination when determining fair value.

Basically, the value of assets, liabilities and equity are in the function of doing business, and are based on their return on invested capital. The cost approach is tantamount to replacing or reproduction of their own or borrowed assets, and market approach is a reflection of market acceptance of their own or borrowed asset and its expected return, while the income approach is reduced to calculate present value.

The present value technique is set in the framework of IFRSs, and is the standard method of evaluation and its technique is determined by IFRS 36, Impairment of Assets. Modification of the method is determined by SFAS 157 and IFRS 13. Appraisers are generally familiar with the valuation techniques based on market approach, the income approach and cost approach. Therefore, the FASB in Appendix B SFAS 157 published the application of techniques of the present value and method of including risks and uncertainties in any other way than usual.

IFRS 13 sets a fair value hierarchy based on the inputs that valuation techniques use to measure fair value, in order to increase consistency and comparability. Input parameters are categorized into three levels, where the highest levels are unadjusted value of quotations in an active market for a particular asset or liability and the lowest unverifiable value. Model of hierarchical value can be partly applied to the equity. Input parameters in determining the fair value of the first hierarchical level are unadjusted price quotations in active markets for identical assets or liabilities. It is required that company have access to the capital market on the date of valuation.

In principle, the prices of the first hierarchical level are unadjusted, but their adjustment in certain circumstances is acceptable. From a practical standpoint, the company can measure the fair value of certain assets and liabilities, using an alternative method that is not based solely on price quotations such as pricing matrix.

In determining the fair value of equity, first hierarchical level assumes quoted share price on the market, however, estimating the fair value of equity require correction even at the first hierarchical level.

If a price quotation in an active market does not represent fair value at the valuation date, the company will set up a policy that will be consistently applied in such circumstances that may affect the fair value. An example of such circumstances is occurrence of significant event after the closing of the market, and before the measurement date if for example announcements of the business combination will happened.

The company can measure the fair value of its liabilities or equity instruments using price quotations of the same instruments traded with respect to the specific difference between the of assets being valued, and these instruments. Any adjustments to quotations of assets and liabilities will result with hierarchy level adjustment of fair value measurement classification as a lower level of the fair value hierarchy. When measuring fair value of equity such corrections are likely to be rule rather than exception. Assessment of whether the determined fair value is within the hierarchy levels 2 or 3 depends on the inputs used in the valuation techniques. Inputs can be verifiable or unverifiable and have or have not a significant effect on the calculated fair value.

Input data are verifiable if they are derived from publicly accessible sources of information about the current situation or transaction, and can be assumed to be used by market participants when determining the value of assets and liabilities and / or equity.

Level 2 hierarchy input values are price quotations of similar assets, liabilities or companies, or available market data. Input parameters for level 3 hierarchy are unverifiable prices that are used to assess assets or liabilities. The company should use as few unverifiable input parameters as possible when determining the fair value , and in any case, users of financial statements should be able to assume that the other participants on the market would done so when they evaluate assets or liabilities.

3. CONCLUSION

The fair value measurement of assets and liabilities and calculating the capital as the difference of these two elements can determine the value of equity, which is approximately equal to the fair value of equity. Because of disorder in the banking markets and broader economic crisis, inflationary pressures and similar, it is necessary to build a model that measures the fair value of equity in a manner that seeks to preserve the value of equity for investors. Preserving only asset or bond component does not lead to system stability and in unstable times leads to a deepening of economic crisis.

REFERENCE

Michael J. Mard, James R. Hitchner, Steven D. Hyden; Valuation for Financial Reporting; John Wiley & Sons Inc. 2011

IFRS Foundation; Educational material on fair value measurement, Illustrative examples to accompany IFRS 13 Fair Value Measurement Unquoted equity instruments within the scope of IFRS 9 Financial instruments; London UK, 2013

IAS 32, International Accounting Standards Board, London UK, 2013, eIFRS, http://eifrs.ifrs.org/eifrs/files/358/RBV2013_IAS32.pdf

IAS 36, International Accounting Standards Board, London UK, 2013, eIFRS http://eifrs.ifrs.org/eifrs/files/358/RBV2013_IAS36.pdf

IFRS 7, International Accounting Standards Board, London UK, 2013, eIFRS http://eifrs.ifrs.org/eifrs/files/358/RBV2013_IFRS07.pdf

IFRS 9, International Accounting Standards Board, London UK, 2013, eIFRS, http://eifrs.ifrs.org/eifrs/files/358/RBV2013_IFRS09.pdf

IFRS 13, International Accounting Standards Board, London UK, 2013, eIFRS http://eifrs.ifrs.org/eifrs/files/358/RBV2013_IFRS13.pdf

SFAS 157, International Accounting Standards Board, London UK, 2013, eIFRS, http://eifrs.ifrs.org/eifrs/files/259/dpFairVa2Nov06_142.pdf

Illustrative examples and comparison with SFAS 141(R), International Accounting Standards Board, London UK, 2013, eIFRS http://eifrs.ifrs.org/eifrs/files/232/ifrs3ie2008_170.pdf

Business combinations and Consolidations...the new accounting standards*, PWC, 2013, http://www.pwc.com/us/en/transaction-services/assets/pwc_business_combinations_briefing_document.pdf

PART V

CHALLENGES
OF THE EU
ENLARGEMENT

Gordana Đurović

University of Montenegro, Faculty of Economics, Podgorica, Montenegro

Nikola Milović

University of Montenegro, Faculty of Economics, Podgorica, Montenegro

EU ENLARGEMENT POLICY FRAMEWORK FOR THE WESTERN BALKANS: SIX “C” PRINCIPLES AND THE NEW NEGOTIATING RULES

ABSTRACT

The purpose of this paper is to analyse enhanced negotiation framework of the EU enlargement policy towards the Western Balkans countries, which is based on specific, so-called six “C” principles. Conditionality, consolidation, and communication principles were defined in the 2005 Enlargement strategy: consolidating of the EU’s commitments on enlargement, applying fair and rigorous conditionality, and better communicating enlargement policy towards ordinary citizens both in EU and in candidate and potential candidate countries. Credibility principle has been included in the EU enlargement strategies since 2009 as essential part of negotiating process. The fifth principle is represented by the current economic crisis as strong limiting factor of EU integration dynamic. One acceding country, three candidate countries and three potential candidate countries present only 4,85% of the EU-27 population, 6,4% of the EU-27 area and less than 1% of EU-27 GDP in 2010. In the format of economic crisis, economic recovery is the priority number one in the region, where EU integration process becomes strong instrument to support that priority. Finally, the sixth principle is principle of presenting concrete results in the most sensitive areas through track-record mechanisms presented for the Western Balkans countries in the EU enlargement strategy 2012-2013, that would be first implemented in the case of Montenegro. It should create favourable environment for positive regional competition in the EU integration process.

Keywords: *EU enlargement policy framework, integration dynamic, Western Balkans, six “C” principles, new negotiation rules*

JEL classification: *F 15*

1. INTRODUCTION

The countries of the Western Balkans have always been considered as a part of Europe, at least historically and geographically. For that reason, they have a place in the future EU enlargement plans. The EU’s activities towards this region have two major goals.

The first goal is an extensive process of stabilization, after all the turbulence of the 1990s, which includes fulfilment of political precondition for integration. In broader context it includes regional cooperation and improvement of neighbouring relations. Another supporting goal of the EU is a process of accession through the democratic and economic development of the countries, which includes fulfilment of administrative criteria for integration. Following that approach, the European integration process has proved to be a successful tool to support development and to some extent to stabilize a politically sensitive region. The individualized approach of the EU together with the membership perspective has motivated the Western Balkans recently to pursue economic reforms, cooperate in combating war crimes and finally opening up and reintegrating with their neighbours. Given access to the EU market, the Western Balkan enterprises have been able to gradually increase the foreign sales of their production and modernize their economies. Therefore, for the EU, as for the region, it is worth pushing for the next steps in bilateral and regional integration as strongly as possible and thus enhancing stability and sustainable growth. Having in mind all mentioned, the EU has to play a difficult political game so as not to discourage the slowest progressing countries in the region, so that they remain attached to the European values and do not revert to periods of instability (Jakubiak, Oruc, 2008).

However, the EU enlargement policy framework for the Western Balkans countries today consist of numerous preconditions and limitations for integration process itself as result of specific circumstances in each country in the region separately, lessons learned from previous enlargement, such as challenges in the EU related to serious economic crisis and needs for deeper integration.

2. INTEGRATION DYNAMIC IN THE CRISIS TIME

Regional picture of Western Balkans traditionally represents mosaic of very different and at the same time very similar cases of a few newly established countries, mostly unfinished European projects in terms of transition and integration. Ever since the conflicts in early nineties of XX century, countries in this region have been limited by numerous constraints (their own and regional) producing very modest positive effects in terms of growth, building good mutual relations and thus fulfilment of European partners' expectations.

2.1. Stabilisation and Association Process

EU has been actively involved primarily in stabilisation process and then in reconstruction process since 1995. Main pillar of this process lies on basic principles of the European strategy for Western Balkans, clearly defined in 1999 and incorporated in Stabilisation and Association Process (SAP). Key objective of this process is accession of the region's countries to the EU with parallel achievement of full and permanent stabilisation not only in individual countries but in the region as a whole. Integral part of the process is fostering of mutual regional cooperation of the countries that wish to join the EU as well as individual requests towards each country individually.

SAP is realised through legal document Stabilisation and Association Agreement (SAA). Legal base for conclusion of the SAA is article 217 of TFEU which indicates that such an agreement establishes "an association involving reciprocal rights and obligations, common action and special procedure". The SAA introduces the institutionalisation of relations with the EU namely: political dialogue between the EU and signatory country, harmonisation of national legislation, gradual development of free trade area between two signatories and promotion of regional cooperation within SAP.

On signing the SAA, before the full ratification in all national parliaments of EU member states and SAA country, an Interim Agreement on trade and trade related matters comes into force enabling for trade provisions to be applied immediately. Key objective is to create the conditions for functioning of Free Trade Area within transitional period defined in the agreement with parallel asymmetric abolishing of customs duties by the EU. Today all countries of the Western Balkans are current enlargement agenda together with Turkey and Iceland. Regional SAP dynamic is provided in Table 1.

Table 1: Stabilisation and association process of the Western Balkans (February 2013)

Phases of the SAP	Croatia	Macedonia (FYRoM)	Albania	B&H	Kosovo*	Serbia	Montenegro
Feasibility study	24/05/00	16/06/99	06/06/01	18/11/03	10/10/12	25/04/05 (SCG)	
Start of SAA negotiations	24/11/00	05/03/00	31/01/03	25/11/05		10/10/05	26/09/06
Signing of the SAA	29/10/01	09/04/01	12/06/06	15/06/08		28/04/08	15/10/07
Interim Agreement	01/03/02	01/06/01	01/12/06	01/07/08		01/02/09	01/01/08
Market opening	6 years	10 years	10 years	5 years		6 years	5 years
SAA plan of implementation	2003 NPAA	2003 NPAA	July 2006 SAA AP	Aug 2008 SAA AP		NPI Oct. 2008	NPI June 2008
Entry into force	01/02/05	01/04/04	01/04/09	(2013)		(2013)	01/05/10
SAA implementation period	6 years / Article 5, SAA	5+5 years max / Article 5, SAA	5+5 years max / Article 5 SAA	6 years / Article 8 SAA		6 years / Article 8 SAA	5 years / Article 8 SAA

Source: Official data of the Governments from the region; compilation of authors;

All countries in the region have signed and start to implement SAA. Today Croatia, as acceding country, is only out of this table, creating place for Kosovo treated as potential candidate country (an asterisk by Kosovo's name refers to the following footnote: This designation is without prejudice to positions on status, and is in line with UNSCR 1244/1999 and the ICJ Opinion on the Kosovo declaration of independence). With the Feasibility study for the SAA between the EU and Kosovo in October 2012, the Commission explained that SAA as an international agreement can be concluded with entities other than sovereign states. In this context, it is important to note that "the

use of Article 217 TFEU, as the legal basis for an agreement with Kosovo, does not constitute recognition of Kosovo by the Union as an independent state nor does it constitute recognition by individual Member States of Kosovo, provided that an express reservation to that effect is made. Equally, it does not constitute a reversal of recognition by the Member States which have already recognized” (EC, Feasibility study, 2012).

SAA ratification process is not completed in the Bosnia and Herzegovina and in Serbia. Although ratified by all member states, the entry into force of Bosnia's SAA has been delayed because Bosnia has to make the required constitutional amendments. Serbia expected entry into force of its SAA in 2013 (the only member state not yet ratified Serbian SAA is Lithuania).

Transitional period for market opening starts with the Interim agreement and is related to the creation of a free trade area between the Union and country after defined period of time for industrial products and the majority of agricultural products. By the end of 2014, market for EU companies will not be opened only on Kosovo and partly in Albania.

Implementation period starts with entering into force of the SAA and is related to its continuous and progressive implementation i.e. to the full SAA realization (the association process). There is original regional term for that integration phase in some countries: “*internal readiness for membership*” which should be followed by finalization of parallel process of the accession negotiations. If it is not the case, market opening is not followed by gradual institutionalization of relation with the EU. In that case, an *integration gap* could be created. Integration gap can be explained as gap between year of the full SAA realisation and year in which an EU association agreement is signed. On previous table integration gap is present in all countries with signed SAA except Croatia. For instance, implementation period for Montenegrin SAA is five years from May 2010 (May 2015 as targeted “internal readiness”); however, it will not be year of signing an accession agreement with Union. Montenegro is in early negotiation phase and can be joined to the Union only a few years later (deepening its institutional integration gap).

In other words, in mentioned countries, market opening goes fluently, but institutional integration is slowed down due to set of different reasons from both EU and regional countries side. Therefore, these reasons create a new enlargement policy framework based on sic “C” principles and the new negotiating rules. Serious economic crisis makes whole process even more complicated and longer. Local markets of the Western Balkans countries are opened for significantly more competitive European companies, and fact that access to EU market for local companies is also fully liberalised does not mean a lot in real economic life. Lack of competitiveness of local companies makes this part of Europe as “market of consumers” of EU goods and services, but not “market of producers” for EU market. At the same time, pre-accession assistance is away from EU cohesion policy.

2.2. Accession negotiations

Next important step in the accession process is submission of application for membership and its positive assessment prepared by the Commission which allowed country to become a candidate. Dynamic of the EU accession negotiations are presented in Table 2.

Table 2: Accession negotiations dynamic: Western Balkans (February 2013)

Phases of the SAP	Croatia	Macedonia (FYRoM)	Albania	B&H	Serbia	Montenegro
Membership Application	21/02/03	22/03/04	24/04/09	(2013)	27/12/09	15/12/08
Questionnaire (Q & A)	09/07/03 09/10/03	01/10/04 15/02/05	20/12/09 13/04/10	(2013)	24/11/10 01/02/11	22/07/09 09/12/09
Avis/Opinion	April 2004	Nov. 2005	09/11/10	(2014)	12/10/11	09/11/10
Candidate country	18/06/04	09/12/05	(2013)	(2014)	02/03/12	17/12/10
Initiation of membership negotiations	03/11/05	(2013)	(2014)	(2015)	(2013)	29/06/12
Main challenges	(Judicial reform, State aid)	Name issue, dispute with Greece	Political criteria	Unfunctional federal state	Dialogue Belgrade Prishtina	Administrative capacities
Screening phase	Oct. 2005 / Sept. 2006					25/03/12 (27/06/13)
Negotiation completed	30/06/11					
Accession Treaty signed	09/12/11					
Expected full-fledged EU membership	July 2013					

Source: Official data of the Governments from the region; compilation of authors;

Croatia and Macedonia were first to apply for membership in 2003 and 2004 respectively, followed by Montenegro in 2008 and Serbia and Albania in 2009. For Bosnia and Herzegovina and Kosovo this process is more complicated and linked with political criteria of integration and state status.

In regional context, Croatia is a positive case with successful finalisation of the whole integration process. After quite complex process of accession negotiation, Croatia signed the Accession agreement on December 9, 2011 and will join the Union by mid 2013.

Decision on whether the country is ready for the next phase - defining of approximate date for initiation of membership negotiations - is made upon the Opinion, achieved candidate country status and quality of SAA obligations implementation. In addition, decision on candidate status should contain the indication on time of establishment of Intergovernmental Conference and opening of negotiations. For instance, the European Commission recommended in 2012-2013 Enlargement strategy, for a fourth time, that accession negotiations should be opened with the former Yugoslav Republic of Macedonia. The Commission strongly believes that "moving the accession process of this country to its next stage is necessary in order to consolidate the pace and sustainability of reforms, in particular as regards the rule of law, as well as to strengthen inter-ethnic relations. The region as a whole would benefit." (EC Enlargement strategy, 2012: 13) Unfortunately, the dispute over FYRoM name with Greece remains unresolved.

Author's estimation of main WB's countries challenges for achieving of next integration phase is also place in Table 2 in brackets. For Albania, BiH and Serbia different political criteria are main concern for the Commission. Montenegro is a small positive case in enlargement dynamic of the region, sometimes called by EU representatives as "lightening house" in the Western Balkans region, "country of good news", "good pupil", or even "enough small not to crate regional problems but enough big to show that enlargement function". At the same time, the main concern for small Montenegro (620.000 inhabitants) in future accession process is strengthening of administrative capacities for demanding integration process and rule of law (Djurovic, 2012).

2.3. Regional economic picture in crisis time

Following the fifth EU enlargement experiences (so-called "Golden enlargement period" of EU-10 finished by May 2004), Western Balkans European integration process in the format of economic crisis creates much more challenges than it was the case with countries in '90s. Majority of countries in the Region, with same political and economic heritage, represents complex structure of seven small countries, divided and different, with six official languages and more than 5,000 km of new state borders, including several unsolved border issues, ethnic issues and sovereignty issues.

One acceding country, three candidate countries and three potential candidate countries present only 4,85% of the EU-27 population, 6,4% of the EU-27 area and less than 1% of EU-27 GDP in 2010. According to Eurostat data, EU-12 fifth enlargement countries were much more attractive presenting 25% of EU-15 population, 6,4% of the EU-15 area and 5,4% of EU-27 GDP in 2004. In the format of economic crisis, economic recovery is the priority number one in the region, where EU integration process becomes strong instrument to support that priority.

Further investment in EU integration are needed such as strengthening of competitiveness of local economies to be able to cope with raising competition coming from the Single market. In addition, related to economic crisis, accession negotiation includes participation of candidate countries in *new economic governance model* created by the Commission, a multilateral coordination mechanism for implementation

of economic policies in areas of joint interest to strengthen economic recovery programmes, financial stabilisations, coordination of financial assistance programmes, fiscal consolidations, structural reforms and national austerity measures. Next table present selected economic indicators of the Region strongly hit by economic crisis:

Table 3: Western Balkans: selected economic indicators

Country	GDP real growth			GDP/pc in PPS, 2010 (EU=100)	Unemployment rate 2011	Current account balance (% GDP) 2011	General Government Balance (% GDP) 2011	Public debt as % of GDP 2010
	2011	2012*	2013*					
Croatia	0	-1,9	-0,4	61	13,5	-0,9	-5,1	45,2
FYRoM	2,8	0,0	1,5	36	31,4	-3,0	-2,5	27,7
Montenegro	3,2	0,2	2,2	41	20,0	-17,7	-5,4	45,0
Serbia	1,5	-0,5	2,0	35	23,1	-8,9	-4,9	44,0
Albania	3,1	0,5	1,7	28	13,3	-12,0	-3,5	55,5
B&H	1,3	0,0	1,0	31	43,8	-9,6	-1,3	25,2
Kosovo	4,5	3,7	4,1	n.a.	45,0	-14,1	-1,7	7,0

Source: EC, DG for Economy and Finance, CCEQ 4, 2012; GDP real growth for SR, AL, BA i Kosovo for 2012 and 2013 - IMF, WEO database, October 2012.

The impact of the economic crisis is being felt throughout the region, with the Western Balkans falling back into recession in conditions of low levels of competitiveness, income, and investment and of high and rising unemployment. Despite some heterogeneity in country-specific performances, growth generally slowed down in the second half of 2012. Unemployment reaches very high level in region, in particular in Bosnia, Kosovo, and Macedonia. Progress was achieved in fiscal consolidation in many countries where budget deficits will be reduced in 2012 compared to 2011, despite the deterioration of the economic situation and its impact on fiscal resources. Public debt level remains high.

3. ENHANCED NEGOTIATION FRAMEWORK OF THE EU ENLARGEMENT POLICY TOWARDS THE WESTERN BALKANS

Enhanced negotiation framework of the EU enlargement policy towards the Western Balkans countries is based on specific, so-called six “C” principles.

3.1. Six “C” principles

Conditionality, consolidation, and communication principles were defined in the 2005 Enlargement strategy: consolidating of the EU’s commitments on enlargement,

applying fair and rigorous conditionality, and better communicating enlargement policy towards ordinary citizens both in EU and in candidate and potential candidate countries. It is essential to foster understanding and informed debate on the impact of enlargement policy, particularly at a time when the EU faces major challenges.

Credibility principle has been included in the EU enlargement strategies since 2009 as essential part of negotiating process. Maintaining the credibility of the enlargement process is crucial to its success.

The fifth principle is represented by the current economic *crisis* as strong limiting factor of EU integration dynamic. In the format of economic crisis, economic recovery is the priority number one in the region, where EU integration process becomes strong instrument to support that priority.

Finally, the sixth principle is principle of presenting *concrete results* in the most sensitive areas through track-record mechanisms presented for the Western Balkans countries in the EU enlargement strategy 2012-2013, that would be first implemented in the case of Montenegro. The new approach to negotiations in the rule of law area introduces the need for solid track-records of reform implementation to be developed throughout the negotiations process. Reforms need to be deeply entrenched, with the aim of irreversibility (EC, Enlargement strategy, 2012: 3).

3.2. Format of future accession negotiation in the prism of six “C” principles

As stated in the Treaty on European Union, the EU is founded on the values of respect for human dignity, freedom, democracy, equality, the rule of law, as well as of the respect for human rights including the rights of persons belonging to national minorities. These values are common to all Member States whose society is characterized by pluralism, non-discrimination, tolerance, justice, solidarity, and equality between men and women. Building and respect of these values are an important motive for countries interested to enter the EU association process.

For that reason, the Union has defined "in time" the accession criteria, getting prepared for the fifth great enlargement to the East. The EU association process in the broadest sense has been defined through the so-called Copenhagen criteria (1993) related to the following criteria: 1. Stability of democratic institutions, the rule of law, respect for human rights and the protection of minorities; 2. Existence of functional market economy and the ability to deal with the competition pressure and EU market; and 3. Ability to accept obligations stemming from the membership, including the goals of the political, economic, and monetary union. Besides these basic criteria, there is one more criterion added in Madrid in 1995 and it is related to adaptation of administrative, governing, and judicial structures to EU norms. Fulfilment of the mentioned additional criterion implies full publicity and transparency of work as well as the active role of the Parliament, chambers, trade unions, non-governmental organisations with the aim of realisation of the social consensus and provision of public support.

Furthermore, the improved policy of conditionality which following the accession criteria puts the focus on *the political accession criteria* which were extended in 1997

(one year before the opening of the first round of accession negotiations for the fifth enlargement) with requirements for the more determined fight against corruption and for the independence of judiciary. This criterion is focused mostly on the Western Balkans region (and Turkey) what was defined as regional approach towards the Southern East Europe. Namely, The Vienna European Council in December 1998 recalled the close interest, which the European Union had in the political and economic development of all the countries of South-East Europe and in the stability and prosperity of the region as a whole. The EU makes a major contribution to these objectives through, on the one hand, the enlargement process involving a number of countries concerned and, on the other hand, *the regional approach* involving countries of the Western Balkans. This approach is confirmed with introduction of the SAP in 1999 and its additional pre-conditions for accession negotiations: full cooperation with ICTY (The International Criminal Tribunal for the former Yugoslavia), protection of minority rights, return of internally displaced persons and refugees, media freedom, solving of border disputes, regional cooperation, and good neighbouring relation. The conditionality of SAP remains the common framework for relations with all Western Balkan countries up to their accession.

Having in mind experiences from the fifth enlargement, the European Council agreed on new *consensus on enlargement* in December 2006 (one month before the official accession of Bulgaria and Romania). Thus, all future enlargements of the Union will be subject to a more detailed pre-accession dialogue and more complex negotiation process. The process becomes more complex already in the battle for the status of a candidate country, which means that the country needs to be "prepared beforehand" for obligations deriving from the membership. The accession and accession negotiations, thereby, become more complicated and demanding so that we can talk about a new trend in the EU enlargement policy – *enlargement plus* (Djurovic i Jacimovic, 2012).

Gradually, with raising of impact of economic crisis on EU and candidate countries economies, the European Commission also developed *the economic sub-criteria* for evaluation of readiness for future membership (EC, 2011).

Progress report 2011 introduced further developed presented conditionality approach in European integration process of Western Balkans countries. All mentioned accession criteria in the prism of the six "C" principles are presented in next scheme:

Table 4: Accession criteria in the prism of six “C” principles

COPENHAGEN CRITERIA (1993)			MADRID 1995
Political	Economic criteria	Legal	Administrative
Democracy and Rule of Law	The existence of a functioning market economy	The ability to take on the obligations of membership	The administrative capacity to adopt, implement and enforce the Acquis
Human rights			
Minorities	The capacity to cope with the competitive pressure and market forces within the Union		
Judicial reform			
"ENLARGEMENT +"			
Focus on political criteria	The economic sub-criteria		SAP criteria
Regional approach	<ul style="list-style-type: none"> • Equilibrium between demand and supply is established by the free interplay of market forces • Prices, as well as trade, are liberalised • Significant barriers to market entry (establishment of new firms) and exit (bankruptcies) are absent • The legal system, including the regulation of property rights in place • Laws and contracts can be enforced; • Macroeconomic stability has been achieved including adequate price stability and sustainable public finances and external accounts • Broad consensus exists about the essentials of economic policy; • The financial sector is sufficiently well developed to channel savings towards productive investment. 	<ul style="list-style-type: none"> • The existence of a functioning market economy, with a sufficient degree of macroeconomic stability for economic agents to make decisions in a climate of stability and predictability • A sufficient amount, at appropriate costs, of human and physical capital, including infrastructure, education and research, and future developments in this field • The extent to which government policy and legislation influence competitiveness through trade policy, competition policy, state aids, support for SMEs, etc. • The degree of trade integration a country achieves with the Union before enlargement • The proportion of small firms. 	Full cooperation with ICTY
Enhanced political conditionality: fight against organised crime and corruption, independent judiciary (1997)			Minority protection
Revised consensus on Enlargement (2006)			Return of Internally Displaced Persons and Refugees
EU integration capacity			Media freedom
WB absorption capacity			Regional cooperation and good neighbouring relation
Screening start with C23 & C24 (2012)			Solving of border disputes
COUNTRY SPECIFIC RECOMMENDATIONS AND CONDITIONALITIES (with focus on meritable results)			
Political environment	Economic environment	Legal Environment /Enforcement/	Administrative capacities

The European Commission proposed new rules for negotiating Chapters 23 and 24. Given the challenges faced and the long-term nature of the reforms, chapters related to judiciary and fundamental rights, and justice, freedom and security will be tackled early in the negotiations to allow maximum time to establish the necessary legislation, institutions, and solid track-records of implementation prior to closing of negotiations. The new negotiating rules are defined for the whole region. Having in mind all abovementioned, it should create favourable environment for positive regional competition in the EU integration process

3.3. New negotiating rules

After the first proposal in Enlargement strategy 2012-2013, EU Joint Negotiation Framework, prepared for the opening of the accession negotiation with Montenegro in June 2012, further developed new negotiation rules. Consequently, first experience with the new negotiation rules is delegated to Montenegro.

The Commission also created *new rules* for screening process and time frame for opening of specific chapters to ensure an overall balance in the progress of negotiations across difference policy areas. “Given the link between the chapters *Judiciary and fundamental rights* (Chapter 23) and *Justice, freedom and security* (Chapter 24) and the values on which the Union is founded, as well as their importance for the implementation of the Acquis across the board, should progress under these chapters significantly lag behind progress in the negotiations overall, and after having exhausted all other available measures, the Commission will on its own initiative or on the request of one third of the Member States propose to withhold its recommendations to open and/or close other negotiating chapters, and adapt the associated preparatory work, as appropriate, until this imbalance is addressed. The Council will decide by qualified majority on such a proposal and on the conditions for lifting the measures taken. The Member States will act in the Intergovernmental Conference in accordance with the Council decision, without prejudice to the general requirement for unanimity in the Intergovernmental Conference” (EU Accession Document, 2012).

According to new rules, screening process for chapters 23 and 24 are realized successfully by late May 2012, even before formal opening of the accession negotiations. In 2012, only Chapter 25 (Science and Research) was temporally closed. Precondition for opening chapters 23 and 24 in the second half of 2013 (instead of EC opening benchmarks) is preparation of Montenegrin Action plan for continuous monitoring of progress in these areas during whole accession process. This Action plan will include proposal for constitutional amendments to strengthen the independence of the judiciary. Agreement on constitutional amendments between political parties in Montenegrin parliament presents real precondition for the Commission’s approval of the Action plan.

The advancement of the negotiations will be guided by Montenegro’s progress in preparing for accession, within a framework of economic and social convergence. This progress will be measured in particular against the following requirements:

- the Copenhagen criteria, which set down the following requirements for membership;
- the SAP conditionality, in particular Montenegro's commitment to good neighbourly relations and the strong contribution expected from Montenegro to the development of closer regional cooperation;
- Montenegro's undertaking to resolve any border disputes in conformity with the principle of peaceful settlement of disputes in accordance with the United Nations Charter and the United Nations Convention on the Law of the Sea, including, if necessary, compulsory jurisdiction of the International Court of Justice;
- The fulfillment of Montenegro's obligations under the SAA as well as Montenegro's progress in addressing areas of weakness identified in the Commission's Opinion (*country specific recommendations and conditions*).

For instance, one of the Montenegrin specific recommendations is related to Chapter 17 "Economic and Monetary policy." The EU joint negotiation platform with accession negotiation with Montenegro underlined the following: "Montenegro's present use of the *euro*, decided by the Montenegrin authorities in exceptional circumstances, is fully distinct from euro area membership. This issue will need to be addressed in the course of the negotiations. Montenegro will participate in economic and monetary union from accession as a Member State with derogation and shall join the euro area following a Council decision to this effect based on an evaluation of its fulfillment of the necessary conditions. The remaining *acquis* in this area fully applies from accession.

4. CONCLUSION

The present European perspective in the region varies. Croatia completed accession process, signed the Accession Treaty and intensified additional efforts to realised all final commitments by mid 2013. There has been a growing optimism that Macedonia (assessed as a possible model for resolution of ethnic conflicts) will have more definite negotiation perspective, and therefore it was awarded with the candidate status in 2005. On spring 2013, possibility for FYRoM to open accession negotiation is still uncertain. Although often perceived as the country with the best administrative capacities and economic potentials for rapid growth, Serbia somehow always fails to meet expectations of the Union and therefore still have only the status of candidate for EU membership. Albania already achieved a very important integration goal – membership in NATO in 2009, and as a Mediterranean country it proceeds towards EU in moderate dynamics.

At the moment, Bosnia and Herzegovina and Kosovo remain at the end of this process. BiH is still facing with serious political turbulences and unclear state format with all the risks posed to the stability of the country. As regards Kosovo, it is difficult to estimate when it will have a clear integration path, completely assuming responsibility for its own European future, with expected support from all European countries.

Although the smallest country in the region, with „huge“ but weak administration, with euroised and very open economy, Montenegro is the country of growing stability, with secure Euro-Atlantic perspective and strong national consensus for European

integration. Slowly but surely, Montenegro starts to play the leading role among the candidate countries for membership, being the first country to enter the demanding so-called „Enlargement plus process“ (new rules for opening of accession negotiations with chapters related to Judiciary and Fundamental rights (Chapter 23) and Justice, Freedom and Security (Chapter 24). Thus, it paves the path to other countries in the region for faster integration, and raises its voice against any form of “Balkan waiting room” for membership in the EU.

However, accession dynamics could not be precisely defined without considering readiness of the other contracting party – the European Union and its *integration capacity*, which will depend on the quality of implementation of institutional reforms envisaged by the Lisbon Treaty and competitive challenges that the Union will face with debt crisis and position at the global scene in the forthcoming period.

On the other hand, the contemporary enlargement process has been significantly hampered by the economic crisis in the period 2008-2012, which brings economic conditions of both parties in the enlargement process to the fore. The crisis causes slow recovery of the EU, such as at the region, while the countries increasingly turn to internal sources of growth and productivity in order to improve their own competitiveness. After slight recovery in 2010 and 2011, the majority of economies of the Western Balkans contracted again in 2012, following negative developments in the Union (debt crisis expanded in „trust crisis“)

Moreover, apart from stricter accession criteria and reflection of all lessons learned from the fifth enlargement, regional dynamics of accession will depend on meeting specific criteria defined for countries in this region including country specific recommendations. Respecting of so-called six „C“ principle (conditionality, consolidation, communication, credibility, crisis and concrete results), including new negotiation rules, will define future integration dynamic.

REFERENCES

- Djurovic G. (2012), *Evropska unija i Crna Gora: politika proširenja*, Ekonomski fakultet, Podgorica, 549-550.
- Djurovic G., Jacimovic D. (2012), *From Stabilisation and Association Process to full Membership of Western Balkans Countries*, in the “Business Competitiveness in the 21st Century: Emerging Challenges in a Changing Global Business Environment” (Group of editors), Macmillan Publishers, India, 12-15.
- IMF (2012), WEO database. (<http://www.imf.org/external/pubs/ft/weo/2012/02/weodata/index.aspx>)
- Jakubiak M. and Oruc N. (2008), *Trade and economic relations between the EU and the Western Balkans*, Breafing paper, European Parliament, Brussels, (september), 23-24.
<http://www.europarl.europa.eu/committees/en/studiesdownload.html?languageDocument=EN&file=22199>
- The EU Accession Document (2012), *General EU Position: Ministerial meeting opening the Intergovernmental Conference on the Accession of Montenegro to the European Union*, AD 23/12, Brussels, (29.6. 2012), 11.
- The European Commission (2012), *Enlargement strategy and main challenges 2012-2013*, COM(2012) 600, Brussels, (10. 10. 2012), 12-13;

- The European Commission (2011), DG for Economic and Financial affairs, Progress towards meeting the economic criteria for accession: the assessments of the 2011 Progress Reports and Opinion (Serbia), Occasional paper, Vol. 85, (December), 2.
- The European Commission (2012), Communication from the Commission to the European Parliament and the Council on a Feasibility Study for a Stabilisation and Association agreement between the European Union and Kosovo*, COM 2012 (602) final, Brussels, (10.10.2012), 3.
- The European Commission (2012), DG for Economy and Finance, Candidate Country Economic Quarterly, CCEQ, Vol. 4, 2012;

Aleksander Aristovnik

University of Ljubljana, Faculty of Administration, Ljubljana, Slovenia

TECHNICAL EFFICIENCY OF PRIMARY EDUCATION: A COMPARATIVE ANALYSIS OF EU AND OECD COUNTRIES

ABSTRACT

The paper joins the efforts of other scholars in investigating education efficiency by applying a non-parametric methodology. Most importantly, Data Envelopment Analysis (DEA) technique is presented and then applied to the wide range of the EU and OECD countries to evaluate technical efficiency within the selected education sector in 1999-2008 period. The empirical results show that within a selected group of EU member states Denmark, Hungary and Portugal are seen as most efficient in primary education sector. In addition, some countries come very close to the frontier (e.g. Czech R. and Italy), while the other countries are further away and therefore less efficient (e.g. Turkey). On the other hand, the least efficient countries are Belgium, Sweden and Croatia. The empirical findings also point out that the new EU member states are relatively more efficient than non-EU countries in the sample, however, they show relatively low efficiency against the old EU-member states.

Keywords: *efficiency, primary education, DEA, EU Member States, OECD*

JEL classification: *I21, J24, H52*

1. INTRODUCTION

Each nation's future wealth and competitive position in the globalised world depends increasingly on its ability to create and absorb knowledge. An essential feature of knowledge is that it requires human capital (educated persons) for both its production and its application. Indeed, long-term economic growth of the economy rests with its capacity to increase productivity through rapid technological progress. Therefore, the national system of education is the quintessential tool for the creation and application of knowledge. However, as most of the countries are faced with increasing demands on their limited (public) resources, there is an increasing pressure to improve resource allocation and utilisation. Accordingly, policy makers in a number of countries became increasingly concerned with measuring efficiency. With education expenditures comprising a relatively important amount of national income, the interest in examining whether such expenditures are cost-effective has increased, recently.

The purpose of the paper is to present and apply Data Envelopment Analysis (DEA) technique to the wide range of the EU and OECD countries to evaluate technical

efficiency of the primary education. The importance of examining public sector expenditure efficiency is particularly pronounced for emerging market economies where public resources are normally insufficient. When services are publicly provided, performance measurement becomes an inevitable management tool because when inefficiency continues, the constituents of that inefficient unit suffer. The government needs benchmarking tools to provide incentives to good performing sectors and to induce inefficient sectors to perform better. However, the focus of the paper is not on how to cut (public) expenditures, but rather more on investigating potential reserves to increase the value for money of public spending, i.e. how to make the most of limited public (and private) resources.

The paper is organized as follows. In the next section we present a brief literature review of measuring public education expenditure efficiency. Section 3 shows a theoretical background of non-parametric methodologies with special focus on Data Envelopment Analysis (DEA) and the specifications of the models. Section 4 outlines the results of the non-parametric efficiency analysis of primary education sector. The final section provides concluding remarks.

2. LITERATURE REVIEW

Previous studies on the performance and efficiency of the public sector (at national level) that applied non-parametric methods find significant divergence of efficiency across countries. Studies include notably Fakin and Crombrughe (1997) for the public sector, Gupta and Verhoeven (2001) for education and health in Africa, Clements (2002) for education in Europe, St. Aubyn (2003) for education spending in the OECD, Afonso et al. (2005, 2006) for public sector performance expenditure in the OECD and in emerging markets, Afonso and St. Aubyn (2005, 2006a, 2006b) for efficiency in providing health and education in OECD countries. De Borger and Kerstens (1996), and Afonso and Fernandes (2006) find evidence of spending inefficiencies for the local government sector. Additionally, Afonso et al. (2008) assess the efficiency of public spending in redistributing income. Most studies apply the Data Envelopment Analysis (DEA) method while Afonso and St. Aubyn (2006a) undertook a two-step DEA/Tobit analysis, in the context of a cross-country analysis of secondary education efficiency.

Other authors (e.g. Mandl et al., 2008; Jafarov and Gunnarsson, 2008) have tried to improve on the work by Afonso et al. (2005). The country-clusters resulted are very similar. Southern European countries present low general and educational performance, the CEE countries show low general performance but high educational one, and the Northern European and Anglo-Saxon countries with high scores in both items (although the differences among countries in the educational performance are high; e.g. Luxembourg with a high macroeconomic score but fairly poor results for the effectiveness of its education system). Additionally, a number of studies examine technical efficiency in education (see also Castano and Cabanda, 2007; Grosskopf and Mourtray, 2001; Johnes, 1996, 2006; Johnes and Johnes, 1995; Ng and Li, 2000; Cherchye et al., 2010).

3. METHODOLOGY AND DATA

A common approach to measure efficiency is based on the concept of efficiency frontier (productivity possibility frontier). There are multiple techniques to calculate or estimate the shape of the efficiency frontier. Most investigations aimed at measuring efficiency are based either on parametric or non-parametric methods. The main difference between the parametric and the non-parametric approach is that parametric frontier functions require the ex-ante definition of the functional form of the efficiency frontier. While a parametric approach assumes a specific functional form for the relationship between input and output, a non-parametric approach constructs an efficiency frontier using input/output data for the whole sample following a mathematical programming method.¹ A calculated frontier provides a benchmark by which the efficiency performance can be judged. This technique is therefore primarily data-driven. Among the different non-parametric methods the Free Disposal Hull (FDH) technique imposes the fewest restrictions.² It follows a stepwise approach to construct the efficiency frontier. Along this production possibility frontier one can observe the highest possible level of output/outcome for a given level of input. Conversely, it is possible to determine the lowest level of input necessary to attain a given level of output/outcome. This allows identifying inefficient producers both in terms of input efficiency and in terms of output/outcome efficiency (Afonso et al., 2005).

An alternative non-parametric technique that has recently started to be commonly applied to (public) expenditure analysis is Data Envelopment Analysis (DEA).³ DEA is a non-parametric frontier estimation methodology originally introduced by Charnes, Cooper, and Rhodes in 1978 that compares functionally similar entities described by a common set of multiple numerical attributes. DEA classifies the entities into “efficient” or “performers” versus “inefficient” or “non-performers.” According to the DEA framework, the inefficiencies are the degrees of deviance from the frontier. Input inefficiencies show the degree to which inputs must be reduced for the inefficient country to lie on the efficient practice frontier. Output inefficiencies are the needed increase in outputs for the country to become efficient. If a particular country either reduces its inputs by the inefficiency values or increases its outputs by the amount of inefficiency, it could become efficient; that is, it could obtain an efficiency score of one. The criterion for classification is determined by the location of the entities’ data point with respect to the efficient frontier of the production possibility set. The classification of any particular entity can be achieved by solving a linear program (LP).

Various types of DEA models can be used, depending upon the problem at hand. The DEA model we use can be distinguished by the scale and orientation of the model. If one cannot assume that economies of scale do not change, then a variable returns-to-scale (VRS) type of DEA model, the one selected here, is an appropriate choice (as opposed to a constant-returns-to-scale, (CRS) model). Furthermore, if in order to

¹ For an overview of non-parametric techniques see Simar and Wilson (2003).

² FDH analysis was first proposed by Deprins et al. (1984).

³ DEA analysis, originating from Farrell’s (1957) seminal work was originally developed and applied to firms that convert inputs into outputs (see Coelli et al. (2002) for a number of applications).

achieve better efficiency, governments' priorities are to adjust their outputs (before inputs), then an output-oriented DEA model rather than an input-oriented model is appropriate. The way in which the DEA program computes efficiency scores can be explained briefly using mathematical notation (adapted from Ozcan, 2007). The VRS envelopment formulation is expressed as follows:

$$\begin{aligned}
 VRS_p(Y_1, X_1, u^1, v^1): \min & -(u^1 s + v^1 e) \\
 & Y\lambda - s = Y_1 \\
 & -\lambda - e = -X_1 \\
 & 1\lambda = 1 \\
 & \lambda \geq 0, e \geq 0, s \geq 0
 \end{aligned}$$

For decision making unit 1, $x_{i1} \geq 0$ denotes the i^{th} input value, and $y_{r1} \geq 0$ denotes the r^{th} output value. X_1 and Y_1 denote, respectively, the vectors of input and output values. Units that lie on (determine) the surface is deemed *efficient* in DEA terminology. Units that do not lie on the surface are termed *inefficient*. Optimal values of variables for decision making unit 1 are denoted by the s -vector s^1 , the m -vector e^1 , and the n -vector λ^1 .

Although DEA is a powerful optimization technique that can assess the performance of each country, it has certain limitations. When one has to deal with large numbers of inputs and outputs, and a small number of countries are under evaluation, the discriminatory power of the DEA is limited. However, analysts can overcome this limitation by including only those factors (input and output) that provide the essential components of "production", thus avoiding distortion of the DEA results. This is usually done by eliminating one of a pair of factors that are strongly positively correlated with each other.

The specification of the outputs and inputs is a crucial first step in DEA, since the larger the number of outputs and inputs included in any DEA, the higher will be the expected proportion of efficient DMUs, and the greater will be the expected overall average efficiency (Chalos, 1997). Common measures of teaching output in education used in previous studies are based on graduation and/or completion rates (see Johnes, 1996; Jafarov and Gunnarsson, 2008), PISA scores (see Afonso and Aubyn, 2005; Jafarov and Gunnarsson, 2008) pupil-teacher ratio and enrolment rate (see Jafarov and Gunnarsson, 2008).

In the majority of studies using DEA, the data are analyzed cross-sectionally, with each decision making unit (DMU) – in this case the country – being observed only once. Nevertheless, data on DMUs are often available over multiple time periods. In such cases, it is possible to perform DEA over time, where each DMU in each time period is treated as if it were a distinct DMU. However, similar to the former empirical literature in this empirical analysis the data set to evaluate education sector efficiency (at different levels) includes input data, i.e. (public) expenditure per student, primary (% of GDP per capita) and output/outcome data, i.e. school enrolment, primary (% gross), teacher/pupil ratio in primary education and primary completion rate, total (% of relevant age group). There are up to thirty countries included in the analysis (selected EU and OECD countries). In our case the data set for all the tests in the study includes

an average data for the 1999-2008 period (including PISA 2006 average scores) in order to evaluate long-term efficiency measures as education process is characterized by time lags in selected countries. The program used for calculating the technical efficiencies is the *DEAFrontier* software. The data are provided by Eurostat, OECD, UNESCO and the World Bank's World Development Indicators database.

4. EMPIRICAL RESULTS

When looking at the education results and applying the DEA efficiency frontier technique within a selected group of EU/OECD countries and Croatia to measure efficiency of primary education, Denmark, Hungary and Portugal are seen as most efficient. The efficient countries are also Greece, Iceland and Romania, however, their primary expenditures per student (in % of GDP) is very low and have averaged less than 12% (the EU/OECD average is 18.7% in the considered period). One can also see that some countries come very close to the frontier (e.g. Czech R. and Italy), while the other countries are further away and therefore less efficient (e.g. Turkey and Croatia) (see Table). Some less efficient countries should significantly decrease their input (primary expenditure per student) (e.g. Slovenia from 27.0% to 22.0%) and/or increase their outputs, i.e. school enrolment (e.g. Ireland and Poland), primary completion rate (Belgium) and teacher-pupil ratio (Turkey and Ireland) in order to become efficient.⁴ Interestingly, the CEE countries are, in general, relatively more efficient than non-EU countries in the sample, however, they show relatively low efficiency against the old EU-member states.

Table 1: The Relative Efficiency of the EU Member States and OECD Countries in Education (Distribution by quartiles of the ranking of efficiency scores)

I quartile	II quartile	III quartile	IV quartile
Denmark	Spain	Lithuania	Slovenia
Greece	Slovakia	Netherlands	Poland
Hungary	Germany	Ireland	Latvia
Iceland	Norway	France	Turkey
Portugal	Austria	Bulgaria	Croatia
Romania	Finland	Cyprus	Sweden
Czech Republic		Estonia	Belgium
Italy		United States	

Notes: Twenty-nine countries are included in the analysis (EU-27, OECD and Croatia).

Sources: World Bank, 2011; UNESCO, 2011; own calculations.

Further empirical analysis, testing the efficiency of the total expenditure on education (in DEA model: as input – average public expenditure and as output – average PISA test) shows that the worse efficiency performers are Bulgaria, Romania and Portugal (see Table 2). Indeed, if these countries would employ the resources in efficient

⁴ The average output efficiency score for primary education is 1.050, which means that the average country could increase the outputs/outcomes for about 5.0% if it were efficient. The results also confirm our expectations, that larger public sector increases the inefficiency in a primary education.

manner, they could increase their PISA scores by 19.5%, 15.6% and 13.6%, respectively. The main reason for the education inefficiency in these countries lies in transforming intermediate education outputs into real outcomes (see IMF, 2008) (same problems have some other CEE countries, particularly Latvia, Lithuania and Hungary). The results also show that the best performers (in terms of efficiency) seem to be Finland and Japan, while Greece presents a good efficiency result due the lowest education spending (averaged only 3.6% of GDP in 1999-2008). Interestingly, output-oriented DEA results confirm that Scandinavian countries could attain the same result with lowering their education expenditure by up to 2.3 percentage points (in Denmark). However, the new EU member states, in general, show the same efficiency as the old EU member states (both groups could increase their PISA scores by around 10% on average).

Table 2: The Relative Efficiency of the selected EU Member States and OECD Countries in Education
(Distribution by quartiles of the ranking of efficiency scores)

Country	Output-Oriented VRS Efficiency	Rank	Benchmarks
Finland	1.00000	1	
Greece	1.00000	1	
Japan	1.00000	1	
Czech R.	1.01370	4	Greece, Japan
Netherlands	1.01971	5	Finland, Japan
Slovakia	1.04248	6	Greece, Japan
Estonia	1.04817	7	Finland, Japan
Germany	1.05221	8	Finland, Japan
Iceland	1.05541	9	Finland, Japan
Switzerland	1.07374	10	Finland, Japan
Croatia	1.07427	11	Greece, Japan
Poland	1.07577	12	Finland, Japan
Spain	1.07915	13	Greece, Japan
Belgium	1.08288	14	Finland
Ireland	1.08607	15	Finland
Austria	1.08700	16	Finland, Japan
United Kingdom	1.08986	17	Finland, Japan
Slovenia	1.09281	18	Finland
Hungary	1.09307	19	Finland, Japan
Sweden	1.09620	20	Finland
Denmark	1.10320	21	Finland
Italy	1.10961	22	Finland, Japan
Turkey	1.11606	23	Greece, Japan
France	1.11721	24	Finland, Japan
Lithuania	1.12536	25	Finland, Japan
Latvia	1.13250	26	Finland, Japan
Norway	1.13547	27	Finland
Portugal	1.13607	28	Finland, Japan
Romania	1.15600	29	Greece, Japan
Bulgaria	1.19523	30	Greece, Japan
Mean	1.082974		
Std. Dev.	0.046890		

Notes: Thirty countries are included in the analysis (EU-27, OECD and Croatia).
Sources: World Bank, 2011; UNESCO, 2011; OECD, 2011; own calculations.

5. CONCLUSIONS

Spending on primary education system represents an important tax burden on taxpayers. The efficiency with which inputs produce the desired outputs is thus an important public policy issue. In this study, an attempt was made to measure the relative efficiency of primary education across selected OECD and EU countries by using data envelopment analysis (DEA) in a VRS framework. The research results suggest that Denmark, Hungary and Portugal are seen as most efficient countries and can serve as benchmarks for their efficient use of primary education resources. On the other hand, Belgium, Sweden and Croatia are the worse efficiency performers among the selected EU and OECD countries. The empirical results also suggest that, in general, new EU member states are relatively more efficient than non-EU countries in the sample, however, they show relatively low efficiency against the old EU-member states.

However, a few limitations of the presented empirical study should be pointed out. Firstly, the applications of presented techniques are hampered by lack of suitable data to apply those techniques. Quality data are needed because the techniques available to measure efficiency are sensitive to outliers and may be influenced by exogenous factors. Indeed, substantial inefficiency may be simply a reflection of environmental factors (such as climate, socio-economic background, etc.). This also suggests applying a combination of techniques to measure efficiency. Secondly, the precise definition of inputs, outputs and outcomes may significantly influence the results. Finally, it seems important to bear in mind that by using a non-parametric approach, and in spite of DEA being an established and valid methodology, differences across countries are not statistically assessed, which can be considered as a limitation of such methodology. Hence, further research is clearly needed to eliminate the above deficiencies, in particular to test the influence of the environmental factors on education sector efficiency.

REFERENCE

- Afonso, A., Schuknecht L. and Tanzi, V., (2005): Public Sector Efficiency: An International Comparison, *Public Choice*, 123 (3-4): 321-347
- Afonso, A. and Aubyn, St., (2005): Non-parametric Approaches to Education and Health Efficiency in OECD Countries, *Journal of Applied Economics*, 8 (2): 227-246
- Afonso, A. and Aubyn, St., (2006a): Cross-country Efficiency of Secondary Education Provision: a Semi-parametric Analysis with Non-discretionary Inputs, *Economic Modelling*, 23 (3): 476-491
- Afonso, A. and Aubyn, St., (2006b), Relative Efficiency of Health Provision: a DEA Approach with Non-discretionary Inputs, ISEG-UTL, Department of Economics Working Paper n° 33/2006.
- Afonso, A., Schuknecht L. and Tanzi, V., (2006), Public Sector Efficiency: Evidence for New EU Member States and Emerging Markets, European Central Bank, Working Paper Series 581, European Central Bank: Frankfurt, 2006.
- Afonso, A. and Fernandes, S., (2008): Assessing and Explaining the Relative Efficiency of Local Government, *Journal of Socio-Economics*, 37 (5), 1946-1979
- Afonso, A., Schuknecht L. and Tanzi, V. (2008), Income distribution determinants and public spending efficiency, Working Paper Series 861, European Central Bank: Frankfurt.

- Castano MC, and Cabanda, E., (2007): Performance evaluation of the efficiency of Philippine Private Higher Educational Institutions: application of frontier approaches, *Int Trans Oper Res*, 14: 431-444.
- Chalos, P., (1997): An Examination of Budgetary Inefficiency in Education Using Data Envelopment Analysis, *Financial Accountability & Management*, 13 (1): 55-69.
- Cherchye, L., De Witte, K., Ooghe, E., and Nicaise, I. (2010): Efficiency and equity in private and public education: nonparametric comparison. *European Journal of Operational Research*, 202 (2): 563-573.
- Clements, B., (2002): How Efficient is Education Spending in Europe?, *European Review of Economics and Finance*, 1: 3-26.
- Coelli T., Rao, D. and Battese, G. (2002): An Introduction to Efficiency and Productivity Analysis (6th edition), Massachusetts: Kluwer Academic Publishers
- De Borger, B., and Kerstens, K., (1996): Cost efficiency of Belgian local governments: A comparative analysis of FDH, DEA, and econometric approaches. *Regional Science and Urban Economics*, 26: 145-170.
- Deprins, D., Simar L. and Tulkens, H. (1984): Measuring labor-efficiency in post offices, in: *The performance of public enterprises: concepts and measurement*, Amsterdam: North-Holland.
- Fakin. B. and de Crombrughe, A., (1997), Fiscal adjustment in transition economies: social transfers and the efficiency of public spending: a comparison with OECD countries, Policy Research Working Paper 1803, Washington, DC: World Bank.
- Farrell, M., (1957): The Measurement of Productive Efficiency. *Journal of the Royal Statistical Society Series A (General)*, 120 (3): 253-281.
- Grosskopf, S., and Mourtray, C., (2001): Evaluating performance in Chicago public high schools in the wake of decentralization, *Econ. Educ. Rev.*, 20: 1-14.
- Gupta, S., and Verhoeven, M., (2001): The efficiency of government expenditure Experiences from Africa, *Journal of Policy Modelling*, 23: 433-467.
- IMF (2008), Republic of Croatia: Selected Issues, IMF Publications, Washington.
- Jafarov, E., and Gunnarsson, V., (2008), Government Spending on Health Care and Education in Croatia: Efficiency and Reform Options, International Monetary Fund, IMF Working Paper, WP/08/136.
- Johnes, J., (1996): Performance assessment in higher education in Britain. *Eur. J. Oper. Res.*, 89: 18-33
- Johnes, J., and Johnes, G., (1995): Research funding and performance in U.K. university departments of economics: a frontier analysis. *Econ Educ Rev*, 14: 301-314
- Johnes, J., (2006): Data envelopment analysis and its application to the measurement of efficiency in higher education. *Economics of Education Review*, 25 (3): 273-288
- Mandl, U., Dierx, A., and Ilzkovitz, F., (2008), The effectiveness and efficiency of public spending. European Commission, Economic Papers 31, Februar 2008.
- Ng, Y. C., and Li, S. K., (2000): Measuring the research performance of Chinese higher education institutions: an application of data envelopment analysis, *Educ Econ*, 8: 2-139.
- Ozcan, Y. A., (2007): Health Care Benchmarking and Performance Evaluation: An Assessment using Data Envelopment Analysis (DEA), New York: Springer.
- Simar, L. and P. Wilson (2003): Efficiency analysis: the statistical approach, lecture notes.
- St. Aubyn, M., (2003): Evaluating Efficiency in the Portuguese Education Sector, *Economia*, 26: 25-51
- Unesco (2010) Data Centre, Montreal: UNESCO Institute for Statistics, *On-line*.
- World Bank (2010) World Development Indicators, *On-line*.

Marino Golob

Polytechnic of Rijeka, Rijeka, Croatia

Martin Golob

University of Rijeka, Faculty of Economics, Rijeka, Croatia

EU ACCESSION OF THE REPUBLIC OF CROATIA AND ITS IMPLICATIONS ON THE CROATIAN INSURANCE MARKET

ABSTRACT

Insurance manages, diversifies and absorbs the risks of various individuals and companies on the world market, but also on the national markets; because of that, insurance is often a precondition for the development of other activities, such is the purchase of housing, and the creation or expansion of businesses. In turn, these activities generate demand for different products and services that insurers provide, thus facilitating and supporting insurance activities. This effect supports the overall development of the economic sector, and works on an individual level as well, expanding as a natural consequence of its social protection value. Due to expansion, deepening and integration of the Internal market of the European Union, companies and corporations from around the world are given the opportunity to easily access this attractive business environment. This fact is especially true for providers of insurance products and services. A larger number of insurance companies are operating daily on the vast European market with nearly 500 million potential clients, which opens up numerous business opportunities, while business activities are in part facilitated by the significant degree of harmonization of insurance products and services. Europe is the largest insurance market in the world with a world market share of around 36%. This paper tries to give answers which are the potential implications of the Croatian accession to the European Union on the Croatian insurance market.

Keywords: *insurance market, EU, Croatia, implications, effects*

JEL classification: *G22*

1. INTRODUCTION

Risk and uncertainty permeate virtually every aspect of human life. The desire for protection against vagaries that our world produces is a fundamental component of human behavior. The desire to protect yourself is the basis for existence of insurance and the insurance sector. Insurance in its most basic form represents protection, risk pooling and risk management. Through a vast number of different services and insurance products, which insurance sector provides, social and economic values of insurance are achieved. Insurance manages, diversifies and absorbs the risks of

individuals and different companies on the world market, but also on national markets, and insurance is often a precondition for the development of other productive activities in the economy, such as the purchase of housing and creating or expanding businesses. In return, these activities generate demand for various products and services that insurers provide. The aggregate impact of insurance is therefore equalizing patterns of consumption and a wider contribution to the financial and social stability. This stabilizing factor of insurance is recognized in the investment role of insurance companies because insurance companies are one of the largest investors in the free market. The insurance sector has an important role in the development of financial markets, especially in its complementary role with the banking sector and the deepening of the insurance market has a positive impact of economic growth. The ways in which insurance contributes to economic growth and the general interest of society as a whole are multiple and manifest themselves in the ability of insurance to: ensure effective management of different types of risks, encourage mitigation of losses, promote financial stability, assist in reducing the burden of the state with regard to the social protection system, facilitate trade activities, support businesses, mobilize savings deposits and encourage a more efficient allocation of capital and thereby enhance the development of financial services (The Geneva Association, 2012).

2. EUROPEAN AND CROATIAN INSURANCE MARKET

Following the very important role of the insurance sector in the economy, with development and expansion of the European Union, policymakers understood the need and value of creating a single market for insurance. Creating the Single Insurance Market - SIM as it is today took almost thirty years. Ultimate goal of creating a common market for insurance in the European Union is due to various legal, economic and political activities. Local, national insurance markets in the European Union were strictly regulated and tightly closed to foreign companies, respectively insurance companies from other Member States of the European Union. Major disparities between national legislative systems regarding the insurance sector in the European Union, primarily resulted from the structure of financial services as defined in a variety of legal and legislative means. The intensity of consumer protection in insurance varied from Member State to Member State of the European Union. Furthermore, under the Treaty of Rome, creating a single market for insurance had to run in parallel with the liberalization of capital flows in the European community countries, which is a key means of establishing and managing an integrated European market for financial services, made up of insurance companies, banks and securities market. The integration process of the European insurance sector could not be achieved in any other way except through liberalization and deregulation of the insurance markets of member countries. The new structure of the European insurance market, however, required a uniform legal framework at least at the basic level. The new structure of European insurance market allows all insurers coming from different member states to establish and provide services freely throughout the European Community without needing any additional authorization by any host country authority. The new structure of the insurance market meant that the same rules apply to all participants in the insurance market with regard to the establishment and provision of insurance activities. The legal framework for the single insurance market in the European Union was established on

the basis of two fundamental principles guaranteed by the founding Treaty: free movement of capital and freedom to provide services and establishment, and was gradually realized through three generations of directives on insurance. The first initiatives towards the integration of the European insurance market were made at the beginning of the 1970's and completed in July 1994 by the implementation of the Third Generation of Insurance Directives. With the implementation of the third generation of insurance directives Single Market for Insurance in the European Union was officially established (Sterzynski, 2003).

Insurance has always been one of the sectors with a strong regulatory framework largely due to the "risky" nature of the insurance business. Over time it progressively moved towards more deregulated environment. Supervisory and regulatory authorities, however, still have a responsibility to protect the interests and rights of consumers of insurance services and products, especially in the light of recent economic and financial developments. In the European Union, the process of supervision of the insurance sector is conducted by the European Agency for the Supervision of Insurance and Occupational Pensions (EIOPA), which replaced the former Committee for the supervision of insurance and occupational pensions (CEIOPS), which was established in 2011 within the institutional architecture of the European supervisory authorities (ESAs). The European Agency for the Supervision of Insurance and Occupational Pensions currently conduct its activities within the legal framework of "Solvency I", and in the near future plans to implement "Solvency II" framework based on the new control principles of capital adequacy, solvency and risk management in insurance companies. It is necessary to stress the importance of Competition policy in the European Union, which has always played a central role in the insurance sector (EC, 2013).

Europe is today the largest insurance market in the world with a market share of 36% of the world's total premiums (Swiss Re, 2011). Total premiums in the 2011 amounted to EUR 1.072 billion, and showed a slight decrease compared to the previous year by 3.2% due to the still present consequences of the global economic and financial crisis that hit in 2008. The largest insurance markets in Europe are still the United Kingdom, France, Germany and Italy, which together account for 70% of total European life insurance premium (Insurance Europe, 2013). The relative dominance of life insurance is particularly pronounced in Europe, and it's a feature of the European insurance markets, while North America dominates in sector of nonlife insurance. In Europe, according to the 2011 data, EUR 1816 per capita was averagely spent on insurance. Most of this amount (EUR 1,072) was spent on life insurance, while the rest was spent on non-life insurance. With nominal GDP growth in Europe of 3.7% and a decline in total premiums of 3.2% in the 2011, the average insurance penetration was 7.6%, which is 0.6 percentage points less than in the previous year. On the insurance market in Europe its activities conducts more than 4,000 businesses and insurance sector employs around 900,000 employees, which speaks volumes about the importance of this sector for the European society. It is important to note that the presence of insurance companies from one Member State in other Member State, after the establishment of the Single Market for insurance, has increased; however, the cross-border activity of insurance companies is still expressed in very low percentages primarily due to inability to provide uniform insurance services throughout the

European Union market (EC Press Release, 2013). The main reasons for this are the differences in contract law of Member States of the European Union, but also the differences in the taxation of insurance services and other reasons.

The insurance market in Croatia has a share of about 0.1% of total European premium and a 2011 premium totaled 9.15 billions HRK. Since 2009, total premiums in Croatia decreased as a consequence of the crisis; due to the increasing unemployment, lower disposable income of the households, but also because of the reduced level of confidence in the capital market and savings instruments. Immediately after the independence of the Republic of Croatia, only four insurance companies were operating on the Croatian insurance market. But the transition to a market economy and involvement in the process of globalization led to a strong growth of competition on the Croatian insurance market - since 1991 until today, the number of insurance companies almost septupled and now the Croatian insurance market counts 27 companies which employ about 11,000 employees. High globalization is certainly a characteristic of Croatian insurance market, with taking into account the fact that 15 insurance companies in Croatia are owned by foreign capital. Comparative review of insurance penetration data, which represents a share of gross written premium in the GDP, shows a significant lag of the Croatian insurance market in regard to European union, where insurance penetration averaged around 7,6%. In 2011 the insurance penetration was 2.68%, while the annual investments in the premium per capita of Croatian citizens totaled around EUR 285 (HRK 2,078). However, the present stakes are much higher than in countries that surround the Republic of Croatia to the east. It is noteworthy that developed countries and developed markets have a share of life insurance premium in total insurance premium above 50% (Jukić, 2009), while in Croatia the percentage is 26.59%. From all referenced above it can be concluded that although the Croatian insurance market is highly globalized, there is still room for development, particularly in the life insurance sector (HUO, 2012).

3. IMPLICATIONS

When accessing the European Union, future member states are obliged to harmonize its legislation with the EU legislation. The harmonization of the insurance sector is carried out in the regulation and liberalization of compulsory motor liability insurance, the capital adequacy requirements, which include the solvency margin and guarantee fund, and through restrictions on the assets covering technical provisions. In order to protect the interest of the insured, requirements have to be placed to ensure the financial stability of insurers and reinsurers, including requirements relating to good corporate governance and business practices. Harmonization of the regulatory and institutional framework with the *acquis communautaire* has been relatively painless, and the Croatian insurance market in this respect is fully compliant and ready to enter the European Union in July 2013 Provisions regarding life and nonlife insurance, in most part, have been transferred to the Croatian insurance law, and the remaining discrepancies with regard to the European Union directives on this issue were harmonized with the Croatian legislation in the 2008. The calculation method of the solvency margin of the insurance companies was harmonized in the 2008 with Directive 73/239/EEC and Directive 2002/13/EZ regarding non-life insurance and

Directive 2002/83/EC regarding life insurance. It was agreed during negotiations that the calculation method of the solvency margin will apply from the date of Croatian accession to the European Union (HANFA, 2011; Pregovaračko stajalište, 2007). The forthcoming implementation of the new legal framework "Solvency II" in the European Union raises the question of whether the Croatian insurance and reinsurance companies are ready for the new regulatory environment, upon entering the Single insurance market. For this purpose, the Croatian Agency for Supervision of Financial Services (HANFA), as a supervisory body for the insurance and reinsurance market in Croatia, together with the Croatian Insurance Bureau and the Croatian Actuarial Association formed a working group for the adequacy and solvency capital - Solvency II-HANFA-HUO-HAD, which aims to adopt the provisions of the "Solvency II" framework and to help insurance and reinsurance companies in the Republic of Croatia to adjust to the new rules of regulation. Quantitative Impact Study (QIS) in the Republic of Croatia was conducted in the period from October 2011 till May 2012 and the vast majority of participants of the QIS study reported that they are not fully prepared for the implementation of the "Solvency II" framework. According to data from the questionnaire, participants in majority feel that they don't have all the available resources and the implementation plan of the "Solvency II" framework is not yet completed (HANFA, 2012).

When a country joins the European Union, insurance market is liberalized in relation to other Member States. The Liberalization is based on the fundamental outline of the treaty establishing the European Union legislation in the field of insurance. Provision of insurance services in the European Union is based on the principle of free movement of services and the freedom of establishment which implies that insurance services are provided through the establishment of subsidiaries, branches or by direct provision of services. These freedoms are often jointly referred to as "Single European license (Wiesenewsky & Baier, 2009). Once the insurer was issued the aforementioned license, any additional permits or licenses are not necessary for the insurer to begin operating in another Member State of the European Union, although services and insurance products must comply with the requirements of the host country. On 1st of January 2008 in the Republic of Croatia, partial liberalization of the compulsory motor liability insurance market was realized, which meant that Croatian insurers had been allowed to use their own insurance terms and tariff systems instead of using common insurance terms and uniform tariffs, which had to be approved by the supervisory authority. However, this partial liberalization did not result in decrease or increase of compulsory motor liability insurance premiums, and there was no major changes in the insurance market. Croatian insurers did not start "price wars", and there were not any cases of unfair competition, thus the Croatian insurance market maintained a "status quo" even though the technical reserves were positive in the majority of insurance companies and there was some room for price reductions. With the accession of the Republic of Croatia to the European Union, full liberalization of the insurance market will be carried out, which is expected to strengthen the competition in the Croatian insurance market due to the arrival of new insurance providers, as well as other European agencies and brokers. Regarding competition issues on the Croatian insurance market, one must take into account the fact that Croatia is a very small market with only 4.4 million potential consumers and that all foreign insurance companies that want to do business on the Croatian market are already present. After the accession to the

European Union, minimum of the principal sum insured will increase, which means an increase in the upper limit of liability of the insurer responsible for one adverse event. There will be no real space for price drops in the short term, despite tougher competition and a possible price war. In the long term, introduction of new services and products is expected, as well as an improvement and expansion of existing services and products, especially in the compulsory motor liability insurance sector. One of the most significant changes in the 2013 on the Croatian insurance market is certainly aforementioned increase in the minimum of principal sum insured regarding compulsory motor liability insurance, even up to 10 times. It is an enormous one-time increase which is positive news for consumers,, but there is a possibility that some insurers will bear some consequences. New minimum of sum insured means increased outflow of domestic capital accumulation for reinsurance mainly to foreign reinsurers.

In the last decade, the number of insurance companies did not change significantly through numerous mergers and acquisitions that occurred on the Croatian insurance market and foreign capital slowly but steadily entered Croatian insurance companies. It is important to note that the number of insurance companies in the new EU Member states from the last two enlargements did not change significantly despite opposite trends in the rest of the European Union in the last decade (HANFA, 2011). Mergers and acquisitions did occur on insurance markets in the new EU Member States, but because of the increase of foreign owned insurance companies, the decrease in the overall number of companies did not happen. Therefore, it is safe to assume that there won't be any decreases in the number of insurance companies on the Croatian insurance market, although there are certain possibilities of mergers and acquisitions of smaller companies. Upon accession to the European Union, insurance markets in the new Member States achieved more consistent and transparent regulation of insurance activities, as well as supervision of the insurance sector. The existing potential for market growth improved, and the same can be expected on the insurance market in the Republic of Croatia, and lead to an even greater influx of foreign capital. Croatian insurers generally agree that Croatian accession to the European Union will have a positive impact through simpler operations, increase in the demand for insurance services, increase in total premiums, better risk management, introduction of new services and products and greater transparency. The greatest fears of Croatian insurers are the possibility of difficulties in business operations regarding "Solvency II" framework and dumping from the European Union insurance companies. Croatian insurers, at least in the foreseeable future, do not plan to expand into the Single Insurance Market of the European Union (Bertoncelj, 2011).

In most of the developed insurance markets of the European Union, the most dominant distribution channels are agencies and brokers regarding the non-life insurance sector. Bancassurance is the main distribution channel for life insurance products in many European countries. Given that insurance is largely distributed through direct writing in the Republic of Croatia, 40% of life insurance premiums and 74% of non-life insurance premiums, in accordance with European indicators it can be assumed that the accession of the Republic of Croatia to the European Union will strengthen the position of agencies and brokers as main distribution channel in the insurance market of Croatia. In addition, Croatian insurers will be faced with equalization of premiums in life and health insurance for men and women because of the ruling of the European Court of

Justice stating that differences in the premiums for men and women are discriminatory. According to the new European legislation, which has been implemented in the Member States by 21st of December 2012, after the Croatian accession to the European Union, men and women will pay the same premiums for all types of insurance services and products. Previous practice of determining risk by gender will not be allowed. Therefore, men will no longer pay a higher premium than women regarding life and health insurance because they could be defined as a "higher risk group". This will also result in life insurance premiums rise for women (Oxera, 2011). Before accession, Croatian insurers have to deal with preparations for higher competitiveness upon accession and focus their efforts on professionalization of business operations, especially in sales departments.

According to the difference in the penetration and density rates of insurance between the Republic of Croatia and EU average, it can be concluded that the Croatian insurance market has a potential for growth, especially in the life and health insurance sector. In fact, the population of the European Union is getting older, and the same demographic changes can be observed in the Republic of Croatia. An ageing population will definitely result in new opportunities for insurers, both in the European Union and the Republic of Croatia. However, the growth and development of the Croatian insurance market will definitely depend on the economic recovery and overcoming the crisis. Accession of the Republic of Croatia to the European Union should foster recovery of economic opportunities, new investments, overcoming the crisis, increase in the number of employees, increase in the standard of citizens and companies, which will ultimately affect the growth and development of the insurance market.

All the advantages of the Croatian accession to the European Union and of growing competition, as well as increased protection of the policyholders, consumers will be able to identify and use, assuming competent authorities will make an effort to increase the financial literacy of Croatian citizens, which is a basic requirement for citizens to know how to choose the right insurance product for themselves. Financial literacy and education is a fairly important issue in the European Union, so it is expected that the accession of the Republic of Croatia to the European Union will force Croatian national government and competent institutions to recognize the importance of investing in financial education and awareness of the need and importance of insurance. The European insurance sector recognizes the importance of financial education of consumers and strives toward awareness by supplying simple and user-friendly access to information that will equip them with basic knowledge about finance. Financial awareness allows consumers to develop skills and increases their self-confidence with regard to financial risk and their financial capabilities. The insurance sector in Europe raises financial awareness about insurance through public events, issuing, publications and brochures, conducting and publishing research and other studies and surveys, internet, consulting consumer services, media activities and campaigns and similar activities, and it is to assume that such and similar activities will be carried out in the Republic of Croatia. (CEA, 2011).

4. CONCLUSIONS

Accession of the Republic of Croatia to the European Union will have certain effects on the Croatian insurance market. These effects will primarily be evident in the increased protection of the policyholders and in the strengthening of the competition in the Croatian insurance market. The fact that over 50% of Croatian insurers has a foreign owner, and that they have been present in the Croatian insurance market for a number of years, indicates that the inevitable upcoming changes will not happen suddenly and quickly, but gradually. This opinion is supported by the experience regarding market of compulsory motor liability insurance, where after the partial liberalization of the Croatian market in 2008 the "price war" did not occur, instead Croatian insurers continued to apply previous insurance terms and tariff systems adopted by the Croatian Insurance Bureau and approved by the Croatian supervisory authority for financial services.

REFERENCES

- Bertoncelj, S., (2011), „Utjecaj ulaska RH u EU na tržište osiguranja – rezultati ankete“ [presentation], Dani hrvatskog osiguranja 2011, Rovinj, 13.-15. Novemember 2011, available at [<http://www.hgk.hr>][02.04.2013]
- CEA, (2011), „Financial Education and Awareness. European Insurance Industry Initiatives“, Brussels
- EC, (2013), The EU Single Market: Insurance and Occupational Pensions, [web page] available at [http://ec.europa.eu/internal_market/insurance/index_en.htm][02.04.2013]
- EC Press Release, (2013) available at [http://europa.eu/rapid/press-release_IP-13-74_en.htm][10.04.2013]
- HANFA, (2012), „Izveštaj O Provedenoj Studiji Kvantitativnih Utjecaja (Qis Studiji) Regulative Solvency II Društava Za Osiguranje I Društava Za Reosiguranje U Republici Hrvatskoj“, available at [<http://www.ripe.hanfa.hr/hr/vijesti/priopcenje-qis-studija>][10.03.2013]
- HUO, (2011), Tržište osiguranja u Republici Hrvatskoj“, Zagreb
- HANFA, (2011), „Analiza utjecaja ulaska Hrvatske u Europsku uniju na financijski sektor“, Zagreb, available at [http://www.ripe.hanfa.hr/repository_files/file/1304][10.03.2013]
- Insurance Europe (2013), „Statistics No.46: European Insurance in Figures“, Brussels
- Jukić, Ž., (2012), "Položaj životnih osiguranja u gospodarskom sustavu Republike Hrvatske" [presentation], Dani hrvatskog osiguranja 2009, Opatija, 9.-10. November 2009, available at [<http://www.institutzaosiguranje.hr/UserFiles/file/institut/.../ppt/Jukic.ppt>][02.04.2013]
- OXERA, (2011), The Impact of a Ban on the Use of Gender in Insurance, Brussels
- Sterzynski, M. (2003). „The European Single Insurance Market: Overview and impact of the liberalisation and deregulation processes“, Belgian Act. Bulletin, Vol.3, No.1, p. 42-59
- Swiss Re, (2011), World Insurance in 2011, Zurich
- The Geneva Association, (2012), “Social and Economic Value of Insurance”, Brussels
- Vlada RH (2007), „Pregovračko stajalište Republike Hrvatske za Međuvladinu konferenciju o pristupanju Republike Hrvatske Europskoj uniji za poglavlje 9. Financijske usluge“, available at [<http://www.mvep.hr/custompages/static/hrv/files/pregovori/4/09.pdf>][18.03.2013]
- Wiesenewsky, U.; Baier, M., (2009) „Easy Access to the European Insurance Market“, Emphasis, Vol. 3, XXX, Towers Perrin

Mirko Tatalović
Croatia Airlines, Zagreb, Croatia
Jasmin Bajić
Croatia Airlines, Zagreb, Croatia
Srećko Šimunović
Oil and Gas Consulting d.o.o., Zagreb, Croatia

FITTING THE FLEET AND THE SERVICE TO THE SEE MARKET DEMAND FUTURE OF SMALL EUROPEAN AIRLINES

ABSTRACT

Airline management teams are facing the challenges of highest degree. The liberalization and increasing competition of the air transport market mainly in Europe made the environment for surviving models of cooperation. How to survive within aviation powerful industry? Small European airlines should start to create new integration processes which include regional cooperation and better position of niche player. Examples of mergers of large airline in the world and Europe point to the same or a similar business strategy. Air traffic market of the Southeast Europe is however undeveloped with insufficient traffic network. Wider flight network within the region would increase economic activities level among the regional countries, economic development and progress, political stability and continuation of the European integrations. Croatia Airlines development strategy should consider and analyses merging possibilities under the new concept of aviation value chain harmonization. Network, fleet structure and frequency optimization are key words in improvement of performance indicators. These activities with successful implementation to facilitate effective regional cooperation are crucial for airlines survival strategy.

Keywords: *airlines, survival strategy, merging, regional cooperation, Croatia Airlines*

JEL classification: *F15*

1. INTRODUCTION

Air transport is one of the most global industries, which in the last two decades is undergoing major challenges of liberalization and increasing competition. In existing airline industry competitive landscape increasing revenues and customer satisfaction together with reducing costs are the main management activities for sustainable business in the future. Such environment has created the needs for new models of cooperation, mainly in United States and European Union, but they are increasingly

present in other world markets. Aviation's global economic impact is estimated to 7.5% of the world Gross Domestic Product. Worldwide commercial airlines transported in the period 2001 – 2012 more than 27 billion passengers (almost 2.3 billion average per annum), generating at the same time net losses of 17 billion US\$ (62 US cents per passenger).

Many national airlines in Europe, including Croatia Airlines are in crisis followed by the same processes in economic, political and financial framework. Some of airlines join alliances trying to promote and increase network strengths. But that was not enough with complexity of cost structure and rising kerosene prices simultaneously with the rising low cost market competition.

In the Southeast Europe all leading European air carriers are already present in the region including low cost carriers. Connections within the region are on very low level and improvements are possible with intensive introduction of regional aircraft (approx. 70-100 seats). At the same time national air carriers need to provide and realize restructuring and privatization processes.

Airline merging possibilities in the region should consider potentials of network, fleet structure, frequency optimization, cost savings, revenue improvement and enhancing the customer experience. Such approach is crucial assumption for surviving on the air transport market.

2. AIRLINE MERGERS AND ACQUISITION TRENDS

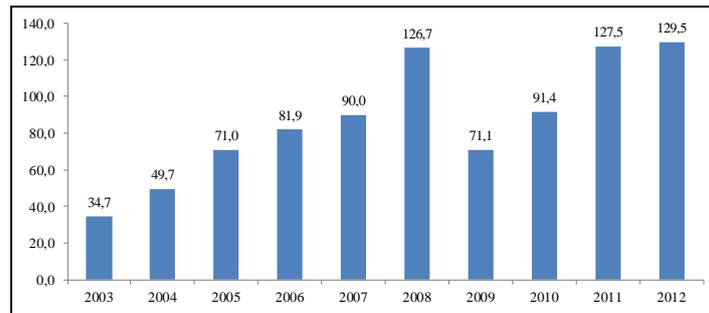
In IATA⁵ Clearing House Member Report for March 2013 overall 44 air carriers from 491 IATA Airline Members and Airline Associates **are suspended** (IATA CH 2013). Air transport cyclical downturns have always been linked to economic cycles, but at times this has also been affected by other significant factors, most notably several oil crisis, Gulf war crisis and Asian crisis. In the new century it was followed by WTC attack (9/11) and SARS (Tatalović, M. et.al 2012: 62). In the period 2008-2009 global economy and consumer confidence have been severely affected by the events in the world's banking community and stock markets, including the knock-on effects of the restriction of finance - the so called "credit crunch" (Mišetić, I. et.al 2010: 30). Inadequate profitability will continue to be inherent in the airline industry because of the ease with which airlines can continue to add additional capacity and because of the failure of many loss-making airlines to exit the market quickly (Doganis, R. 2010: 324).

The key generator of changing aviation strategies are fuel prices trend. In last ten years (2003-2012) total fuel expenses increased from 44 billion US\$ to 209 billion US\$ (Index 475). Traffic increase was, of course, part of explanation but in the structure of airline expenses fuel increased from 14 to 33 percent. At the same time non-fuel airline unit costs stagnated – average annual growing rate was only 0.64 percent (IATA 2013:4).

⁵ IATA – International Air Transport Association

Jet kerosene prices in the year 2012 were on the highest level ever in the history of civil aviation. In last decade kerosene price increased 3.7 times (Figure 1).

Figure 1: Jet kerosene prices 2003 – 2012 in US\$/barrel



Source: Prepared by authors from <http://www.iata.org/whatwedo/Documents/economics/industry-outlook-financial-forecast-march-2013.pdf> (Updated, March 30 2013).

Barring government intervention, the airline industry can expect a vastly changed landscape with mergers on the rise. Pro-merger advocates argue consolidation through mergers is inevitable for an industry that can't get to sustained profitability even after more than a decade of cost slashing, capacity cutting and postponing investments in aircraft, facilities and other expenditures. **No other industry is so fragmented**, and the ways to build more efficiency are mergers and consolidation (Clark, L. 2010: 32-35).

In airline industry there are lot of mergers and acquisition examples from American model (Delta + Northwest, keeping **Delta** brand; United + Continental, keeping **United** brand; American Airlines + US Airways, keeping **American Airlines** brand) to **European model** which assumed **keeping the national identity brand of all integrated partners**:

- Air France / KLM;
- International Airlines Group (IAG) – British Airways & Iberia;
- Lufthansa Passenger Airline Group – Lufthansa & Swiss & Austrian Airlines & Brussels Airlines & Germanwings...

There is also example of South American carriers LAN and TAM (Latam Airlines Group), even low cost carriers in North America are in merging process (Southwest Airlines & AirTran Airways).

Industry downturns can present a particularly intense challenge to airline managements needing to balance the four elements in the operating performance model: traffic, yield, output and unit cost (Holloway, S. 2010: 539). The main benefits for merged airlines arising from reduced redundancies within the organization, increase of service efficiency, fleet and network restructuring and joined initiatives for cost and revenue optimization. All those benefits are going in the direction of increasing competitiveness for future market positioning. Obviously small and regional carriers should also reconsider their business strategy towards mergers and acquisition trends.

3. EUROPEAN REGIONAL CARRIERS

Mergers of the leading players on European air transport market and strengthen their role in airline alliances, followed by expansion of low cost carriers, significantly changed competition environment. In the European air transport liberalization processes the biggest carriers (Lufthansa, British Airways, Air France, KLM, Iberia, Alitalia...) are recapitalized and privatized and keep their slots on the biggest European airport hubs (Tatalović, M. et.al 2012: 228). Thus their retain control over the market and profit potentials on the most important route areas (e.g. North Atlantic). In principle European Airline landscape can be divided in three categories (Figure 2).

Figure 2: European Airline Landscape in the Year 2012

Mergers, Acquisition...	State Aid / Restructuring	Bankrupt
<ul style="list-style-type: none"> • Air France & KLM • British Airways & Iberia • Lufthansa (+ Austrian Airlines, Swiss, Brussels Airlines, Germanwings...) • Optimizing flights network and reducing the number of employees 	<ul style="list-style-type: none"> • Czech Airlines • Air Malta • LOT • SAS • Adria Airways • Croatia Airlines • Air Baltic • Estonian • JAT • Montenegro Airlines • • The search for a strategic partner 	<ul style="list-style-type: none"> • Malev • Spanair •

Source: Prepared by authors

European national carriers had to find their role in a liberalized European airline market. It is necessary to have in mind that transitional economies are converting in regional economic periphery (Sundać, D., Nikolovska, N. 2003: 65). The smaller European airlines are largely acting as feeder carrier for their Alliance partners, (Adria Airways, Croatia Airlines, LOT are part of the Star Alliance, Malev was Oneworld member, Czech Airlines Skyteam member...) rather than operating an independent hub-and-spoke⁶ network and taking in account that the development of hub and spoke network was based on providing maximum O&D⁷ coverage with limited number of flight legs (Jacobs, T.L. et. al 2012: 36). It is not clear whether this represents the optimal business model for the carriers. The question is can each national carrier create a solid hub that feeds passengers to onward connections. The carrier cannot completely focus on this goal, while at the same time feeding traffic to major alliance partners. While national airlines benefits from attachment to a recognizable brand, shared use of

⁶ In air transport "Hub and spoke" term describes a common method for an airline to organize their network connecting hub with non-hub cities.

⁷ O&D - Origin and destination market is defined by the passenger point of entry/exit from the airline system.

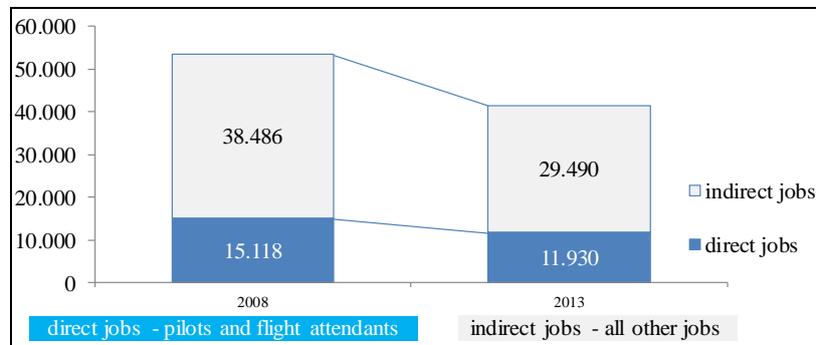
resources, it effectively sacrifices a degree of independence in return. At the basic level, the three alternatives to the current situation would be (Müller, J. Bilotkach, V. 2011):

- More independent position within an Alliance may allow ad hoc code sharing with carriers independent of the current Alliance;
- Changing the alliance affiliation;
- Operating independently, entering into ad hoc code sharing partnerships (few carriers in the region follow this strategy (Ukraine International Airlines, Aerosvit).

One third of all regional carriers in Europe⁸ went out of business between 2008 and 2013 nearly one fourth of the employees lost their jobs. The results are quite frightening: 44 new airlines were founded from 2008 on, 22 of them have already vanished (Schaal, H., Oldorf, M. 2013: 1). At the same time in 2008, 706 aircraft with 20-50 seats were operated by European regionals. Within five years, this number decreased by 53.26 percent to 330. There was also a decrease in the number of aircraft with less than 19 seats (by 13.79 percent) and only the number of aircrafts with capacity 50-100 seats increased by 3.37 percent (from 682 to 705). In summary, a trend away from aircraft with fewer than 50 seats towards aircraft with 50-100 seats is evident (Schaal, H., Oldorf, M. 2013: 5).

The victims of the aviation market reality are employees (Figure 2) showing that over the last five years seven jobs were lost every day (Schaal, H., Oldorf, M. 2013: 7).

Figure 3: Number of employees at European regional airlines 2008 vs. 2013



Source: Prepared by authors from http://www.prologis.aero/fileadmin/data/pdf/PDFs/Are_European_Regional_Successful_Days_Numbered.pdf Updated March, 30 2013

European Commission has defined procedures relating to the implementation of competition policy – examples Czech Airlines and Air Malta.

ČSA Czech Airlines (net losses 2008-2011: -352.3 million US\$): The total notified restructuring aid measures were (i) a CZK 2,500 million loan by the State-owned company Osinek; (ii) the de-collateralization and a debt-to-equity swap of the Osinek

⁸ According to Prologis research including all European Union member states plus 11 non EU states

loan; and (iii) a guaranteed bank credit in the amount of EUR 20.8 million to finance the acquisition of an airplane. The total notified envisaged restructuring costs amount to EUR 360-410 million. The aircraft fleet should be reduced by more than 50%, resulting in 20 to 23 aircraft as opposed to 49 aircraft before restructuring. The overall number of flights will be reduced by 36-40% and ASK by 21-24%. Consequently the seat-load factor should improve and reach 66-73% under the base case scenario. Moreover, ČSA offered to eliminate or reduce its capacity on 16 profitable routes in order to compensate its competitors. Upon completion of the restructuring process, the Czech Republic aims at finding a strategic partner for ČSA. The current timeframe for the entry of a strategic investor in ČSA is November 2013, at the latest. In preparation for the planned privatization, the Czech Government decided to create a new corporate structure under the umbrella of Český Aeroholding⁹ (European Commission No. SA.30908, 2012: 3-26).

Air Malta (net losses 2007-2011: -67.2 million US\$): The Commission authorised rescue aid to Air Malta of EUR 52 million on 15 November 2010 (N 504/10). On 16 May 2011, Malta notified a restructuring plan to the Commission containing restructuring aid in the form of a capital injection amounting to EUR 130 million, including a debt-to-equity swap of the approved rescue loan of EUR 52 million. Air Malta will raise 45.5% of a total restructuring funding requirement of EUR 238 million as own contribution through the sale of land, subsidiaries and other assets. The restructuring plan covers a five year restructuring period from 2011 to 2016 aiming to restore Air Malta's long-term viability by 2016 by implementing several cost and revenue initiatives. As compensatory measures for possible distortion of competition, Air Malta offers inter alia an overall capacity reduction of 20% including surrender of certain profitable or potential profitable routes (European Commission No. SA.33015, 2012: C 50/7).

Other European regional air carriers are also facing significant net losses and privatization attempts followed by restructuring programs and many examples (IATA WATS and ATW 2012 World Airline Report):

- LOT Polish Airlines 2008-2011: -450.3 million US\$ net losses. Poland's Government owns 93% of LOT. In April 2013 in announced restructuring process and privatization predicts cutting staff number for 30%, reducing the fleet from 40 to 25 aircraft. LOT already received 127 million US\$ of emergency financial support in 2012.
- Alitalia net losses 2009-2011: -775.7 million US\$ US\$.
- Aerosvit - Ukraine net losses 2008-2011: -362.6 million US\$.
- Ukraine International net losses 2008-2011: -71.4 million US\$.
- Blue 1 net losses 2008-2011: -172.3 million US\$.
- Malev net losses 2008-2010: -322.2 million US\$ and bankrupt at the beginning of the year 2012.
- Air Baltic Two dominant shareholders Latvian Government and Baltic Aviation System injected 202 million US\$ in 2011. but the company is still in trouble

⁹ Český Aeroholding (ČAH) currently includes the following companies: ČSA, Prague Airport, and ČSA's former subsidiaries, i.e. Czech Airlines Handling, HOLIDAYS Czech Airlines, Czech Airlines Technics, and ČSA Services.

- Cyprus net losses 2008-2012: -82.6 EUR. European antitrust regulators are investigating about 104.3 million EUR of illegally financial support that company received in the year 2011 plus 20 million EUR of financial state aid. According to the recently news there are three possible scenarios for the year 2013: (i) Shut down the company immediately, (ii) Continue the operations during the summer season, (iii) Restructuring the company according to the program of 560 job cuts, fleet reduction from 11 to 6+1 aircraft and 83.2 million EUR of financial aid.

Such examples show that airline consolidation processes reduces capacity, the number of competitors and the capital employed in the sector. With less seats and competition, pricing should improve (Jonas, D. 2010). Airlines in difficulties in all European regions are seeking for appropriate adjustments that will ensure sustainable future business.

4. SOUTHEAST EUROPE REGIONAL AIRLINES

In the SEE region recent scientific papers are showing a lot of similar difficulties described in the previous chapters. Air traffic market analyses offer the following suggestions (Misetić, I. et.al 2009: 263):

- Connections with main European destinations are dominant in the region;
- LCC are more and more coming but also with dominant connection to the most developed European markets. In the expansion financing of LCC carriers in Europe some airports have taken part (various concessions), regions (direct or indirect “subventions”) and other subjects obtaining through the so increased transport effects level some positive economic and social benefits;
- The undeveloped network within the region is real fact – approximately 10% of existing routes (Steiner, S. et. al 2009: 551);
- Due to demand level, connection within the region is possible with regional aircraft (approx. 50-100 seats), with indispensable relationship of national air carriers, as a first step to provide and realize privatization process for some of the most successful air carriers;
- Possible implementation of PSO¹⁰ within the region would increase economic activities level among the regional countries, economic development and progress, political stability, continuation of the European integrations.

Actual realities for airlines in the region are losses and restructuring activities shown below (IATA WATS and ATW 2012 World Airline Report):

- Adria Airways net losses 2008-2011 million – 123.2 million US\$. European Commission opens in-depth investigation about four capital injections between 2007 and 2011 amounting to around 85.5 million EUR (EC Competition 2012: 1).
- Croatia Airlines net losses 2008-2011 – 96.3 million US\$.
- JAT net losses 2008-2011: 106.8 million US\$.
- Tarom net losses 2008-2011: -248.3 million US\$.
- BH Airlines net losses 2008-2011: -60.7 million US\$.
- Montenegro Airlines net losses 2009-2011: - 20.3 million US\$.

¹⁰ PSO – Public Service Obligation

- Dubrovnik Airlines net losses 2008-2010: -10,6 million US\$ (Bankrupt in 2011)
- MAT Macedonian Airlines (Bankrupt in 2009).

Relatively good result after integration of Hemus Air and Viaggio Air and modernization of the fleet (3 A319, 1 A320 and 4 ERJ 190) achieved Bulgaria Air with net loss in the period 2007-2011 of only 5,9 million US\$ and three consecutive years with marginal positive profitability. Similar results (or lack of proper information) achieved Moldavian Airlines (-2.5 million US\$ net loss in 2009-2010) and Air Moldova.

Obviously poor airlines financial performances are happening also in the Southeast Europe region similar like in the rest of Europe.

5. CROATIA AIRLINES

The airline is largely acting as a feeder carrier for its Star Alliance partners, most notably Lufthansa. Existing fleet structure is suboptimal, as evidenced by the low load factors and in the longer term, more emphasis should be placed on smaller sized aircraft. Croatia Airlines is a small carrier, which is rather niche positioned to compete in the global airline market. Airline uses its partnership with Star Alliance partly as a way to survive by attaching itself to a major player on the global airline market, but is losing market share and has not achieved a profitable strategy after the recent financial crisis. In order to compete profitably, the **main problems** seem to be the **current scheduling structure** and the **fleet mix**. (Müller, J., Bilotkach, V. 2011) Croatia Airlines is providing rationalization of the fleet through smaller aircrafts (Dash 8 Q 400), to provide more efficient frequent services.

The crucial issue for the Croatia Airlines success is turning Zagreb into a more solid hub that feeds passengers to onward connections. The carrier cannot completely focus on this goal, while at the same time feeding traffic to major Star Alliance partners. At the basic level, the four alternatives to the current situation would be:

- More independent position within the Star Alliance;
- Changing the alliance affiliation;
- Operating independently, entering into ad hoc code sharing partnerships;
- Merger processes with complementary airlines in the region.

The first options appear the most appealing but could be optimized with simultaneous implementation of merger and integration activities. Changing the alliance affiliation does not appear to make sense due to the geographical location of Zagreb relative to the main hub airports on the continent (Müller, J. Bilotkach, V. 2011). At the same time, more independent position within the existing alliance may allow ad hoc code sharing with carriers independent of Star Alliance, which is not significant improvement indicator of success.

Croatia Airlines is in restructuring program relates to period 2011-2015 with two additional years. Based on Government decision from December, 20 2012 the issued capital of the company has been increased by the 862 million HRK. Restructuring

program shows the validity of state aid in total amount of 1,097 million HRK, which have to be approved by Croatian Competition Agency and Government. The principles of the European State Aid regulation (ČSA and Air Malta cases) will be also implemented. Consistent application of all elements of the restructuring program will enable airline to insure the viability of the future operations.

6. REGIONAL COOPERATION AND MERGERS

Following the breakup of Yugoslavia, several national carriers were created with relatively poor financial and traffic performance. In last twenty years these new airlines did not find their role in the European aviation market. Only five of those carriers survived, but all of them are deeply in restructuring processes with questionable market strategy and uncertain future. In the meantime several airlines have gone bankrupt: MAT Macedonian Airlines, Avioimpex – Skopje, Air Adriatic – Rijeka, Dubrovnik Airline, Air Bosna- Sarajevo and Air Srpska – Banja Luka...

Five existing airlines generated in the period 2008-2011 net losses over 400 million US\$.¹¹ Hub and spoke strategic approach in the region was implemented by Croatia Airlines (Zagreb hub), Adria Airways (Ljubljana hub) and Jat Airways (Beograd hub).

Similar strategy approach was implemented by the Austran Airlines, Czech Airlines and Malev, connecting airports in the region via their hubs (Vienna, Prague and Budapest) to the rest of the flight network. Described business strategy failed with increasing financial losses. Malev have gone bankrupt, Czech Airlines withdrawn from the region and Austrian restructure and reduce number of frequencies to/from region.

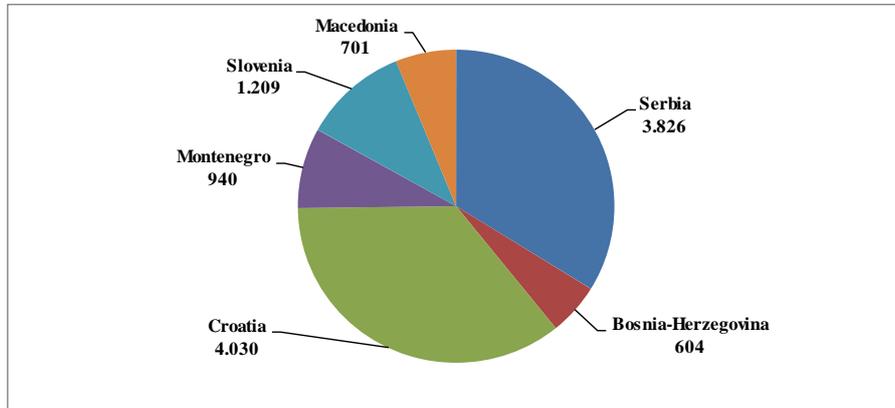
Vasigh research shows that empirical evidence indicates that the airline industry may be contestable when viewed as a network and may be even be that increased concentration and cooperation through mergers and alliances can benefit consumers, primarily through economies of scale, and return the airline industry to a reasonable level of long-run profits. Mergers may increase efficiency and reduce prices through economies of scale, scope and density impact (Vasigh, B. et.al 2010: 205-236).

So, what is the future for small regional European airlines?

First of all it should be noted that the international scheduled market size in the region (ex-Yugoslavia) was 11.3 million passengers in 2011 (Figure 4) (IATA 2012).

¹¹ Including the year 2012 the losses will be increased at least for 100 million US\$ - authors estimation

Figure 4: International Scheduled Passengers Carried Structure in the Region Countries – 2011 (in thousands)



Source: Prepared by authors according to IATA (2012) Airline Industry Forecast 2012-201, Montreal-Geneva.

But, only 8.2 percent of passengers (930 thousand) of the total sample are traveling within the region. Similar result (namely 10.1 percent) was achieved in research of destinations and frequencies within the Southeast Europe in the year 2008 (Misetic, I. et al: 261).

IATA Passenger Forecast 2012-2016 predicts average annual growth rate for the region countries of 6.3 percent. Same forecast for the route area within Europe are on the level of 4.0 percent (IATA 2012: 57).

How to create sustainable role for the small regional national carriers in the context of predicted more intensive growth on the regional air transport market?

What are appropriate strategy under the unfavorable political, economic, market and operational threats and obstacles?

From the fleet structure point of view it is visible that five analyzed airlines dispose with 50 aircraft, 9 aircraft types and 11 seat configurations (Table 1).

Table 1: Fleet Structure of Selected Regional Carriers 2012

Adria Airways	Operating 13 aircraft: 1 Airbus A320 (180 seats), 2 Airbus A319 (135 seats), 4 Canadair Regional Jet CRJ900 (86 seats), 6 Canadair Regional Jet CRJ200 (48 seats).
BH Airlines	Operating 2 aircraft: 2 ATR 72 (66 seats),
Croatia Airlines	Operating 13 aircraft: 3 Airbus A320 (162 seats), 4 Airbus A319 (144 seats), 6 Dash 8 Q 400 (76 seats),
Jat Airways	Operating 14 aircraft: 10 Boeing 737-300 (124 seats), 4 ATR 72 (66 seats),
Montenegro Airlines	Operating 8 aircraft: 5 Fokker 100 (102 seats), 3 Embraer 195 (116 seats),
	 
Recap	5 Airlines 50 Aircraft 9 Aircraft Types 11 Seat Configurations
Seat configuration: 48	- 66 - 76 - 86 - 102 - 116 - 124 - 135 - 144 - 162 - 180

Source: According to the presentation Tatalović, M., Bajić, J.: Fitting the Fleet and the service to the market demand Croatia Airlines Challenges on Southeast Europe Market, Airline Business Seminar Eastern Europe & Central Asia - Istanbul May 30th 2012.

It should be emphasized that such fleet structure is a big obstacle for the possible merging process since results with potential negative cost drivers, particularly on the maintenance and financial sides. All carriers are in search of a strategic partner for possible privatization and recapitalization.

In spite of that fact building the integration process should be considered in a few phases. First phase could consist of:

- Implementation of individual airline restructuring - clean start for all players (all are under the threat of bankruptcy);
- Selection of similar or same characteristics of the business model implementation (Adria Airways and Croatia Airlines as Star Alliance members and EU community carriers from July 2013);
- Adria Airways and Croatia Airlines fleet, network and schedule structure rationalization and harmonization – mainly Ljubljana and Zagreb;
- Reducing redundancies in maintenance, sales, promotion, pricing, revenue management and administration business functions;
- Possible capital merger modeled on presumption of keeping the national identity brand (e.g. International Airlines Group (IAG) – British Airways & Iberia)

- Shares offer on the capital market...

Second phase could consist of spreading the integration to Montenegro Airlines with repeating the business steps defined in first phase. Particularly mentioning the fleet, network and schedule structure rationalization and harmonization it is devoted to Podgorica / Tivat vs. Dubrovnik/Split combination.

Third phase could include also other players on the air transport market according to defined rules and processes.

It should be also emphasizes that the airline profitability is a function of the collective strength of the *Five Forces* (Bargaining Power of Suppliers, Rivalry Among Competitors, Bargaining Power of Buyers, Bargaining Power of Channels, Threat of Substitute Products and New Entrants), as well as the interaction among them. These forces shape the behavior of the actors and determine both the overall value created in the industry and the way in which this value is divided among them.

Creating a stronger airline and improving regional cooperation is obviously only surviving and sustainable model that can attract the possible investors, with appropriate benefits for the airlines and states in the region.

7. CONCLUSIONS

Survival of Southeast Europe airlines is directly related to the cooperation between the existing players.

Consequently reducing capacity and the capital employed leads to consolidation in the sector. Through mergers can benefit consumers, primarily through economies of scale, and return the regional airline industry to a reasonable level of long-run profits and create a sustainable basis for the privatization.

Fitting the fleet and service to the regional air transport market must include and harmonize production, environmental, financial, strategic development and human resources policies, as necessary preconditions for sustainable business.

It is necessary to understand the importance of merging and integration processes as a crucial management challenge of highest degree. Such approach could be confirmation of survival and future for small European airlines.

Croatia Airlines development strategy should consider and analyses merging possibilities under the new concept of aviation value chain harmonization.

REFERENCES

ATW (2012), World Airline Report July 2012, The Magazine of Global Airline Management, Air Transport World, Skokie.

- Clark, L. (2010), *The New Normal Ascend Magazine 2010, Issue No2*, Ascend, Southlake.
- Doganis, R. (2010), *Flying off Course Fourth Edition*, Routledge, Abingdon.
- EC Competition (2012), *State Aid Weekly e-News No 40/12*, November 23 2012, http://ec.europa.eu/competition/state_aid/newsletter/23112012.pdf, (Updated, March 30 2013).
- European Commission No. SA.30908 (2012), http://ec.europa.eu/competition/state_aid/cases/239781/239781_1369871_444_3.pdf, (Updated, March 30 2013).
- European Commission No. SA.33015 (2012), <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2012:050:0007:0021:EN:PDF>, (Updated, March 30 2013).
- Halloway, S. (2010), *Straight and Level Practical Airline Economics*, Third Edition, Ashgate, Farnham.
- IATA (2011), *IATA Vision 2050*, Montreal.
- IATA (2013), *Industry Outlook 2013 03*, <http://www.iata.org/whatwedo/Documents/economics/industry-outlook-financial-forecast-march-2013.pdf> (Updated, March 30 2013).
- IATA CH (2013), *IATA Clearing House Member Report*, <http://www.iata.org/services/finance/clearinghouse/Documents/ich-member-list.pdf>, (Updated, March 30 2013).
- IATA WATS (2012), *World Air Transport Statistics (WATS 56)*, Montreal.
- Jacobs, T.L. et.al (2012), *Airline Planning and Schedule, Quantitative Problem Solving Methods in the Airline Industry*, Barnhart, C., Smith, B.C. (editors), Springer, New York.
- Jonas, D. (2010), *Airline Mergers And Alliances: Consolidation, Antitrust Immunity Alter Corporate Contracting*, <http://www.businesstravelnews.com>, June 10, 2010 (Updated, March 30 2013).
- Mišetić, I., Tatalović, M., Bajić, J. (2010), *An Enterprise Odyssey: From Crisis to Prosperity – Challenges for Government and Business*, Opatija, May 26 – 29 2010, University of Zagreb, Faculty of Economic & Business, Zagreb, 30-31.
- Mišetić, I., Tatalović, M., Bajić, J. (2009), *Public Service Obligation Model on European Southeast Air Transport Market*, *Proceedings from the Third International Conference Regional Cooperation and Economic Integration Challenges and Opportunities*, Kikerkova, I. (editor), Skopje, 251-264.
- Müller, J. Bilotkach, V. (2011), *Proposal for a Panel at the Conference on Competition and Regulation of Network Industries, Eastern European Flag Carriers in the Global Airline Industry*, 25 November 2011 Brussels, Belgium.
- Schaal, H., Oldorf, M. (2013), *Are European Reegionals' Successful Days Numbered? Prologis AG & ch-aviation GmbH*, https://www.ch-aviation.ch/static/blog/2013_03_19_Are_European_Regional_Successful_Days_Numbered.pdf, (Updated, March 30 2013).
- Sundać, D., Nikolovska, N. (2003), *Scenarij za ekonomski slom zemalja u tranziciji*, International Business Consulting Center d.o.o., Rijeka.
- Steiner, S., Tatalovic, M., Bajić, J., (2010), *Competition and Cooperation on European Southeast Air Transport Market, Economic integrations, competition and cooperation*, Research monograph, Kandzija, V., Kumar, A. (editors), University of Rijeka, Faculty of Economics, Rijeka, 534-552.
- Šimunović, S., Tatalović, M., Bajić, J. (2011): *Global Airline Alliances In The Light Of Economic Integrations – Croatia Airlines Challenges*, Economic integration, competition and cooperation, University of Rijeka Faculty of Economics, Opatija.
- Tatalović, M., Bajić, J. (2012), *Fitting the Fleet and the service to the market demand - Croatia Airlines Challenges on Southeast Europe Market*, Airline Business Seminar Eastern Europe & Central Asia - Istanbul May 30th 2012.
- Vasigh, B., Fleming, K., Tacker, T. (2010), *Introduction to Air Transport Economics*, Ashgate, Farnham.

PART VI

LA THÉORIE ET LA
PRATIQUE DE
L'INTÉGRATION
ÉCONOMIQUE

Maria Negreponi-Delivanis
CEDIMES Komotini, Grèce

LA FIN DE LA ZONE EURO : LE NORD DE L'EUROPE CONTRE SON SUD

RESUME

Le fossé se creuse de plus en plus entre le Nord riche de l'Europe et le Sud, pauvre et surendetté, ne laissant aucun espoir de rapprochement. Il s'agit d'un conflit terrible et original dans sa forme, sans armes de destruction massive mais dont les moyens s'avèrent plus drastiques, plus efficaces et plus délétères que les armes traditionnelles. L'Europe du Sud, est victime volontaire d'une union économique dont les lignes directrices avaient été tracées, dès le début, pour servir avant tout ses partenaires les plus puissants. La cure imposée aux économies du Sud pour faire face à l'endettement, soit celle de la dévaluation interne est une « première mondiale » et a des conséquences dramatiques pour les économies qui la subissent. Ce qui est pire, à cause de la profonde récession provoquée ainsi, la dette, comme pourcentage dans le PIB augmente au lieu de diminuer. La destruction de la Grèce et de l'Europe du Sud en général met aussi en danger la survivance de l'Europe du moins, telle que nous la connaissons, tandis que dans ce contexte l'euro devient facteur qui menace la démocratie dans la zone euro. La survie de l'UE a besoin des chefs d'Etat illuminés ainsi que des réformes fondamentales pour qu'elle retrouve ses valeurs qu'elles fussent les fondements de sa création.

Mots-clés: récession, la dette, la Grèce et de l'Europe du Sud

JEL Classification : G01, H6

1. INTRODUCTION

La dégradation en chaîne de la situation au sein de la zone euro, ces deux dernières années et plus encore ces derniers mois, ne permet plus d'occulter la terrible réalité. Le fossé se creuse de plus en plus entre le Nord riche de l'Europe et le Sud, pauvre et surendetté et ne laisse plus aucun espoir de rapprochement. En cause, la rudesse avec laquelle la Commission Européenne a entrepris d'affronter le problème des économies endettées qui révèle surtout l'absence totale de toute forme de cohésion et de solidarité entre les Etats-membres. Mais plus triste encore, c'est d'avoir cru qu'un tel projet était possible. L'enthousiasme des années 50 et 60, surtout chez les jeunes, pour une Europe des peuples unie, et toutes ces belles promesses autour de sa création, tout cela n'était soutenu par aucune base solide. C'était en fait une façon séduisante de détourner les populations de la vraie visée des principaux artisans de l'Union lesquels, notons-le,

étaient de même nationalité que leurs successeurs d'aujourd'hui. Ainsi l'Allemagne, qui voyait dans l'Union Européenne la concrétisation enfin de son rêve ; ce rêve qui avait échoué à deux reprises, à savoir la domination de l'Europe. Ainsi, la réunification allemande¹ ne se fit pas sans concessions puisqu'il lui fallut abandonner le Mark en échange de la monnaie unique. Quant à la France, l'autre pays à l'origine de la création de l'Europe unie, ses préoccupations étaient dès le début - et continuent d'être - de moindre envergure. Ce qu'elle voulait, c'était juste s'assurer une position stable de leader en Europe. Or, la France a un problème, qui explique en partie sa totale identification aux choix de l'Allemagne², c'est sa position géographique. Mais, que son économie appartienne à l'Europe du Sud ou à l'Europe du Nord, son désir ardent est de faire partie de celle du Nord.

La situation toutefois n'était peut-être pas aussi cynique dans les premiers temps. Les fondateurs de l'Union Européenne avaient probablement les meilleures intentions et ils croyaient même l'accomplissement de leur projet possible. Pour ma part, je veux croire que les pères de l'Europe³ s'étaient démenés pour y garantir paix, démocratie, égalité, prospérité pour tous, croissance rapide et plein emploi, et qu'ils seraient atterrés de voir comment leur œuvre grandiose a dégénéré⁴. Ils verraient avec effroi que non seulement leur projet initial ne s'est pas concrétisé, mais qu'en plus une guerre larvée et ravageuse sévit en son sein, entre le Nord et le Sud. Un conflit terrible et original dans sa forme, sans armes de destruction massive mais dont les moyens s'avèrent plus drastiques, plus efficaces et plus délétères que les armes traditionnelles⁵. En effet, l'Allemagne, utilisant comme cheval de Troie la dette du Sud, semble être entrée dans la phase accélérée de concrétisation d'un plan d'assujettissement du Sud, nouveau type de colonisation, et dont elle serait le chef incontestable. En dehors des vues ostensiblement expansionnistes de l'Allemagne, ce projet démoniaque trouve un appui dans l'évolution rapide de l'économie mondiale qui menace de marginaliser l'Europe et l'Occident tout entier. Il s'agit surtout de la concurrence intensifiée avec les économies émergentes, notamment la Chine. Il s'agit de la compétitivité de l'Allemagne⁶, sérieusement mise à mal et qui pour s'en sortir a besoin, semble-t-il, de main d'œuvre

¹ D'après le célèbre économiste Max Keiser, comme on a pu récemment le constater dans le journal télévisé de la chaîne satellite *Russia Today*

² Du moins sous la présidence de Nicolas Sarkozy

³ L'acte fondateur de l'Union européenne est la *Déclaration du 9 mai 1950* de Robert Schuman, ministre français des Affaires Etrangères. Sous l'impulsion de personnalités politiques surnommées « Pères de l'Europe », comme Konrad Adenauer, Jean Monnet et Alcide de Gasperi, six États créent en 1951 la Communauté européenne du charbon et de l'acier. Après l'échec d'une Communauté européenne de défense en 1954, une Communauté économique européenne est instaurée en 1957 par le traité de Rome. La coopération économique est approfondie par l'Acte unique européen en 1986 (Wikipedia)

⁴ Je fus parmi les premiers étudiants à participer aux rassemblements du début, en Hollande, dans les années 60 en faveur de l'Europe unie.

⁵ L'actualité de l'article paru dans *Eleftherotypia* il y a 17 ans, daté du 9 septembre 1995 et signé MAR. POL, fait froid dans le dos : « Les peuples oublient vite, déclarait un haut responsable Nazi il y a 50 ans. C'est d'ailleurs ce qui les différencie d'une nation qui entretient le souvenir, comme la race supérieure allemande. L'Allemagne recevra beaucoup d'argent pour sa reconstruction, et même ceux qui jusqu'ici nous ont combattus viendront travailler pour nous. Nous sommes une race travailleuse et nous allons recréer l'Allemagne puissante et unie. Vous verrez que nous deviendrons le pays le plus fort économiquement. Et alors, Goebbels se réveillera et de sa tombe il s'exclamera: Nous avons gagné ! »

⁶ L'agence indépendante de notation *Egan Jones* vient d'abaisser la note de l'Allemagne de A + à AA – estimant que l'intensification de la crise de la dette dans la zone euro touchera les exportations allemandes.

en abondance et bon marché. C'est exactement ce que pourrait lui assurer l'Europe du Sud⁷, si celle-ci finit par se soumettre à son hégémonie.

Dans ce rapport, je vais tenter de montrer dans quelle mesure l'heure de la fin est venue pour l'Europe du Sud, victime volontaire d'une union économique dont les lignes directrices avaient été tracées, dès le début, pour servir avant tout ses partenaires les plus puissants. Pendant des dizaines d'années, le Sud a vu s'éroder et se désorienter ses capacités de développement, il a pâti d'une exploitation cachée et constante des pays riches du Nord⁸, et doit être sacrifié sur l'autel des projets réactivés de l'Allemagne. La première partie de ce rapport portera sur l'attaque ouverte particulièrement violente menée par les pays du Nord de l'Europe contre le Sud, Allemagne en tête évidemment. Dans la deuxième partie, on se penchera sur les conséquences de cette mise à sac, pour la Grèce surtout, première de la série qui s'étend déjà au reste des pays du Sud européen.

2. ATTAQUE OUVERTE CONTRE LE SUD

L'Allemagne, qui veut à tout prix mettre en place des réformes tout autant tyranniques qu'inefficaces, est allée trop loin, elle ne peut plus faire croire qu'elle vise le sauvetage de la Grèce. Je voudrais néanmoins rappeler, avant d'aborder ce qui ressemble à la phase terminale de cette tragédie, que les attaques contre le Sud sont loin d'être un phénomène nouveau. L'Europe du Sud subit ainsi, depuis les premiers temps, les conséquences négatives de la coexistence, dans la même union économique, d'économies peu développées avec des économies plus développées. Et ce qui a porté un coup dur aux pays européens les plus vulnérables, c'est à n'en pas douter le Pacte de Stabilité⁹, imposé par l'Allemagne en contrepartie de l'abandon de sa monnaie nationale forte et stable pour l'euro. Or, comme il apparaissait déjà en 2004¹⁰, ce ne sont pas les économies les plus faibles du Sud qui ne purent supporter les conditions asphyxiantes et récessives du Pacte de Stabilité, mais bien le pays qui en fut l'inspirateur, l'Allemagne. Celle-ci n'a pas hésité en effet, le 25 novembre 2003, avec la France et la Grande-Bretagne, à suspendre le Pacte de Stabilité pendant à peu près quatre ans, parce qu'il « limitait dangereusement son rythme de croissance ». Ce qui est scandaleux dans cette décision, ce n'est bien sûr pas la suspension du Pacte, qui s'avérait de toute façon néfaste à l'Europe, mais le fait qu'elle n'incluait pas les pays du Sud. En effet, l'Allemagne et la France exigèrent qu'ils continuent de le respecter, sans conditions¹¹. En substance, la décision prise ce jour de novembre 2003, rendait la stabilité de l'euro dépendante de l'Europe du Sud qui, pris au piège, voyait s'éteindre

⁷ Le nombre d'immigrés Espagnols et Grecs en Allemagne a augmenté respectivement de 84% et 49% au cours du premier semestre 2011. Voir l'enquête d'Olivier Cyran « L'effroi du retraité allemand face à l'épouvantail grec »(2012), *Le Monde Diplomatique*, No 700-59e année, Juillet

⁸ D'une part, le Nord qui tire parti de la balance commerciale excédentaire de l'Allemagne et qui contraint le Sud à lui acheter du matériel de guerre, et de l'autre les conséquences fortement négatives, sur les économies les plus faibles, du Pacte de Stabilité

⁹ Véritable entrave à la croissance des Etats-membres mais soutien indispensable de l'euro à cause des graves problèmes liés à sa mauvaise conception

¹⁰ Voir M. Negreponi-Delivanis (2004), *Le sort de l'euro*, édité par la Fondation Delivanis et Kornilia Sfakianaki, Thessalonique, p. 32

¹¹ ibidem

ses perspectives de croissance. Ce n'est que maintenant, neuf ans après cette décision, que le magazine *Spiegel*¹² révèle que l'Allemagne « a construit l'euro à sa mesure » et qu'elle a ainsi pu se préserver aux dépens du Sud : « La Chancelière a commencé en secret au milieu de l'été 2003. L'économie allemande stagnait, son rythme de croissance était presque nul, tandis que le chômage et le déficit augmentaient constamment ». Ajoutons à cela les effets particulièrement défavorables de l'énorme et permanent excédent commercial de l'Allemagne sur les pays du Sud, et combien le niveau commun pour tous les Etats-membres du taux en vigueur se révélait dangereux pour les plus faibles, malgré les différences importantes de rythme d'inflation entre eux. Ce taux commun est pour beaucoup responsable du recours excessif à l'emprunt des pays du Sud¹³. Or, ces questions essentielles, l'Allemagne les a délibérément ignorées. Aux commandes d'un pogrom sans précédent contre le Sud, elle s'est d'abord attaquée au maillon le plus faible mais aussi le plus symbolique de l'Europe, à savoir la Grèce¹⁴. A ce pogrom, le FMI a été appelé à participer, ce qui n'est pas sans susciter des questions jusqu'à maintenant restées sans réponses concernant son rôle exact dans les affaires strictement européennes.

3. MESURES DE PILLAGE¹⁵, MESURES DE SAUVETAGE

A partir des années 70, les idées de Margaret Thatcher et de Ronald Reagan s'imposent partout, y compris en Europe. Mélange barbare, fait d'ultra néolibéralisme et de croyance inébranlable que la libéralisation des échanges profite à tout le monde. L'absolutisme de ce régime macroéconomique a créé un environnement aux antipodes de l'héritage de John Maynard Keynes, même si on lui doit le rythme de croissance très rapide de l'économie occidentale après la Seconde Guerre Mondiale, et une répartition plus juste des fruits du progrès. C'est dans cette Europe du néolibéralisme effréné que la Troïka et les banquiers ont lancé une campagne de pillage de la Grèce. Voyons-en de plus près les grandes étapes :

3.1. La préparation

Cette sorte de génocide des Grecs d'un genre nouveau¹⁶ a donc commencé il y a à peu près deux ans et entre manifestation dans le cadre d'une restructuration progressive du Sud de l'Europe.

L'entrée en matière s'est faite de façon très habile, l'accent a été mis sur la singularité du cas grec, en aucun point comparable bien sûr aux autres pays du Sud¹⁷, même si par ailleurs ils présentent des faiblesses similaires. Cette façon, tout à fait consciente,

¹² <http://olympia.gr>, le 18-7-2012.

¹³ M. Negreponi-Delivanis (2011) , Une analyse plus détaillée existe dans son livre (en grec) : *Toute la vérité sur la dette et le déficit et comment nous en sortir*, édité par la Fondation Delivanis et les Editions Ianos

¹⁴ Avec l'asservissement de la Grèce, ce sont les fondations de l'Europe toute entière qui sont ébranlées

¹⁵ Le pillage de la Grèce par la Troïka et les banques à travers les Mémoires et les accords de prêt est parfaitement décrit par le *New York*

Times, http://www.defencenet.gr/defence/index.php?option=com_content&task=view&id=43278&Itemid=139

¹⁶ *Greece is a crime scene* (2011), Vidéo CNBS tirée de l'émission *Dylan Ratigan Show*, 15.11

¹⁷ Sous-entendu que des pays de l'ex-bloc soviétique font aussi partie de cette catégorie, à un degré différent

d'inspiration goebbelsienne, de chercher à isoler la Grèce de son environnement « familial » géoéconomique a permis d'exclure d'emblée toute réaction immédiate, évitant ainsi la formation d'un front commun des économies de l'Europe du Sud qui aurait permis de tenir tête au fléau allemand. Ainsi, jusqu'à ces derniers temps, les déclarations officielles de pays du Sud soutenant qu'ils « ne sont pas comme la Grèce et ne le seront jamais » étaient chose courante. Et c'est comme cela qu'un rideau de légitimation est tacitement venu voiler les horreurs en série infligées à cet infortuné pays de lilliputiens, puni exemplairement pour ses « crimes » par une Angela Merkel intransigeante. Et comme au Moyen Age, les autres, tout autour, assistaient au spectacle du supplice, bien contents de ne pas être à sa place. Voilà pourquoi les peuples du Sud ont mis si longtemps à prendre conscience de la gravité de la situation ; trop tard pour éviter le pire. Les Espagnols viennent enfin de réaliser ce qui les attend et ils descendent eux aussi massivement dans la rue aux cris de « Voleurs », « Mains en l'air, c'est un hold-up ».

L'attaque contre la Grèce a commencé avec de basses marques de mépris lancées surtout par des dignitaires Allemands et une partie de la presse allemande, une ironie incroyable, - qui laisse apparaître le sentiment d'absolue supériorité du peuple Allemand sur les autres - avec tout un tas de moqueries, d'insultes et de menaces d'une envergure inconcevable, le tout évidemment ponctué de mensonges énormes. C'est ainsi que les Grecs sont « paresseux », bien que de source officielle, ils travaillent plus hebdomadairement¹⁸ que la moyenne européenne ; ils sont « fraudeurs », ce qui n'est pas faux, à mettre néanmoins sur le compte de la spécificité structurelle de la Grèce qui, avec presque trois fois plus de travailleurs indépendants par rapport à l'emploi total, favorise la fraude fiscale effectivement importante, couvant un secteur public prétendument démesuré qu'il faut donc absolument réduire et ce, au mépris des données officielles qui attestent exactement le contraire ; ils sont « corrompus », à quoi l'on peut répondre que les activités scandaleuses de Siemens en Grèce, ou celles de Ferrostaal¹⁹ devraient décourager ce genre d'assertions²⁰. Les génocides du passé ont montré que lorsqu'on veut faire disparaître un peuple – physiquement, économiquement, géopolitiquement, culturellement – on commence par lancer une campagne de dénigrement, l'accusant des pires péchés - bon à rien, alcoolique, arnaqueur, etc. – et l'opinion publique finit par accepter l'idée de sa disparition comme inévitable. C'est exactement ce qui est en train de se passer avec la Grèce²¹ depuis deux ans et demi, avec une constance impressionnante. Et les résultats sont spectaculaires, puisqu'une grande partie des Grecs est convaincue de son incapacité invétérée... même pas bons à remettre sur les rails le processus de croissance.

Et pourtant, la Grèce n'est pas le seul Etat à présenter des irrégularités financières. Au sujet des manipulations statistiques qu'elle a faites pour être autorisée à intégrer la zone

¹⁸ Eurostat

¹⁹ Où, comme il ressort du dossier judiciaire de Munich, le chef de Marine – filiale de Ferrostaal en Grèce – a déclaré: « Nous savions tous que si cela s'avérait nécessaire, il faudrait que nous avancions de l'argent aux personnes qui décident et que c'est ce que nous ferions ». Mais aussi, toujours d'après le dossier, la société allemande cherchait en Grèce, à partir des années 1996-97, les personnes les plus aptes à promouvoir une commande de sous-marins

²⁰ M. Negrepointi-Delivanis (2012), « Lettre ouverte à Madame Christine Lagarde », *Le Monde électronique*, 18.06

²¹ N. Klein (2010), *La Stratégie du choc*, (trad. Lori Saint-Martin, Paul Gagné), Babel

euro, je n'alléguerai pas comme circonstance atténuante le fait avéré que presque aucun Etat-membre n'a résisté à la tentation de quelque « artifice d'embellissement comptable ». J'alléguerai par contre que dans cette affaire, les commissaires de l'Union Européenne sont tout aussi responsables que la Grèce, puisque leur rôle était de contrôler les finances publiques des Etats-membres, notamment ceux qui étaient candidats à l'euro. Ils auraient dû signaler les activités acrobatiques de Goldman Sachs dans le cas grec, car il ne fait aucun doute qu'ils le savaient. On imagine d'ailleurs très bien que, pour ne pas perturber le cours tranquille de l'achat de matériel de défense militaire de la Grèce - sous-marins, frégates, avions de chasse, etc. - à la France mais surtout à l'Allemagne, ils préféreraient fermer les yeux lors de leurs visites à Athènes. Et face à ce flot incoercible d'accusations à l'encontre de la Grèce, à qui soit dit en passant, la fin de la zone euro est également imputée, il est bon de rappeler certains aspects essentiels du problème que l'on a tendance à oublier. Premièrement, la Grèce n'est pas le seul Etat-membre à être confrontée à des problèmes financiers, presque tous les pays du Sud de l'Europe sont dans une position peu enviable. Deuxièmement, la dette grecque ne représente qu'à peu près 2,5% de l'ensemble européen, qui est évalué à 8,215 trillions d'euros, tandis que l'Allemagne, la France, l'Espagne et l'Italie enregistrent des dettes trois fois plus élevées que la dette des treize autres Etats-membres de la zone euro, avec une dette de 6,44 trillions d'euros. Troisièmement, on reproche au Sud de vivre inconsidérément au-dessus de ses moyens, de vivre aux crochets du Nord. Les faits montrent toutefois que rien ne permet d'affirmer, statistiques officielles à l'appui, que la gestion financière du Nord soit particulièrement vertueuse. Exemple caractéristique, la dette de l'Allemagne représente 81,2% de son PIB en 2011, celle de la France 85,8%, celle de l'Italie 120,1%. Alors, compte tenu des critères allemands pour le moins sévères, ces pays-là ne devraient-ils pas être promptement exclus de la zone euro ? La moindre des choses donc, ne serait-ce pas de mettre un terme à cette triste farce ? Et le comble du ridicule, n'est-ce pas cette vindicte enflammée à l'encontre de la Grèce, jugée responsable des épineux problèmes financiers de l'Union Européenne ? Et puis, n'oublions pas le nœud du problème : les économies du Sud qui sont en fait les otages des fameux marchés financiers, ne sont pas libres de réagir efficacement, puisqu'elles ne disposent pas d'une monnaie nationale.

Dès le début de la crise grecque, la Troïka a pris les rênes, qu'elle brandit avec suffisance, du « sauvetage » de la Grèce, et auquel les Allemands sont « généreusement » mis à contribution. Or, la réalité est tout autre : depuis deux ans et demi le peuple grec est saigné à blanc, tandis que la totalité des prêts qui pèsent sur la dette, retournent tels quels aux créanciers, c'est-à-dire pour l'essentiel aux banques. Citons pour cela quelques éléments particulièrement significatifs :

- Pour l'année 2012, les dépenses publiques s'élèvent à 170 milliards d'euros. Or, seulement 21 milliards couvrent les dépenses nettes de l'Etat, tandis que 149 milliards retournent aux créanciers.
- Des éléments officiels ont été publiés selon lesquels l'Allemagne a gagné 55 milliards d'euros depuis le début de la crise, tirant bénéfice de la différence du taux avec lequel elle emprunte et du taux avec lequel elle prête ensuite à la Grèce.
- Les banques empruntent à la BCE à un taux de 1% et prêtent ensuite à l'Etat à 7%. La différence, naturellement, pèse sur le peuple grec.

- La BCE elle aussi spéculé aux dépens de la Grèce, achetant des obligations grecques sur le marché secondaire, décotées à 25% de leur valeur nominale, mais ensuite rechigne sur la « coupe » de 50%, bien que là encore, elle tirerait un bénéfice de l'ordre de 100% par rapport au montant de leur achat²².
- Au cours de ces quinze dernières années, la Grèce a dû payer 265 milliards d'euros d'amortissements et 156 milliards d'euros d'intérêts à ses créanciers. Comme le rappelle la rédactrice économique de BBC, Stephanie Flanders, dans son analyse de la dette grecque pour le compte du site britannique de la chaîne²³, le pays a déboursé en 2011 23% d'intérêt en plus par rapport à 2010, et ce, malgré les prêts « à un taux bas » concédés par l'Europe et le FMI (les guillemets à caractère ironique sont de la journaliste). Rappelons aussi que le capital a été largement remboursé et que maintenant, le pays paie les intérêts.
- La fameuse restructuration de la dette, tant vantée par ses défenseurs et sensée soulager l'économie, a été en réalité un véritable fiasco. La dette n'a été réduite que de 30 milliards d'euros mais en même temps, l'opération a « coupé » dangereusement dans les caisses de retraites, les hôpitaux et les universités. Etant donné que la Grèce a reçu une nouvelle aide financière, qui est venue s'ajouter à la précédente, sa dette s'alourdit constamment, et de 250 milliards d'euros au début de 2012, elle est aujourd'hui de 355^E milliards.

3.2. L'imbroglie de « l'opération de sauvetage »

La deuxième phase de cette opération criminelle de sauvetage de la Grèce, ce sont les Mémoires, les accords de prêt, les réactualisations, les plans à moyen terme et tout ce ramassis indescriptible qui suce le sang du peuple et du pays. Même s'il s'est trouvé des gouvernants pour les signer alors qu'ils auraient mieux fait de descendre dans la rue et de s'inviter dans les chaînes de télévision internationales – ce que font les Espagnols – pour alerter l'opinion publique, cela ne change en rien le caractère odieux de ces plans. La Grèce pourrait essayer de s'en affranchir, elle pourrait recourir à la Cour Internationale de Justice²⁴, évoquer l'état de nécessité, car rien ne justifie le fait que ses créanciers imposent leurs intérêts au mépris de la vie de la population entière. L'idée qui régit le plan du prétendu sauvetage de la Grèce – tout comme celui, à quelques variations près de la presque totalité de l'Europe du Sud – repose sur deux thèses, qui non seulement sont impossibles à soutenir, mais qui en plus sont totalement erronées :

- D'une part, Angela Merkel, malheureusement soutenue par ses alliés politiques qui décident avec elle, n'en démord pas : pour elle, trop dépendants et pas sérieux, les pays du Sud sont entièrement responsables de tous les problèmes et doivent être punis exemplairement, ils doivent se sacrifier et payer en conséquence²⁵. D'où cette remarque, très juste : « le débat sur la crise fait parfois penser à une croisade

²²http://news.kathimerini.gr/4dcgi/_w_articles_politics_2_01/07/2012_487609

²³ <http://www.bbc.co.uk/news/business-18099336>

²⁴En 1936, le Gouvernement grec fit appel à la Cour Internationale de Justice car sa situation budgétaire et monétaire le mettait dans l'impossibilité de rembourser l'emprunt contracté à la Banque Commerciale de Belgique. Dans son Mémoire, Métaxas expliquait que « les intérêts du peuple grec en ce qui concerne l'administration, l'économie, l'état de santé et la sécurité intérieure et extérieure du pays ne laissait pas d'autre choix ». La Cour rendit l'appel, créant ainsi un précédent légal dont l'Argentine se servira plus tard, en 2003 pour demander la cessation de paiement

²⁵ P. Krugman (2012), « Europe's great illusion », IHT, 5.6

des chevaliers blancs contre les infidèles »²⁶. N'oublions pas que depuis le début de la crise et jusqu'à aujourd'hui les dépenses publiques réelles ont été réduites de 25%, contre toute logique et d'une façon tout à fait arbitraire, par des mesures prises dans l'urgence et n'en prévoyant naturellement pas les effets dramatiques sur la population²⁷. Rien à faire, les partenaires européens soutiennent que... « les Grecs ne font rien ».

- D'autre part, Berlin fonctionne comme s'il pensait que les réductions continues des dépenses publiques ouvrent la voie de la croissance²⁸. Cette politique de l'austérité n'est pas provisoire, Berlin la voit plutôt comme une réforme définitive, qui s'insère dans le nouveau Pacte de Compétitivité, est inscrit obligatoirement dans les constitutions des Etats-membres et prévoit de lourdes sanctions pour ceux qui ne s'y soumettent pas.

La cure toutefois imposée à la Grèce – et qui s'étend aux économies du Sud contraintes, l'une après l'autre, de faire appel à des plans d'aide – est une « première mondiale »²⁹. La politique de la dévaluation interne est en effet destinée à remplacer la politique disons, classique de dévaluation externe et concerne les économies qui ne disposent pas d'une monnaie nationale, comme celles de la zone euro. Les conséquences en Grèce de cette politique sont dramatiques. D'ailleurs, l'ensemble des experts en économie du monde entier dignes de ce nom mais aussi les revues économiques³⁰ s'accordent sur le fait que ce plan est un imbroglio désastreux qui doit absolument être remplacé de toute urgence par quelque chose d'autre. Or l'Allemagne ne fléchit pas et persiste. Dans le cas présent, elle demande en plus une intensification progressive de cette politique. Les effets sont déjà visibles et cette petite économie qu'est la Grèce présente les symptômes de la tiersmondialisation. Le FMI quant à lui, a adopté la même attitude. Il apparaît clairement alors que l'insistance de la Troïka, tout aussi inexplicable qu'absurde, et ses efforts pour se montrer convaincue du bien-fondé de ce plan, s'expliquent par le fait qu'elle n'a aucune solution alternative. Ainsi ne lui reste-t-il qu'à continuer d'accuser la Grèce d'être fautive du désastre, qu'elle a elle-même en fait provoqué.

La dévaluation interne concerne les économies soumises à ce plan et consiste en une réduction massive des salaires, des retraites et des dépenses publiques en général. Notons au passage qu'aucune étude préalable n'a été effectuée. Ce sont d'abord les salaires du secteur public qui sont touchés, puisque le public se trouve dans l'œil du cyclone, puis les salaires du privé pour rétablir, paraît-il, la compétitivité perdue, car l'augmentation des exportations est soit disant synonyme de relance économique. La réduction des dépenses concerne aussi l'Etat-providence³¹, c'est-à-dire l'éducation et la santé, l'administration publique, la défense. Nous avons donc affaire, comme on le voit, au démantèlement pur et simple de l'économie, de la société, de l'éducation, de

²⁶ B. Fehrie (2011), « Pourquoi Mme Merkel a raison de douter », *Frankfurter Rundschau*, publié dans *Courrier International* du 6 au 12 octobre

²⁷ Basés sur le dernier rapport du FMI sur la Grèce : <http://blogs.mediapart.fr/blog/mehdi-zaaf/05.02.12/la-grèce-en-panne-de-democratie>

²⁸ J. Ewing (2012), « Berlin clings to austerity despite pleas », *IHT*, 9.1

²⁹ Le terme est de l'ex-représentant de la Grèce au FMI, M. Roumeliotis (http://www.epikaira.gr/epikairo.php?id=41095&category_id=88)

³⁰ Y compris *The Economist*, néolibéral par excellence

³¹ Je dirais même surtout l'Etat-providence car il représente ce que les ultralibéraux détestent le plus

l'administration publique, pour un schéma qui n'a absolument aucune base théorique et n'a encore jamais été appliqué nulle part avec du succès³². Dans le cas de la Grèce notamment, il est évident qu'un tel schéma est irréaliste. Jamais le pays ne parviendra à redresser son économie par la dévaluation interne, et ce, pour deux raisons. D'abord, parce que la part des exportations dans son PIB est faible, moins de 20%, et puis parce que plus de la moitié de ses exportations est concurrencée par des produits provenant d'économies émergentes. Il est complètement farfelu de penser que le niveau des salaires dans les économies européennes pourrait s'aligner très bien sur celui des pays émergents³³.

Ce qui arrive en Grèce et tend à se généraliser au reste des pays de l'Europe du Sud est décrit avec beaucoup d'humour et d'acuité dans l'excellent article de Slavoj Žižek, paru dans *Le Monde*³⁴, citant un journaliste de CNN. Les décideurs européens sont comparés à « des jongleurs d'assiettes chinoises », « la difficulté est bien sûr de continuer de préserver le mouvement, sans quoi les assiettes tombent et se cassent ». Et il continue avec des extraits du film *Nitotchka*, d'Ernst Lubitsch (1939). « Quelqu'un commande un café sans crème, et se voit répondre par le serveur : « Désolé, mais nous n'avons plus de crème, nous n'avons que du lait. Puis-je vous apporter un café sans lait ? ». En d'autres termes, « ce ne sont pas les Grecs qui bénéficieront des épreuves qu'ils traversent » mais les Banques.

Même Dominique Strauss-Kahn a déclaré depuis Pékin³⁵: « La recette du FMI n'a pas été correctement mise en œuvre en Grèce, c'est dommage ». Paul Krugman³⁶, le prix Nobel d'économie, est sur la même longueur d'onde.

La dette grecque n'est pas gérable, au même titre que n'importe quelle dette quand elle dépasse 90% du PIB³⁷. Et la « coupe » qu'elle a subie n'a rien changé à la dure réalité. Au contraire. Alors que la dette, au début de la crise représentait 115% du PIB, elle est de 165% en 2012 et en 2020 on espère qu'elle ne sera plus que de 120%, mais déjà cet objectif semble impossible à satisfaire³⁸. La profonde récession de la Grèce qui l'a conduite à la cure d'austérité, augmente toujours plus la dette, dans un PIB qui se réduit à un rythme effrayant. Ainsi, les discussions sur un défaut de la Grèce, quand et comment il se fera, sur son retour ou non à la drachme, sur les intentions de la Troïka etc., visent tout simplement à gagner du temps. Quant à la dette, il ne fait guère de doute qu'elle n'est pas gérable et qu'elle ne le sera jamais, même en 2020. La politique mémorandienne s'avère donc être un échec monumental, confirmé par la récente déclaration du FMI qui menace de ne plus apporter de fonds d'aide à la Grèce au mois

³² Les pays baltes sont dernièrement présentés comme une réussite de cette politique. Or, le rythme de croissance satisfaisant de ces économies s'accompagne d'un taux élevé de chômage

³³ Bien que cette tendance se confirme, à un rythme accéléré

³⁴ « Lamentable fiction, l'austérité continue de servir et de servir les Banques », 13.07- 2012

³⁵ Malgré son aventure, il reste l'un des économistes les plus mondialement connus et connaît très bien les rouages du FMI. <http://www.ethnos.gr/article.asp?catid=22769&subid=2&pubid=63592023>

³⁶ « Sans logique les scénarios de Troïka » (2012), article paru dans le journal électronique du *New York Times*, 7.2 (en anglais)

³⁷ D'après les travaux de Carmen M. Reinhart et Kenneth S. Rogoff

³⁸ C'est-à-dire que dans le meilleur des cas, tous ces efforts pour « sauver » la Grèce l'auraient amenée, au bout de onze longues années de sacrifices inhumains, à un niveau pire qu'il ne l'étaient initialement. Pauvre Sisyphe !

de septembre prochain³⁹. En effet, la charte du FMI ne permet pas le financement des dettes non gérables. Alors, les tentatives maladroites pour démentir cette réalité constituent une duperie supplémentaire à l'encontre de la Grèce.

Et pourtant ! Les envoyés spéciaux de la Troïka, avec l'accord discret des responsables grecs, se rendent régulièrement à Athènes. Imperturbables et distants vis-à-vis de « l'imbroglio mémorandien grec », ils soutiennent que « c'est la faute des Grecs si les objectifs ne sont pas atteints », et qu' « une renégociation du plan de sauvetage est hors de question tant que les engagements, déjà reportés, ne seront pas mis en œuvre ». Ceux, en d'autres termes, qui mènent la Grèce tout droit à la catastrophe.

4. LES OBJECTIFS OCCULTES DE LA PSEUDO-OPERATION DE SAUVETAGE

Cette politique des Mémoires, des accords de prêt etc., et ses conséquences tragiques incite naturellement à chercher les vrais motifs, au-delà de ceux mis officiellement en avant. Car, aussi invraisemblable que cela puisse paraître, les économistes du monde entier, néolibéraux aussi bien que keynésiens, s'accordent à dénoncer les dangers que représente le plan d'aide à la Grèce. Et tout aussi surprenant, le fait qu'un certain nombre des membres des gouvernements successifs de la crise, finissent par reconnaître à un moment donné que ...« le programme de la Troïka est une impasse » ! En tout cas, dès qu'ils arrivent au pouvoir, ils se démènent, ils s'épuisent – toute leur énergie y passe – à satisfaire au mieux les exigences de la Troïka conquérante, se soumettent au *théâtre de l'absurde*, bafouant les intérêts de leur propre pays. Il ne fait aucun doute que les deux parties, la Troïka et les gouvernants, ont parfaitement conscience que les mesures imposées aux seconds par la première, privent l'économie de tout espoir de relance et aggravent la misère, l'appauvrissement et le désespoir du peuple grec. Ce sacrifice total n'est rien d'autre qu'une nouvelle forme de génocide méthodique.

Devant la gravité de la situation, il serait alors impardonnable de ne pas chercher à percer les motifs réels qui poussent la Troïka à commettre ce « crime contre l'humanité ». Avant tout, il est bon de rejeter les thèses qui veulent que la Troïka se trompe, qu'elle ne connaît pas les paramètres du problème grec ou encore, qu'elle est aveuglée par son fanatisme idéologique. En effet, ce genre d'interprétations tendrait à détourner la recherche des enjeux réels de ce conflit qui, à n'en pas douter, vise la perte de la Grèce :

4.1. La fin de l'Etat-providence⁴⁰

Le plus simple est de laisser la Troïka imposer sa vindicte idéologique contre le secteur public et contre surtout l'Etat-providence, mais cette thèse n'est pas satisfaisante et n'éclaire pas les motifs barbares qui visent, semble-t-il, l'instauration d'une gouvernance et d'une monnaie mondiale avec au passage la germanisation de

³⁹ *Der Spiegel* (2012), 19.07

⁴⁰ M. Schuman, (2011) « Au revoir Welfare State », *Time*, 28.11

l'Europe⁴¹. Un tel cadre – mis en place à travers la mondialisation, suppose qu'une poignée d'individus – les banques et les banquiers – aura le contrôle absolu et illimité de la planète et qu'il amassera et accumulera toutes les richesses à son seul profit. Ce processus est déjà bien engagé. Sa principale arme, la baisse de l'imposition des hauts revenus, qui a réduit la taille de la classe moyenne aux Etats-Unis et en Europe⁴², et a fait exploser les inégalités.

L'Etat-providence s'est incontestablement développé en Occident pour éviter la révolte des travailleurs influencés par les idées socialistes dans le bloc soviétique, jusqu'à son effondrement. Après, l'Etat-providence a brusquement perdu sa raison d'être et les travailleurs furent délaissés. Les gouvernements, aux Etats-Unis comme en Europe, cherchent en réalité à mettre en place au plus vite ce qu'on appelle des *réformes structurelles*, à faire disparaître donc les droits des travailleurs. Plus clairement, faire retourner le marché du travail à ce qu'il était au début du XIXe siècle. C'est ainsi que l'idée très répandue dans les années 60 et 70⁴³ qui prévoyait que la croissance et la maturité du capitalisme s'accompagneraient d'une plus grande égalité et de la prospérité pour tous, est malheureusement démentie par la réalité.

La vérité est flagrante : la Grèce a été choisie pour servir de cobaye et la mission est presque accomplie, sans que cela ait provoqué de remous notoires. Or, la Grèce n'est pas un objectif en soi, c'est juste par elle que s'introduira et s'étendra l'appauvrissement des travailleurs européens, avec des salaires abaissés à ceux de la Chine ou de l'Afrique, et la disparition de toute forme de protection dans le marché du travail. C'est pour cela que l'on ne peut espérer aucune amélioration de ce programme délétère.

4.2. La spoliation des richesses de la Grèce

La spoliation de sa richesse nationale est la deuxième grande étape de la tentative d'anéantissement de la Grèce. Il va sans dire que le pays ne pourra pas satisfaire les exigences des Mémoires qui, entre parenthèses, n'ont pas été forcément vus et lus par ceux qui les ont signés au nom du peuple grec et pour son plus grand malheur. Pouvait-il d'ailleurs en être autrement ? Probablement non puisque les Mémoires en questions sont impossibles à tenir. Et le peuple, à force de voir sa dignité nationale bafouée, son présent et son avenir vidés de leur sens, convaincu de son inutilité et laissé à son triste sort, ne finira-t-il pas par abandonner sans résister sa vie et son sort à ses conquérants ?

Les termes extrêmement contraignants et désorientants de la prétendue « mise en valeur de la richesse publique », de « l'effort pour attirer les investisseurs », des « réformes nécessaires depuis longtemps » et autres subtilités du même acabit visent à justifier l'odieux crime contre la Grèce et son peuple : le bradage de sa richesse.

⁴¹ M. Dassù (2011), « Une Europe allemande est née », *Courrier International*, no 1095, 27.10

⁴² J. D. Sachs (2012), « Why America must revive its middle class », *Time*, 10.10

⁴³ Qui par ailleurs est développée dans la thèse de doctorat de l'auteur de la présente étude, *L'Influence du développement économique sur la répartition du revenu national* (1959), Paris-SEDES-CNRS

Ici, ce n'est pas mon point de vue idéologique par rapport à la privatisation que j'exprime ; je m'oppose simplement – ce que toutes les Grecques et tous les Grecs devraient également faire – à ce que les privatisations servent à rembourser la dette et non à valoriser les éléments du patrimoine public⁴⁴.

Il apparaît en effet clairement que cette démarche peu patriotique ne vise pas des entreprises ou des éléments du patrimoine en général qui gagneraient en efficacité s'ils passaient du public au privé -à supposer qu'une étude comparative approfondie ait d'abord été effectuée. Même les services auquel le public est très attaché, comme l'électricité, l'eau, les télécommunications, la défense, la santé, ne sont pas épargnés par ce marché aux bonnes affaires.

Pression, intimidations et chantages, tout est bon pour obliger la Grèce à s'engager dans des privatisations hâtives. De sa conduite dépendent la nouvelle tranche d'aide, la faillite incontrôlée ou la relance, l'exclusion de la zone euro ou non. Tout est à vendre, peu importe dans quelles conditions, à quel prix. Peu importe les sacrifices que cela implique. Indépendamment du fait que la privatisation d'entreprises prestataires de services est *rigoureusement* interdite⁴⁵, d'autant plus si elles passent dans des mains étrangères, cette période est bien la pire pour privatiser ou mettre en vente des éléments du patrimoine. Mais ce n'est pas seulement le mépris de tout ce qui a trait à la Grèce qui pose problème, ce sont aussi les propos stupides du ministre des Finances grec lorsqu'il déclare que tout ce qui sera adjugé « pourra être payé en obligations grecques », c'est-à-dire... que le prix de vente du patrimoine dépendra de la dévaluation de la valeur nominale des obligations grecques, jusqu'à 80%.

Cette braderie, heureusement, est retardée pour des raisons artificielles, compte tenu des nombreuses difficultés à la vente⁴⁶, et même dans les cas les plus mûrs, il faudra deux ou trois ans pour achever les procédures. Il est donc permis d'espérer que quelque chose peut encore empêcher, ne serait-ce qu'au dernier moment, ce sacrilège qui équivalait à la faillite définitive de la Grèce.

4.3. La Grèce sous protectorat européen

Et enfin, cette comédie, ces attermoissements, ces hésitations, toutes ces séances nocturnes dans le but non pas de trouver des solutions, mais de gagner un peu de temps, toutes ces menaces et exhortations semblent obéir à un troisième objectif, imposé lui aussi sous la menace, et qui apparaît maintenant sous son véritable jour. La zone euro, si elle survit à la tempête, ce qui semble en fin de compte peu probable, ne sera plus constituée d'Etats-membres « égaux », mais de puissants qui tiennent les plus vulnérables en servitude. La ligne qui démarquera ces deux catégories sera le degré d'assainissement de leurs finances. Le professeur d'économie Philippe Murer⁴⁷

⁴⁴ M. Negreponti-Delivanis (1993), *Entreprises privées et publiques*, éd. Sakkoula, Thessalonique (en grec)

⁴⁵ *ibidem*

⁴⁶ P. Pavlopoulos (2012), «Les limites constitutionnelles des privatisations» de l' *olympiada*,21.07 (en grec).

⁴⁷ Vidéo ici http://www.dailymotion.com/video/xrv99o_une-guerre-invisible-contre-la-population-l-esclavage-moderne-par-une-dette-

souligne très justement qu'il s'agit d'un retour, sous un autre aspect, de la servitude pour dettes qui avait été abolie par les Romains il y a 2000 ans. En effet, on pouvait lire récemment dans la presse européenne qu'Angela Merkel avait l'intention de placer un « superviseur » au budget en Grèce, ce qui revient à faire du pays un protectorat européen.

Le sort qui est réservé à la Grèce – à moins qu'elle ne finisse par réagir et prendre son destin en main – risque fort de s'étendre à tout le reste de l'Europe du Sud. Ce scénario d'une Europe à deux vitesses ou plus a déjà été avancé par le directoire européen. Rappelons que ce schéma avait été soumis dès le début de l'Union, et qu'il avait été catégoriquement rejeté par les responsables politiques d'alors.

Tous les signes sont là, pour ne pas dire les preuves, et confirment le fait que la Grèce sert d'animal de laboratoire pour tester l'abandon volontaire de sa souveraineté nationale. Le processus électoral dans ce cas ne serait plus qu'une parodie de démocratie. Cela a été rendu possible parce que ceux qui sont élus – « préparés » de l'extérieur – et sont amenés à occuper des postes-clés appartiennent à un réservoir d'hommes puissants bien choisis, étroitement liés avec le groupe Bilderberg entre autres clubs de l'ombre. Par conséquent, on ne peut raisonnablement rien attendre de ces gens dont la priorité ne sera certainement jamais de servir les intérêts nationaux mais plutôt d'expédier les directives de leurs mandants.

5. LES EFFETS DE LA POLITIQUE D'AUSTERITE

La deuxième partie portera sur quelques unes des conséquences de l'utilisation de la Grèce comme premier « animal de laboratoire » de l'Union Européenne. L'économie, la société, l'éducation, l'administration, la défense tout autant que les perspectives de la Grèce ont été durement touchés par la politique d'extrême austérité et il est important de comprendre qu'il ne s'agit pas d'une « exclusivité grecque » mais bien d'une « chronique de la mort annoncée » de l'ensemble des Etats endettés du Sud de l'Europe. La Grèce est en train de perdre la totalité de sa souveraineté, elle est en train de disparaître et prépare malgré elle la voie aux autres pays du Sud⁴⁸ auxquels le même sort ou à peu près est réservé.

Dans un deuxième temps, nous aborderons succinctement l'étendue des dégâts en Grèce, et le flétrissement de l'idée européenne :

5.1. L'anéantissement de l'économie grecque

Si la Grèce avait la possibilité de reprendre un processus de croissance – et ramener la récession en-dessous de la barre des 2% – elle pourrait équilibrer son budget en 2013, elle n'aurait donc pas besoin d'emprunter en permanence et à partir de 2014, elle serait en mesure de rembourser sa dette. Le fait est que les partenaires européens ont

⁴⁸ A peu près, car la Grèce est un cas spécial du point de vue de sa position géostratégique mais aussi de sa richesse minière et sous-marine, jugée importante.

sciemment exclu cette possibilité, contraignant le pays à se plier à un programme qui tue littéralement tout espoir de relance économique.

La récession de l'économie grecque, sans précédent en temps de paix, tant du point de vue de la durée que de celui de l'intensité, met le pays à l'épreuve pour la cinquième année consécutive. Une récession comme on le voit, encore plus longue que celle des Etats-Unis à suite de la crise de 1929. Outre sa longueur, la récession a ravagé littéralement l'économie grecque, puisque son PIB a chuté de plus de 20%, le pouvoir d'achat de la classe moyenne de 50%, le chômage est en constante augmentation, de l'ordre de 22%, 52% chez les jeunes. La non valorisation d'éléments du patrimoine, la diminution de l'épargne, le découragement des propensions au développement, mais surtout celle de l'investissement représenteraient 500 milliards d'euros. On ne peut espérer sérieusement qu'une économie à ce point malmenée puisse reprendre vie, surtout quand les investissements sont limités à quelques milliards, alors qu'il faudrait des investissements à rendement rapide d'au moins 10 ou 12% de son PIB.

En des périodes perturbées où l'économie, la société, la politique et la morale sont à ce point dégradés, le facteur psychologique prend une importance décisive. Ainsi, la Grèce vit dans la peur, l'insécurité, la méfiance à l'égard des annonces gouvernementales, et plus rien ne fonctionne. Il n'est pas surprenant dans ces conditions, que le pays figure aujourd'hui parmi les cinq pays les plus pessimistes de la planète⁴⁹. Il n'est pas étonnant non plus que sept jeunes sur dix pensent s'expatrier. La Grèce, depuis le début du fléau, a enregistré une baisse des salaires et des retraites de 25% en moyenne – la Troïka juge pourtant cette baisse insuffisante et demande une nouvelle coupe d'au moins 20% – 439 000 enfants vivent dans la pauvreté⁵⁰, des élèves le ventre vide s'évanouissent à l'école, les plus démunis qui cherchent à manger dans les poubelles et les sans-abris ont envahi les grandes villes, cinq fois plus de repas ont été servis à Athènes, à l'initiative notamment de l'Eglise, juste pour le mois de juin de cette année, 350 désespérés se sont suicidés. La production industrielle présente une chute de plus de 30%. Plus de 500 000 magasins ont déjà fermé, tandis que quatre consommateurs sur dix déclarent que leur porte-monnaie est vide après avoir couvert leurs besoins de base⁵¹. Des enfants sont abandonnés dans les orphelinats par leurs parents qui se suicident, le nombre des naissances, dans les milieux démunis mais aussi dans la classe moyenne, a baissé dans ce pays qui souffrait déjà de sous-natalité. Certains sont assez désespérés pour vendre leurs organes. Nombre de « bas salaires » et de « basses retraites » n'ont plus les moyens de se chauffer au mazout et se chauffent au charbon, comme autrefois. Les hôpitaux ne disposent plus des médicaments de base et de gazes, la défense nationale est abandonnée à son sort, tout cela parce que chaque euro prêté retourne tel quel aux créanciers. L'ESY, le Système de Santé National, est en train de disparaître. Les impôts n'entrent plus dans les caisses. Bref, la machine étatique se détériore chaque mois un peu plus et le grand « crash » est attendu pour le début de l'automne.

⁴⁹ Selon l'enquête en ligne Nielsen sur la Confiance des Consommateurs, effectuée au deuxième trimestre de 2012.

⁵⁰ D'après un récent rapport de l'Unicef sur la pauvreté dans les pays considérés comme riches.

⁵¹ Newsbomb.gr

Ainsi, le plan barbare de sauvetage de la Grèce ne l'aura pas sauvée. Le pays est même déjà beaucoup plus près du chaos qu'il ne l'était au début de la crise. Le risque de faillite, d'après le CMA, est monté à 96,7% au deuxième trimestre 2012. Les recettes fiscales, comme il fallait s'y attendre, se sont effondrées, emportées par la lubie névrotique de certains gouvernants néophytes qui mettaient toute leur énergie à inventer de nouveaux subterfuges pour ponctionner toujours plus. Des impôts anticonstitutionnels, qui portent atteinte à la démocratie, à la croissance mais surtout inefficaces au possible. Et en dépit de toutes ces trouvailles, les recettes qu'aurait dû apporter la TVA étaient inférieures de 13,4% au mois d'avril de cette année par rapport à l'an dernier, soit 221 millions d'euros, aggravant ainsi le problème, tandis que la perte pour l'ensemble de l'année 2012 devrait s'élever à un milliard. La récession qui échappe à tout contrôle, le taux du chômage qui atteint des sommets, les revenus qui ont subi une baisse importante, l'Etat-providence qui perd du terrain, les différentes « ponctions fiscales » : tout cela a contribué à précipiter le pays à la catastrophe.

Et pourtant, les envoyés de la Troïka continuent, imperturbables. Ils demandent toujours plus de sacrifices et insistent sur la poursuite des réformes contre toute logique. Ils ne veulent même pas entendre parler d'une restructuration ou d'une renégociation de la dette. Ils répètent que les Grecs sont fautifs de l'échec du programme de la Troïka. Le même discours est tenu par les dignitaires de certains Etats-membres manifestement convaincus de la bonne tenue des finances de leur pays. Ils en ont « assez de ce pays ...qui profite du fruit de leur travail et n'honore pas ses engagements », disent-ils. Même son de cloche de la part de la presse⁵².

Ils savent parfaitement que le programme n'aboutit nulle part. Ils savent aussi qu'ils mènent la Grèce à la catastrophe. Alors, le but n'a jamais été de sauver le pays. Le but est de le mener à la faillite. Les conditions et les détails, ce sont eux qui les définissent, à leur convenance. Faire disparaître la Grèce en tant qu'Etat indépendant. Mais maintenant qu'ils sont sur le point d'y arriver, ils hésitent à franchir le pas, car ils craignent les effets imprévisibles sur le reste de l'Europe du Sud. Et puis, comme l'Espagne et l'Italie sont elles aussi au bord de la catastrophe, la Grèce est en train de passer au second plan.

5.2. La destruction de l'Europe

La destruction de la Grèce et de l'Europe du Sud en général marque aussi par conséquent la fin de l'Europe, du moins, telle que nous la connaissions. L'Europe a très mal géré son autre moitié et se trouve maintenant sur des sentiers dangereux sans retour possible. A cause de la crise de la dette, du chômage qui atteint 11,5% et de la récession, son image s'est fortement détériorée. Elle s'est surtout détériorée à cause de son manque de démocratie, de l'explosion des inégalités, du manque de cohésion et de solidarité. C'est justement à cause de l'effondrement de l'Europe du Sud contrainte d'assainir rapidement ses finances, que la croissance économique de la zone euro devrait ralentir en 2013. Exemple significatif, George Soros, et bien sûr il n'est pas le seul, pour qui « l'Allemagne pousse l'Europe au désastre économique ». Au-delà de tout ce qui se passe en son sein, on est en droit de se demander comment il est possible

⁵² Al Jazeera, 22-07-2012

que l'Union Européenne abandonne ainsi son sort aux mains du chef d'un seul de ses vingt-sept membres, aidé par la patronne du FMI, Christine Lagarde qui semble en plus éprouver le même mépris à l'égard des pays du Sud, y compris la Grèce.

Dans ces conditions, les conclusions des sondages effectués au cours de l'année 2012 dans les vingt-sept pays membres, où 30% seulement des personnes interrogées avouent avoir une bonne opinion de l'euro et de la zone euro, contre 52% en 2007, n'ont rien de surprenant. Il faut bien se rendre à l'évidence que l'Union Européenne n'est pas en mesure d'assurer à la nouvelle génération des conditions de vie meilleures que celle d'avant. Pire encore, le recul flagrant de la démocratie. Ainsi la mise en place, en Grèce et en Italie, de premiers ministres non élus et le soutien déclaré d'Angela Merkel au candidat Sarkozy lors de la dernière campagne des présidentielles, hostile à l'élection de son adversaire François Hollande, lequel sera finalement élu.

Les scénarios de la catastrophe de l'Europe sont multiples et ils sont tous valables. Je vais toutefois me limiter à ma propre version.

6. CONCLUSION GENERALE

La Grèce, tout comme le Sud de l'Europe, subit une attaque sans équivoque de la part du Nord et se trouve littéralement en danger de mort. Les dirigeants Grecs, au lieu de se soumettre aux Mémoires, au lieu de se perdre dans d'interminables débats et d'évaluer mollement laquelle des méthodes de ponction sera assez rentable pour satisfaire la Troïka, auraient dû déclarer que le programme mémorandien est criminel, qu'il dépasse les limites de l'humainement acceptable, et qu'ils l'abandonnent. Ils auraient dû créer une alliance avec les autres économies du Sud de l'Europe.

Aussi inconcevable et inacceptable que soit le comportement de ses partenaires européens vis-à-vis de la Grèce, sensée être elle aussi un Etat-membre à l'égal des autres, la triste réalité est là : les Mémoires conduisent le pays à la tiermondisation, ce qui ne semble nullement les préoccuper.

Bien au contraire, ils continuent les déclarations insultantes et les piques, ils ne reconnaissent pas les sacrifices inouïs imposés au peuple, ils menacent et font du chantage, dénigrent impitoyablement le pays, et passent énergiquement au cran supérieur du « toujours plus ». D'ailleurs, les perspectives qui s'ouvrent à la Grèce sont accablantes, rien ne permet d'espérer quoi que ce soit. Avec l'effondrement des grandes économies de l'Europe du Sud, c'est-à-dire l'Espagne et l'Italie, et peut-être bientôt la France, s'est éteint aussi le dernier espoir d'un arrangement des conditions qui permettraient de résoudre le problème de la dette.

Si les épreuves, l'infortune, la guerre psychologique de la dégradation, odieuse caricature sensée illustrer la Nation grecque et son peuple, celle qu'ont dessinée et qu'ont répandue partout dans le monde ses « partenaires », l'indescriptible peur qu'ils cultivent avec une grande habileté – « Vous allez voir ce qui vous attend une fois sortis de la bergerie » – ... si donc, après deux années et demie, cette pression écrasante nous a laissé un tant soit peu l'envie de vivre, il est temps pour nous, les Grecs, de quitter la

zone euro sans tarder, pour sauver ce qui reste à sauver. Si nous restons, nous sommes définitivement perdus. Pour la simple raison que tous les sacrifices qui nous ont été infligés n'ont servi qu'à engraisser nos créanciers, le fond du problème a été dès le début ignoré. Si nous prenons notre avenir en main, les difficultés ne disparaîtront pas mais nous aurons au moins l'espoir de voir notre situation s'améliorer et notre avenir dépendra enfin de nos décisions.

La chose est simple. Tout dépend de notre capacité à faire la distinction entre la peur qui nous empêche de franchir le pas et la conviction que nous pourrions nous en sortir.

BIBLIOGRAPHIE

Vidéo CNBS tirée de l'émission *Dylan Ratigan Show (2011)*, *Greece is a crime scene*, 15.11

Cyran O. (2012), *L'effroi du retrait allemand face à l'épouvantail grec*, *Le Monde Diplomatique*, No 700-59e année, Juillet

Dassù, M. (2011), « Une Europe allemande est née », *Courrier International*, no 1095, 27.10

Ewing, J. (2012), « Berlin clings to austerity despite pleas », *IHT*, 9.1

Fehrie, B. (2011), « Pourquoi Mme Merkel a raison de douter », *Frankfurter Rundschau*, publié dans *Courrier International* du 6 au 12 octobre

Klein, N (2010), *La Stratégie du choc*, (trad. Lori Saint-Martin, Paul Gagné), Babel

Krugman, P. (2012), « Europe's great illusion », *IHT*, 5.6

Negreponi-Delivanis, M. (2012), « Lettre ouverte à Madame Christine Lagarde », *Le Monde électronique*, 18.06

Negreponi-Delivanis, M. (2011), Une analyse plus détaillée existe dans son livre (en grec) : *Toute la vérité sur la dette et le déficit et comment nous en sortir*, édité par la Fondation Delivanis et les Editions Ianos

Negreponi-Delivanis, M. (2004), *Le sort de l'euro*, édité par la Fondation Delivanis et Kornilia Sfakianaki, Thessalonique, p. 32

Negreponi-Delivanis, M. (1993), *Entreprises privées et publiques*, éd. Sakkoula, Thessalonique (en grec)

New York Times, article from 30/05/2012, available at:
http://www.defencenet.gr/defence/index.php?option=com_content&task=view&id=43278

Pavlopoulos P. (2012), «Les limites constitutionnelles des privatisations» de l' *olympiada*, 21.07 (en grec).

Sachs, J. D. (2012), « Why America must revive its middle class », *Time*, 10.10

Schuman, M. (2011) « Au revoir Welfare State », *Time*, 28.11

Srdjan Redzepagic

Institut des sciences économiques, Belgrade, Serbie

Jovan Zafiroski

l'UKIM à Skopje, Faculté de droit, Skopje, Macédoine

Vinko Kandžija

Le comté de Primorsko Goranska, Rijeka, Croatie

LE MECHANISME DE SUPERVISION UNIQUE – LE PREMIER PAS VERS UNE UNION BANCAIRE EFFICACE

RESUME

La dernière crise financière a montré toutes les imperfections de l'Union économique et monétaire européenne et la fragilité du système financier avec le secteur bancaire dans son noyau. Un secteur financier solide est crucial pour la transmission de la politique monétaire décidée au niveau européen et il est très important pour le bon fonctionnement de l'économie européenne intégrée. Ce qui semble clair c'est que l'intégration des marchés financiers doit être suivie par une application des règles communes, une coordination et coopération dans le domaine de la surveillance des institutions financières opérant au niveau européen. Néanmoins, malgré qu'ils existent des règles communes ou le «common rulebook» adoptée pour réglementer les institutions financières et les opérations qu'ils mènent, leur surveillance et contrôle est toujours effectué au niveau national. Les développements récents dans l'UE relatives au choix du modèle pour la poursuite de la supervision au niveau européen avec la mise en place des autorités de contrôle européens a montré que la simple coordination et coopération ne pourraient pas garantir la stabilité et la solidité du système financier dans son ensemble. Il est évident que la surveillance doit être plus centralisée au moins pour les banques ayant des activités transfrontalières et pour les banques de grande échelle. Sur cette base, la création ou l'achèvement d'une union bancaire européenne a été proposé par les institutions européennes dans le cadre d'un vaste plan pour mettre la zone euro sur une base plus stable présenté en Juin 2012 par le Président du Conseil européen. À cet égard, le Mécanisme de supervision unique (MSU) doit remplir l'écart entre le besoin de stabilité du système financier et l'idée pour un système financier plus intégré. Parallèlement à un mécanisme de résolution européen qui régirait la résolution bancaire et un système de garantie des dépôts commun, le MSU devrait fournir un cadre solide pour la future union bancaire européenne. Le MSU va séparer les banques de pays souverains permettant des recapitalisations directes des banques de la zone euro par le Mécanisme européen de stabilité et permettra également de réaliser un bon fonctionnement de l'union économique et monétaire. Il s'agira d'un système unique avec compétences partagées entre la BCE en tant qu'institution responsable de la supervision des banques de la zone euro et les autorités nationales effectuent la surveillance sur une base quotidienne.

Mots-clé : Mécanisme de supervision unique, union bancaire européenne, stabilité du système financier

JEL classification : K39, G21, G38

1. INTRODUCTION

Pendant les six dernières années on est témoin d'une crise économique et financière qui se déroule dans les pays du monde développé. Il y a plusieurs raisons pour cette crise ou, comme Joseph Stiglitz (2010a pp. 35-42 et 2010, pp.122-125) a souligné dans son rapport, ils existent trois raisons principales. **La première** est le niveau très faible sur le taux d'intérêts des banques centrales dans les pays développés, **la deuxième** est le processus de dérégulation et **la troisième** raison est le modèle actuel de la supervision des institutions de crédit conduite au niveau national alors que ses opérations sont transfrontières. La dernière faiblesse du système financier globale est beaucoup plus présente au niveau européen où les marchés financiers sont intégrés dans le cadre plus vaste de l'idée de la création d'un espace économique européen sans frontières promouvant des libertés économiques. La réalisation finale de cette idée est la création d'une monnaie unique pour (maintenant) dix huit États membres. Le problème de mal fonctionnement du marché financier européen et le système bancaire au son noyau a été considéré comme le secteur où plusieurs réformes sont nécessaires notamment dans le domaine de surveillance des institutions financières. Dans ce regard, le rapport de la groupe de la crise et la réponse par la groupe de Larosière¹ qui a essayé à faire une analyse sur les raisons et les réponses possibles au niveau européen sur la dernière crise a estimé que la surveillance des institutions de crédit doit être réformée. La groupe a proposé la création des institutions de surveillance au niveau européen qui vont remplir l'écart de différents autorités nationales chargées pour la supervision des institutions financières. Sur ses propositions les trois nouvelles autorités ont été créées².

Néanmoins, la dernière crise de la dette souveraine en Europe a montré le rôle et la signification d'un système bancaire et financier bien intégré. Aussi, il est devenu clair que une simple coordination dans la matière de la surveillance n'est pas suffisante pour qu'un contrôle efficace sur ses institutions est effectué. Avec le contrôle dans la main des autorités nationales le secteur bancaire reste isolé et opérant dans les frontières nationales et avec cela incapable à agir dans le combat avec les crises et amortissant ces conséquences. Ainsi, **le premier pilier** de l'intégration bancaire et financière est la réglementation qui comparent la mise en place des règles communes qui dans le cas européen et achevé par le transfert des compétences au niveau européenne et la création du «**règlement uniforme**». En ce qui concerne **le deuxième pilier** d'une union bancaire c'est-à-dire **la surveillance** des activités conduites par les banques la

¹ Report of The High-level Group on Financial Supervision in the EU, Chaired by Jacques de LAROSIERE, Bruxelles, 25 février 2009

² L'Autorité bancaire européenne, l'Autorité européenne des assurances et des pensions professionnelles et l'Autorité européenne des marchés financiers. Sur les nouvelles autorités de supervision financière européenne voir, Anne-Catherine MULLER (2010, pp.1-3) et Niamh MOLONEY (2010, pp. 1335-1341)

supervision est faite par les autorités nationales qui fait la supervision inefficace dans un marché financier intégré.

Les réformes doivent continuer par un approfondissement de l'intégration et un transfert des compétences de États membres à l'UE. L'Europe doit faire un choix entre l'intégration de ses systèmes financiers, le transfert des compétences dans le niveau supranationale et la stabilité et le bon fonctionnement du système financier. Dans la théorie ce phénomène est connu comme *trilemme financier* (Schoemaker, 2010, pp. 1-14). Inspiré par le *trilemme monétaire* selon laquelle il n'est pas possible d'avoir une politique monétaire indépendante, libre circulation de capitaux et le taux de change fixé le *trilemme financier* explique qu'un système financier stable, un système financier intégré et une autonomie nationale dans le domaine de la supervision sont incompatibles. On doit faire toujours faire un choix et n'en garder que deux. En conséquence, tenant en compte que la libre circulation des capitaux est l'une des libertés fondamentales européennes, on peut dire que le système financier européen qui est bien intégré a besoin d'une surveillance centralisée.

En ce sens, afin de créer des conditions pour une sortie de la crise et la création des conditions pour une croissance économique durable plusieurs réformes dans le système économique et financier européen ont été proposées. En conséquence, le rapport présenté par M. Herman Van Rompuy en juin 2012 offre une vision de l'avenir de l'UEM qui pourra contribuer à la croissance, à l'emploi et à la stabilité. Le rapport propose une vision pour une union économique et monétaire fondée sur quatre éléments essentiels : *un cadre financier intégré, un cadre budgétaire intégré, un cadre de politique économique intégré et à la légitimité démocratique et l'obligation de rendre compte*³.

Inspirée par le rapport du président du conseil européen et par les conclusions de Conseil européen du 28 et 29 juin la Commission a proposé la création d'un mécanisme de surveillance unique qui soit la première brique de la création de l'union bancaire européenne⁴.

Malgré les difficultés⁵ dans le processus de la mise en œuvre des décisions du Conseil et les problèmes de la mise en œuvre de détails qui doivent être négociés par les États participant dans la zone euro la nouvelle système de surveillance verra le jour l'année prochaine au plus tôt et ouvrira la voie pour la nouvelle union bancaire européenne qui améliorera les conditions pour le bon fonctionnement de la zone monétaire et contribuera à la stabilité financière. Les bénéfices d'une union bancaire en Europe peuvent se systématiser en trois positions principales :

³ Vers une véritable union économique et monétaire, Rapport présenté par M. Herman Van Rompuy, président du Conseil européen, Bruxelles, le 26 juin 2012 EUCO 120/12, p. 3

⁴ Feuille de route pour une union bancaire, Communication de la Commission au Parlement Européen et au Conseil Bruxelles, le 12.9.2012, COM(2012) 510 final

⁵ Voir le commentaire dans La Tribune, L'union bancaire européenne n'est pas encore née qu'elle est déjà en danger, 16.1.2013, disponible sur : <http://www.latribune.fr/actualites/economie/union-europeenne/20130116trib000742936/l-union-bancaire-europeenne-n-est-pas-encore-nee-qu-elle-est-deja-en-danger.html>

- un system bancaire intégré **peut contribuer à combat des débalancés entre le sud et le nord de l'Europe**. Autrement dit, le nord de l'Europe ou l'Allemagne, Autriche, Pays-Bas etc. a surplus de moyens financiers tandis que les pays du sud comme la Grèce et l'Espagne souffrent d'un déficit ou ont besoin de moyens financiers. Les taux d'intérêt sont dans un niveau bas dans les premières tandis que très élevés dans les dernières. Une union bancaire peut facilement contribuer à une allocation efficace de finances et résoudre les problèmes de déséquilibre entre les pays européens.
- **Le cercle vicieux entre dettes bancaires et dettes souveraines soit définitivement brisé**. Comme c'était souligné lors du sommet européen du 28 juin 2012 suite à la création du mécanisme de surveillance unique le Mécanisme européen de stabilité pourrait avoir la possibilité de recapitaliser directement les banques. C'est dire que la recapitalisation des banques qui ont besoin de capital ne dépend pas de la situation dans l'État membre où elle est établie, sur la viabilité de son dette publique, des perspectives de croissance économique du pays et de la viabilité des banques et autres établissements de crédit etc. mais la recapitalisation sera faite directement selon les conditions à et l'analyse de la performance de la banque concernée et la possibilité de son récupération.
- L'accomplissement de l'union bancaire européenne contribuera au bon fonctionnement du système financier européen et son cohérence qui **va améliorer la transmission de la politique monétaire** décidée au niveau européen. Le marché monétaire qui est crucial pour la transmission de la politique monétaire fonctionnera mieux aux moments où les banques ont confiance dans le système et ne craint pas pour la faillite d'une institution financière.

L'union bancaire européenne soit fondée sur trois piliers : un cadre unique de surveillance bancaire européenne, un cadre unique de garanties des dépôts et un mécanisme commun pour la résolution des défaillances. Dans l'analyse qui suit le rôle et le fonctionnement du MSU sera examiné à travers le prisme des débats qu'il provoque dans la théorie (2), puis on présentera les futures étapes pour la création de l'union bancaire européenne (3).

2. LE RÔLE ET LE FONCTIONNEMENT DU MSU

Le nouveau mécanisme pour la surveillance des banques européennes soit un système *sui generis* qui ressemble de l'organisation entre les autorités nationales et supranationales c'est dire européens dans la matière de la politique monétaire. Ainsi, il s'agit d'un system de surveillance centralisé composé par la BCE et les autorités nationales de surveillance.

Le mécanisme est principalement crée pour les États membres qui one adopté l'euro comme leur monnaie alors que les non participants peuvent également décider de participer dans ce système. C'est une décision logique ayant à l'esprit que ce mécanisme est créé pour promouvoir la stabilité de la zone euro qui, en ce qui concerne la politique monétaire, ont les mêmes exigences et intérêts. En ce sens, la base juridique utilisée pour la création de supervision unique est l'article 127, paragraphe 6, du TFUE concernant l'octroi à la BCE de pouvoir de surveillance directe des banques dans la

zone euro⁶. Tenant en compte que l'article fait référence à règlement pour régler cette problématique la Commission a proposé⁷ deux règlements.

Le but principale du MSU est de garantir que «le règlement uniforme» des services financiers s'applique de la même manière aux établissements de crédit de tous les États membres et que la politique européenne matière de surveillance prudentielle des banques et autres établissements de crédit est mise en œuvre de manière cohérente et efficace. Aussi, cela résoudra les dilemmes pour la séparation des compétences entre autorités des pays d'origine et d'accueil dans certains cas car dans le nouveau mécanisme proposé il y aura un seul superviseur au niveau européen.

Proposé par la Commission et puis développé par les décisions faites par le Conseil européen le MSE provoque plusieurs débats concernant la justification de la décision que la BCE soit le superviseur ultime dans l'espace bancaire européenne et les questions se posent sur la portée des pouvoirs de contrôle de la BCE. La question qui se pose est de savoir si toutes les banques européennes devraient être surveillées par la BCE ou la surveillance sur les grandes banques est suffisante pour la réalisation de la stabilité de la zone euro et du système financier européen. Cette analyse sera présentée dans le part suivant.

2.1. La BCE est-elle l'institution le plus propre pour une supervision centralisée ?

La BCE soit l'institution responsable pour la surveillance des banques dans la zone euro. En vertu de l'article 4 du Proposition la BCE aura la compétence exclusive de missions de surveillance pour détecter les risques menaçant la viabilité des banques et les obliger à prendre les mesures qui s'imposent, d'agréeer les établissements de crédit, d'évaluer les participations qualifiées, de veiller au respect des exigences minimales de fonds propres ainsi qu'à l'adéquation du capital interne. Aussi, la BCE examinera la mise en œuvre des dispositions en matière de degré de levier et en matière de liquidité. En coordination avec les autorités de résolution la BCE pourra imposer la constitution de coussins de fonds propres et mettra en œuvre des mesures d'intervention précoce lorsqu'une banque ne respecte plus, ou est en passe de ne plus respecter, ses exigences de fonds propres réglementaires. Néanmoins, selon les propositions, les autorités nationales pour surveillance gardent le pouvoir de : réceptionner les notifications soumises par les établissements de crédit dans le cadre de l'exercice du droit d'établissement et de la libre prestation de services, de surveiller les entités qui ne relèvent pas de la définition des établissements de crédit en droit européenne, de surveiller les établissements de crédit de pays tiers qui établissent une succursale ou fournissent des services en prestation transfrontière dans l'Union, de surveiller les services de paiement, d'accomplir des vérifications quotidiennes concernant les établissements de crédit et d'exercer la fonction d'autorités compétentes pour les

⁶ Traité sur le fonctionnement de l'UE, JO N° C 115/103

⁷ Proposition de Règlement du Parlement Européen et du Conseil modifiant le règlement (UE) n° 1093/2010 instituant une Autorité européenne de surveillance (Autorité bancaire européenne) en ce qui concerne son interaction avec le règlement (UE) n° ... du Conseil confiant à la Banque centrale européenne des missions spécifiques ayant trait aux politiques en matière de contrôle prudentiel des établissements de crédit, Bruxelles, le 12.9.2012 COM(2012) 512 final et Proposition de Règlement du Conseil confiant à la Banque centrale européenne des missions spécifiques ayant trait aux politiques en matière de contrôle prudentiel des établissements de crédit, Bruxelles, le 12.9.2012 COM(2012) 511 final

établissements de crédit relativement aux marchés d'instruments financiers et à la prévention de l'utilisation du système financier aux fins du blanchiment de capitaux et du financement du terrorisme.

Pour démarquer la politique monétaire de l'influence de la mission concernant la supervision, un comité de surveillance chargé de préparer les décisions en matière de surveillance sera institué auprès de la BCE. Ce comité soit dirigé par un président et un vice-président élus par le conseil des gouverneurs de la BCE, et être composé, en outre, de représentants de la BCE et des autorités nationales. Le comité aura connaissance pour la situation dans le système bancaire et financier européen dans son ensemble alors qu'il bénéficiera de l'expertise spécifique des autorités nationales de surveillance.

Bien que il est indéniable qu'en ce qui concerne la supervision des banques les banques centrales sont les responsables pour cette mission dans 12 Etats membres de la zone euro des différents opinions sont présents en déterminant le model de supervision des instructions financières en Europe. La première question qui se pose est si la BCE faut être inclus dans le processus de supervision ou une autre institution faut être créée ? Ils existent des arguments (Vasso IOANNIDOU, 2012, pp. 90-94) *pros*⁸ et *cons* pour l'intégration des compétences de surveillance à la BCE.

2.1.1. Pros

Le premier argument pour octroyer à la BCE la mission de superviseur ultime est qu'elle possède **un grand intérêt** pour le bon fonctionnement du système financier européen. Lorsque le système financier ne marche pas bien la bonne transmission de la politique monétaire est en danger car les problèmes dans une institution provoque des inquiétudes pour les autres institutions qui affectent les marchés monétaires qui sont essentielles pour la transmission de la politique monétaire.

Aussi, c'est le deuxième raison, la supervision des institutions contribuera à bon achèvement de la stabilité du système financier entier qui est une des fonctions de la BCE en vu des dernières compétences consacrées au ESRB pour **la surveillance macro prudentielle**⁹.

Troisièmement, la BCE est l'une des institutions européennes qui possède une vaste **indépendance** par rapport aux autres institutions de l'Union et par rapport aux autorités nationales qui peut servir au bon accomplissement de son mission concernant la surveillance des banques dans la zone euro. L'indépendance de l'institution qui agit comme le superviseur ultime est une *condition sine que non* pour une surveillance efficace.

⁸ Vítor Constancio, Vice-President of the ECB, Towards a European Banking Union, Lecture held at the start of the academic year of the Duisenberg School of Finance, Amsterdam, 7 September 2012

⁹ Sur les responsabilités de la BCE relatives à la surveillance macroprudentielle voir, Daniel Gluch, Lucia Škovranova et Mikael Stenstrom (2013, pp.2-17)

2.1.2. Cons

La décision de consacrer les pouvoirs de contrôle à la BCE est parfois perçue comme une grande erreur. Ces opinions vont dans le sens que la BCE possède un mandat important dans la matière de la politique monétaire avec une mission claire c'est-à-dire de maintenir la stabilité des prix. La première question qui se pose est ce qu'il y a des conflits entre la mission de l'achèvement la stabilité des prix qui est la première et la mission la plus importante de la BCE et la tâche de surveillance des banques. Est-il possible une situation dans laquelle la BCE peut risquer la politique monétaire pour sauver une banque ou plusieurs banques ? **Le conflit d'intérêts** des différentes missions de la BCE est un argument fort pour la création d'une autre institution européenne spécialisée qui soit exclusivement chargée pour la surveillance des banques dans la zone euro. Le deuxième argument contre la mission de la BCE dans la surveillance des banques européennes se situe dans le **risque de la crédibilité**. Autrement dit, pourrait-il une faillite d'une banque nous amener à la conclusion que la BCE n'est pas capable à accomplir ces missions et avec cela met à danger la réalisation de la stabilité des prix qui est la mission principale de la BCE ?

2.2. L'objet de surveillance par le MSU

Une de plus grandes obstacles pour la mise en place du MSU était la question de la portée de la surveillance ou sur l'échelle de la surveillance transférée au niveau européen. Ils existaient deux positions différentes, celle de la France et l'autre de l'Allemagne. La première avait la position que toutes les banques dans la zone euro faudrait être surveillées par l'autorité supranational c'est-à-dire la BCE tandis que la position de l'Allemagne était que seules les grandes banques avec des activités transfrontalières devraient être surveillées par l'autorité européenne.

Le compromis a été trouvé par le Conseil européen qui est arrivé sur l'accord qui détermine les modalités de l'accord du mécanisme de supervision des banques de la zone euro. Ainsi, selon l'accord obtenu, la BCE supervisera directement les banques dont les actifs sont supérieurs à 30 milliards d'euros ou représentant un cinquième du produit intérieur brut de leur pays d'origine. Aussi, les trois plus grandes banques de chaque pays seront également consacrées.

Ce compromis est bienvenu de point de vue de l'urgence pour un rapprochement des positions différentes sur la mise en œuvre d'une union bancaire mais cette décision pour une surveillance limitée pourrait provoquer plusieurs problèmes et instabilité sur le système financier européen. Ainsi, il est clair que les grandes banques européennes avec des activités transfrontalières qui sont considérées « too big to fail » peuvent entraver la stabilité et d'avoir effet systémique mais il faut observer les petites banques dont la participation dans un certain marché dans un État membre est considérable. Plusieurs petites banques ayant des caractéristiques similaires peuvent agir de la même manière afin que le secteur dans son ensemble puisse présenter une menace pour la stabilité du système bancaire et financier dans son ensemble Voir (Rudolf MAIER 2012, p. 9) Ainsi, on doit faire attention sur les petites banques dans l'Espagne. Chacune de ces banques est petite pour avoir une influence systémique mais le total de ces banques est considérable. Une autre différence entre la France et l'Allemagne était le calendrier

pour la mise en œuvre du MSU. Pour la raison de son « calendrier électoral » l'Allemagne souhaitait que le dispositif de l'accord pour la surveillance unique soit effectif fin 2013 après les élections tandis que l'intérêt de France était le mécanisme soit effectif le plus tôt possible. Le compromis a été trouvé pour 2014 pour la mise en œuvre du MSU.

En outre, pour effectuer ces missions la BCE coopérera étroitement avec les autorités nationales de surveillance et l'ABE. En ce qui concerne la matière de surveillance la BCE fonctionnera dans le cadre du SEFS. Ici, il est nécessaire de faire une démarcation entre les compétences de la BCE et l'ABE. Bien que la BCE possède des compétences dans la matière de supervision des banques l'ABE conservera ses compétences et ses missions, consistant à élaborer plus avant le « règlement uniforme » et à assurer la cohérence et la convergence des pratiques prudentielles. Aussi, la composition du conseil des autorités de surveillance de l'ABE restera inchangée, et les décisions resteront prises par des représentants des autorités nationales.

Les relations avec les autorités de surveillance dans les États membres non participants à la zone euro seront réglées par memoranda qui soit signées avec toutes les autorités nationales. La coopération sera mise en œuvre dans la matière de la surveillance en générale avec un accent sur les filiales des banques de la zone euro dans le États membre non participant.

Après avoir analysé les fondements du MSU et le débats qu'il provoque, il convient, dans la partie suivante de s'interroger sur les questions des futures étapes pour la création de l'union bancaire européenne.

3. LES FUTURES ETAPES POUR LA CREATION DE L'UNION BANCAIRE EUROPEENNE

Afin d'avoir des effets positifs de la création du MSU il faut continuer avec les réformes dans le système financier européen dans la ligne de l'accomplissement de l'union bancaire européenne. C'est aussi prévu dans le Rapport présenté par le président du Conseil européen et dans le Feuille de route pour une union bancaire de la Commission européenne¹⁰.

Ces textes préparés par de différentes institutions européennes soulignent la nécessité et l'importance pour compléter le projet de l'union bancaire européenne. Néanmoins, en mars 2013 nous sommes confrontés à des problèmes de non existence d'une vraie union bancaire en Europe alors que sans d'avoir un système européen de garantie des dépôts et un système de résolution européen le système financier européen ne fonctionnera pas. La dernière crise bancaire en Chypre nous le montre bien. La signification et l'échelle du secteur bancaire dans ce pays est considérable. Il représente près de huit fois le PIB du pays qui fait des autorités du pays impuissantes pour combattre la crise. La gestion du sauvetage de Chypre est chaotique sans avoir une règle uniforme pour tous les pays européens qui peuvent se trouver dans les difficultés.

¹⁰ Voir, le Rapport p. 5 et le Feuille de route pour une union bancaire p. 10

Les solutions pour les problèmes dans les secteurs bancaires différents en Europe sont établies au cas par cas selon la situation du pays concerné, sans modèle prédéfini¹¹. Cela provoque des incertitudes dans les marchés européennes pour la stabilité des autres États membres qui peuvent se trouver en difficultés, comme l'Espagne et la Slovaquie par exemple, ou dans le cas des pays dont le secteur bancaire est très important, comme le Luxembourg. Toutes ces incertitudes ont contribué à l'effondrement des indices des banques européennes, entraînant avec elles les grands indices européens¹². La réponse sur la crise chypriote qui prévoit la restructuration massive des deux principales banques du pays, en imposant des pertes à leurs déposants, actionnaires et créanciers a provoqué des problèmes dans le secteur qui sera dans un grand minus aux années qui viennent.

Les leçons du sauvetage de Chypre pour l'Europe est qu'afin d'avoir un bon fonctionnement du système financier européen un cadre unique de garanties des dépôts et un mécanisme commun pour la résolution des défaillances sont nécessaires.

3.1. Le cadre unique de garanties des dépôts

Malgré que dans la crise financière a forcé les États en Europe de harmoniser partiellement les règles concernant les garanties de dépôts qui avait un résultat d'un minimum couverture de 100.000 euros pour toutes des dépôts dans les banques ayant son siège dans l'UE qui a été introduit en 2009 les règles et les schémas de garanties de dépôts en Europe resta dans le niveau national. Le cadre unique de garantie des dépôts renforcera la crédibilité du système bancaire européen et apportera une garantie importante que les dépôts des banques relevant de la surveillance à l'échelon européen sont suffisamment assurés. Cela fait tous les dépôts dans chaque banque dans la zone euro d'être traité d'une manière uniforme. Ils n'existent des différences pour entre les dépôts sur la base du siège social de la banque dans un pays de la zone euro.

3.2 Le mécanisme commun pour la résolution des défaillances

Bien que la surveillance unique améliore la stabilité de secteur bancaire européen il est indéniable que les faillites des banques sont probables. Afin de préserver la stabilité de du système financier dans son ensemble il faut d'avoir un mécanisme commun pour la résolution des défaillances qui permettra de liquider d'une manière coordonnée les établissements non viables et de protéger ainsi des fonds de contribuables. Selon certaines opinions¹³ **le mécanisme commun pour la résolution devrait être proposé au même temps avec le MSU**. Il y a plusieurs raisons pour cela. **Premièrement**, les

¹¹ Sur la réponse européenne sur la crise en Chypre voir, Jeroen Dijsselbloem, le président de l'Eurogroupe, "Chypre est un cas spécifique, qui justifie les mesures prises sur ses banques", Le monde, 26.3.2013, disponible sur : http://www.lemonde.fr/economie/article/2013/03/26/dijsselbloem-chypre-est-un-cas-specifique-qui-justifie-les-mesures-prises-sur-ses-banques_3147935_3234.html

¹² Voir, Les Echos, Bourse : pourquoi les banques européennes se sont soudainement effondrées, Par Guillaume Maujean, 25.3.2012, disponible sur : <http://www.lesechos.fr/entreprises-secteurs/finance-marches/actu/0202664197287-pourquoi-les-banques-europeennes-se-sont-soudain-effondrees-en-bourse-552369.php> et Les Echos, Bourse-Chypre et l'Italie plombent les banques de la zone euro, 27.3.2013, disponible sur : <http://www.lesechos.fr/entreprises-secteurs/finance-marches/actu/reuters-00510050-bourse-chypre-et-l-italie-plombent-les-banques-de-la-zone-euro-553077.php>

¹³ André SAPIR, Martin HELLWIG et Marco PAGANO (2012, p.5)

pouvoirs de surveillance incluent notamment le pouvoir d'agr er les  tablissements de cr dit et de leur retirer leur agr ement. La question qui se pose est de savoir comment la BCE va d cider la r solution et partager les pertes qui suit de la d cision pour la cl ture d'une banque ? **Deuxi mement**, qui sera responsable pour couvrir les pertes ? Sont –ils les autorit s nationales alors que la surveillance est faite au niveau europ en ? Il est clair que la surveillance des  tablissements de cr dit n cessite un cadre commun pour la r solution des d faillances. N anmoins, bien qu'il soit li    la mission de la BCE concernant la surveillance le nouveau m canisme pour la r solution des d faillances ne faut pas  tre plac  dans la BCE pour la possibilit  de conflit d'int r ts. Il ne pas logique d'avoir la surveillance et r solution de d faillance situ    la m me institution¹⁴. Ainsi, la r solution des fautes des grand conglom rats bancaires dans l'espace europ en, comme c' tait le cas du Fortis en 2008 quand les responsabilit s des autorit s n erlandais et luxembourgeois n' taient pas distinctes n'est par possible. Le m canisme commun va am liorer le cadre ou donner des  gales quand et comment une banque ou autre institution de cr dit pourrait  tre l'objet de sauvetage (bail-out) par l' tat avec ces finances publiques.

En vue de cela, la Commission europ enne a bien propos ¹⁵ un cadre unique pour la r solution des d faillances qui, ce qui devrait suivre dans la p riode suivante est la cr ation d'un m canisme commun charg  pour r solution situ  dans le niveau supranational qui r soudra les d faillances des banques surveill es par la BCE.

4. CONCLUSION

La derni re crise  conomique et financi re en Europe et au monde d velopp  ont accentu  l'importance d'un syst me financier stable et bien int gr  pour combattre la crise et ces effets. Il est devenu clair que l'UE et notamment les  tats membres participant dans la zone euro doivent continuer avec les r formes et efforts pour la cr ation d'une union bancaire europ enne. La premi re pas dans la voie de la cr ation de cette union bancaire est la cr ation du M canisme europ en de surveillance qui soit le responsable pour la surveillance des banques dans la zone euro dont les actifs sont sup rieurs   30 milliards d'euros ou repr sentant un cinqui me du produit int rieur brut de leur pays d'origine et aussi pour les trois plus grandes banques de chaque pays. Malgr  des diff rentes opinions dans la th orie qui donne des arguments *pros* et *cons* pour une telle d cision la BCE soit l'institution responsable pour la surveillance. N anmoins, afin de pr server sa mission principale la surveillance sera mise en  uvre par autres organes de d cision de la BCE. Cela fait une division entre la politique mon taire et les responsabilit s de la BCE dans le domaine de la surveillance. Aussi, dans l'accomplissement de ces missions la BCE coop era avec les autorit s nationales.

¹⁴ Voir, Dirk Schoemaker, (2012, pp. 98-100) et The European banking union – first steps on a long march, Speech by Yves Mersch, Member of the Executive Board of the ECB, Finanzplatztag, 27 February 2013

¹⁵ La Commission europ enne, Proposition de Directive du Parlement Europ en et du Conseil  tablissant un cadre pour le redressement et la r solution des d faillances d' tablissements de cr dit et d'entreprises d'investissement et modifiant les directives 77/91/CEE et 82/891/CE du Conseil ainsi que les directives 2001/24/CE, 2002/47/CE, 2004/25/CE, 2005/56/CE, 2007/36/CE et 2011/35/UE et le r glement (UE) n  1093/2010 du Parlement europ en et du Conseil, Bruxelles, COM(2012) 280

Il est indéniable que la création du MSU favorisera la stabilité et la cohérence de l'espace bancaire européen mais il faut dire qu'une union bancaire européenne sera réalisée lors de la création d'un mécanisme commun pour la résolution des défaillances qui permettra de liquider d'une manière coordonnée les banques non viables et un cadre unique de garanties des dépôts assurant que tous les dépôts dans chaque banque dans la zone euro soit traité d'une manière égale.

REFERENCES

- Beck, T, Gros, D. (2012), Monetary Policy and Banking Supervision: Coordination instead of separation, CPES policy brief, No. 286, 12 décembre
- Commission européenne, Proposition de Directive du Parlement Européen et du Conseil établissant un cadre pour le redressement et la résolution des défaillances d'établissements de crédit et d'entreprises d'investissement et modifiant les directives 77/91/CEE et 82/891/CE du Conseil ainsi que les directives 2001/24/CE, 2002/47/CE, 2004/25/CE, 2005/56/CE, 2007/36/CE et 2011/35/UE et le règlement (UE) n° 1093/2010 du Parlement européen et du Conseil, Bruxelles, COM(2012) 280
- Commission européenne, Proposition de Règlement du Conseil confiant à la Banque centrale européenne des missions spécifiques ayant trait aux politiques en matière de contrôle prudentiel des établissements de crédit, Bruxelles, le 12.9.2012 COM(2012) 511 final
- Commission européenne, Proposition de Règlement du Parlement Européen et du Conseil modifiant le règlement (UE) n° 1093/2010 instituant une Autorité européenne de surveillance (Autorité bancaire européenne) en ce qui concerne son interaction avec le règlement (UE) n° .../... du Conseil confiant à la Banque centrale européenne des missions spécifiques ayant trait aux politiques en matière de contrôle prudentiel des établissements de crédit, Bruxelles, le 12.9.2012 COM(2012) 512 final
- Constancio, V., Vice-President of the ECB, Towards a European Banking Union, Lecture held at the start of the academic year of the Duisenberg School of Finance, Amsterdam, 7 September 2012
- Dijsselbloem, J., le président de l'Eurogroupe, "Chypre est un cas spécifique, qui justifie les mesures prises sur ses banques", Le monde, 26.3.2013, disponible sur : http://www.lemonde.fr/economie/article/2013/03/26/dijsselbloem-chypre-est-un-cas-specifique-qui-justifie-les-mesures-prises-sur-ses-banques_3147935_3234.html
- Feuille de route pour une union bancaire, Communication DE LA Commission AU Parlement Européen ET AU Conseil Bruxelles, le 12.9.2012, COM(2012) 510 final
- Gluch, D.; Škovranova, L. Stenstrom M. (2013), Central Bank Involvement in Macro-prudential Oversight, Legal Working Paper Series, No 14, janvier, pp.2-17
- Ioannidou, V. (2012), A first step towards a banking union, dans Banking Union for Europe, Risks and Challenges edited by Thorsten BECK, pp. 90-94,
- La Tribune, L'union bancaire européenne n'est pas encore née qu'elle est déjà en danger, 16.1.2013, disponible sur : <http://www.latribune.fr/actualites/economie/union-europeenne/20130116trib000742936/l-union-bancaire-europeenne-n-est-pas-encore-nee-qu-elle-est-deja-en-danger.html>
- Les Echos, Bourse : pourquoi les banques européennes se sont soudainement effondrées, Par Guillaume Maujean, 25.3.2012, disponible sur : <http://www.lesechos.fr/entreprises-secteurs/finance-marches/actu/0202664197287-pourquoi-les-banques-europeennes-se-sont-soudain-effondrees-en-bourse-552369.php>
- Les Echos, Bourse-Chypre et l'Italie plombent les banques de la zone euro, 27.3.2013, disponible sur : <http://www.lesechos.fr/entreprises-secteurs/finance-marches/actu/reuters-00510050-bourse-chypre-et-l-italie-plombent-les-banques-de-la-zone-euro-553077.php>

- Maier, R. (2012) How should a European Banking Union Work? Policy department Economic and Scientific Policies, septembre 2012, p.9
- Mersch, Y. (2013) The European banking union – first steps on a long march, Speech by Yves Mersch, Member of the Executive Board of the ECB, Finanzplatztag, 27 February 2013
- Moloney, N. (2010), EU Financial Market Regulation after the Global Financial Crisis: “More of Europe” or More Risk?, *Common Market Law Review* 47, pp. 1335-1341
- Muller, A.-C. (2010), Présentation des nouvelles autorités européennes de surveillance, *Revue de Droit bancaire et financier* no 1, Janvier, comm. 33, pp.1-3
- Report of the High-level Group on Financial Supervision in the EU, Chaired by Jacques de Larosiere, Bruxelles, 25 février 2009
- Sapir, A., Hellwig M., Pagano, M. (2012) Reports of the Advisory Scientific Committee, A contribution from the Chair and Vice-Chairs of the Advisory Scientific Committee to the discussion on the European Commission’s banking union proposals, *ESRB*, No 2 Octobre, p.5
- Schoenmaker D. (2010), The Financial Trilemma at work in Europe, *SSRN*, février, pp. 1-14
- Schoenmaker D. (2012), Banking union: Where we’re going wrong, dans *Banking Union for Europe, Risks and Challenges* edited by Thorsten BECK, pp. 98-10
- Stiglitz J. (2010a), Le triomphe de la cupidité, *Les liens qui libèrent*, pp. 35-42
- Stiglitz, J. et les membres d’une commission d’experts financiers réunie par les Nations unies (2010), Le rapport Stiglitz, Pour une vraie réforme du système monétaire et financier international après la crise mondiale, *Les liens qui libèrent*, pp. 35-42
- Traité sur le fonctionnement de l’UE, JO N° C 115/103
- Van Rompuy, H. (2012) Vers une véritable union économique et monétaire, Rapport présenté par M. Herman Van Rompuy, président du Conseil européen, Bruxelles, le 26 juin 2012 *EUCO* 120/12, p. 3

Elisabeth du Réau

Université Sorbonne Nouvelle (Paris 3), Paris, France

L'UNION EUROPEENNE ET LES BALKANS, ENJEUX GÉOPOLITIQUES ET PROCESSUS D'ADHESION

RESUME

La première partie de l'étude rappellera brièvement l'arrière plan historique c'est-à-dire les mutations qui ont affecté cet espace au tournant des années 1990 dans le contexte international de post-guerre froide.

Tandis que de graves conflits se développaient dans l'espace yougoslave, l'Union européenne en formation, à l'issue du traité signé à Maastricht en février 1992, par les 12 Etats de la Communauté européenne, se divisait sur les actions à engager, et se révélait impuissante, ne s'impliquant que tardivement dans une action multilatérale complexe et laissant aux USA les principales initiatives au moment des accords de Dayton (en 1995) puis lors de la crise du Kosovo (en 1999). Les enjeux géopolitiques sont déterminants au cours de cette époque mais gardent une place fondamentale dans la période suivante marquée par la politique d'élargissement de l'U.E.

La deuxième partie de l'intervention évoquera ces enjeux géopolitiques dans la période 2000-2012 marquée par l'élargissement aux Etats d'Europe centrale et orientale et la mise en œuvre des accords de stabilisation et d'association dans l'espace balkanique en relation avec des préoccupations politiques, économiques mais aussi sécuritaires. Enfin, plus récemment, les démarches en vue de l'adhésion de la Croatie marquent un tournant dans l'évolution du processus d'adhésion.

Mots-clés : l'élargissement, Europe centrale et orientale, accords de stabilisation et d'association, Balkan

JEL Classification : F15

1. INTRODUCTION

L'Union européenne a été officiellement instituée le 1^{er} novembre 1993, date de l'entrée en vigueur du traité institué à Maastricht le 7 février 1992 entre les 12 Etats de la Communauté économique européenne (C.E.E). C'est au cours de la Conférence intergouvernementale de la fin de l'année 1991, que des dissensions éclatent, entre les douze, sur l'attitude à adopter face aux très graves conflits en ex Yougoslavie, l'Allemagne récemment réunifiée étant favorable à une intervention en faveur de la Slovanie et de la Croatie qu'elle « reconnaît » le 21 décembre alors qu'une commission d'arbitrage présidée par Robert Badinter avait initialement préconisé la temporisation.

De l'hiver 1992 aux accords de Dayton, les 12 Etats de la Communauté ne s'accordent pas pour confier une véritable mission à l'Union de l'Europe occidentale qui vient de bénéficier de pouvoirs renforcés aux termes des articles du traité instituant les bases de la politique européenne de sécurité commune, (la PESC). C'est dans un contexte multilatéral où les Etats-Unis jouent un rôle majeur que les Accords de Dayton créent une situation géopolitique très complexe.

Ainsi dès l'origine du conflit la communauté économique européenne puis l'Union européenne ont été confrontées à de graves difficultés à une époque où la dimension de politique étrangère de l'action communautaire était embryonnaire puisqu'elle n'est apparue que sous forme de mention dans un appendice de l'Acte unique européen, entré en vigueur en 1987. Dans le texte du traité de Maastricht c'est à l'Union de l'Europe occidentale que sont confiées des missions limitées définies par le titre V du traité de Maastricht. Mais il n'y a pas de **consensus** au sein de l'U.E.O sur le principe d'une intervention.

L'étude présentera en premier lieu cet arrière plan historique et montrera les limites de l'action engagée par les Etats européens, membres de l'Union européenne, du déclenchement du conflit à la crise du Kosovo.

La situation géographique des Etats de l'espace balkanique à la périphérie de l'Union européenne en formation et les mutations politiques surgies de l'automne 1989 à l'hiver 1992 en Europe centrale et orientale et dans l'ex URSS ont provoqué un véritable séisme géopolitique dans la région. Pour évaluer les défis de la reconstruction de cette zone il est impératif de garder en mémoire l'ampleur de ces bouleversements qui accompagnent la fin de la guerre froide. L'approche des historiens est donc une démarche qui s'impose et ne peut être passée sous silence pour la période 1989-1999.

Dans un second temps, nous nous interrogerons sur la décennie suivante, 2000-2010, marquée par la volonté d'élargissement de l'Union européenne en direction des Etats d'Europe centrale et orientale mais aussi en direction de la Slovénie, de la Bulgarie et de la Roumanie. Soucieuse de stabiliser l'espace balkanique, l'Union européenne a adopté dès juin 1999 le principe de la création d'un Pacte de stabilité pour les Balkans occidentaux. Elle élabore des accords de stabilisation et d'association dont bénéficiera dès 2001 la « Macédoine ».

Tandis que parallèlement l'adhésion de dix candidats se prépare, la question de l'élargissement de l'UE aux Balkans occidentaux n'est pas réglée.

La portée des tensions qui subsistent, notamment au Kosovo et l'aggravation de la tension internationale après les événements de 2001 (crise du 11 septembre 2001 et rebonds terroristes en Europe) ne constituent pas des facteurs favorables à la perspective de l'élargissement en direction de l'Europe du Sud Est. Les enjeux sécuritaires sont donc largement présents mais d'autres facteurs doivent être pris en compte pour apprécier la lente évolution qui se dessine depuis l'entrée des nouveaux membres de l'Union en 2004.

2. UN ESPACE FRACTURE, A LA PERIPHERIE DES L'UNION EUROPEENNE : QUELLE STRATEGIE POUR LES ACTEURS EUROPEENS.

2.1. Les premiers développements des conflits balkaniques. Une Europe « empêtrée ».

C'est en février 1992 que l'Union européenne nouvellement constituée se penche officiellement sur la question de la reconnaissance de l'indépendance de la Slovénie et de la Croatie. Mais les fractures au sein de l'espace yougoslave sont plus anciennes. L'examen par les historiens et les juristes des conflits à l'ouest de l'espace balkanique est loin d'être achevé. La présente étude se fonde sur certains documents disponibles dans divers sites d'archives et plusieurs rapports aujourd'hui consultables en ligne sur différents sites des institutions internationales concernées.¹

Parmi les acteurs nationaux l'Allemagne tout récemment réunifiée et la France jouent un rôle stratégique mais au début de la crise leurs vues ne convergent pas. C'est en juin 1999, que le Président de la République François Mitterrand consulte son ministre des Affaires étrangères Roland Dumas sur les affrontements serbo-croates et serbo-slovènes qui débouchent le 25 juin sur la proclamation de leur indépendance par la Croatie et la Slovénie, immédiatement dénoncée par la Serbie.

Dès cette date les principales questions posées sont celles de la légitimité d'une intervention étrangère au profit de ces deux « entités ». En effet ces Républiques étaient membres de la Fédération yougoslave. L'armée fédérale à la demande du président de la Fédération Slobodan Milosevic intervient et ouvre les hostilités sans ménagement. Dans un passé récent une décentralisation avait été proposée qui convenait aux divers peuples sauf aux Serbes. En effet, ils acceptent mal une décentralisation qui les rend minoritaires dans diverses républiques et provinces notamment en Croatie (12%), Bosnie (31%), et Kosovo (10%). Les conflits éclateront précisément dans ces régions².

Les problèmes suscitent des questions dans la communauté internationale et seront bientôt examinées à l'O.N.U. Mais les organisations régionales du voisinage vont se saisir de la controverse. Parmi les acteurs européens deux Etats jouent un rôle important, l'Allemagne et la France. Le Chancelier Kohl, se déclare favorable à la réunion de l'Union de l'Europe Occidentale (U.E.O) alors présidée par l'Allemagne. Les ministres de la défense de cette institution se réunissent le 19 septembre et examinent l'éventualité de la création d'une force d'interposition sur le terrain. Mais le Royaume Uni soutenu par le Portugal s'oppose formellement estimant que les Etats en question ne sont pas dans la zone couverte par l'obligation d'assistance militaire car non membres de la Communauté économique européenne. Ces deux Etats estiment préférable un soutien à une opération de paix conduite par l'O.N.U.

¹ Archives nationales France Caran, Fonds François Mitterrand, consultés par nous, à Paris, prochainement consultables au nouveau site de Pierrefitte. Site en ligne de l'Union de l'Europe occidentale, Western European Union (WEU) à Bruxelles.

² Documentation Française, *Questions internationales* n° 23, Paul Garde « De la question d'Orient à l'intégration européenne » pp 16 à 19

La France a des relations diplomatiques anciennes avec Belgrade et s'est préoccupée de l'évolution de la situation politique dans la fédération Yougoslave notamment à l'époque où elle s'est dotée d'une nouvelle Constitution en 1974. Dès août 1991, des contacts sont pris entre Paris et Belgrade. La France préconise l'examen du dossier par une Commission d'arbitrage constituée des présidents de cours constitutionnelles ; Robert Badinter, éminent juriste français est pressenti pour la présider³.

Tandis que les combats s'exacerbent et que la situation en Slovénie, en Croatie et Bosnie Herzégovine s'aggrave, la Chancellerie allemande décide de prendre position. Le 23 décembre 1991, l'Allemagne reconnaît l'indépendance de la Croatie et de la Slovénie face à l'échec de la coopération politique au sein de la communauté européenne. On notera que cet acte diplomatique intervient au moment où l'URSS cesse d'exister et où la Communauté des Etats indépendants émerge (21 décembre 1991).

La France préconisait d'attendre les conclusions de la Commission d'arbitrage. Ainsi se précisait au grand jour l'importance des divergences franco-allemandes sur ce dossier. En janvier la Commission d'arbitrage validera à certaines conditions la reconnaissance de l'indépendance de la Croatie et de la Slovénie et préconise de différer l'examen de la situation en Bosnie où les problèmes ethnico-politiques sont beaucoup plus complexes. L'ONU prend alors le relai, son Conseil de sécurité décide de la création d'une force d'interposition la Forpronu, à laquelle participeront des forces françaises⁴.

2.2. Le rôle croissant de l'O.N.U et de l'O.T.A.N dans un conflit très meurtrier qui affecte gravement les populations de la région.

2.2.1. Le rôle de l'O.N.U

Dès le 19 septembre, le Canada avait saisi le Conseil de sécurité de l'O.N.U, dès le 25 septembre celui-ci décrète un embargo sur les armes. Ainsi d'autres acteurs de la Communauté internationale, notamment issus du continent nord américain interviennent. A partir de la fin novembre le représentant personnel du Secrétaire Général de l'O.N.U, l'américain Cyrus Vance, présente un plan (dès lors appelé plan Vance) qui prévoit le déploiement des troupes d'interposition de l'O.N.U en Croatie.⁵

La stratégie de la Communauté internationale par l'entremise de l'O.N.U se décline suivant trois modes opératoires : la mise en place d'un embargo sur les armes visant à limiter l'étendue de la violence et l'extension du conflit. En second lieu l'imposition de sanctions économiques et politiques destinées à punir les comportements agressifs.

³ Védrine, H. (1996) *Les mondes de François Mitterrand*, Paris, Fayard 1996, p.61. Hubert Védrine futur ministre des Affaires étrangères est alors Secrétaire Général à l'Elysée.

⁴ Buffotot, P. (1995), *La défense en Europe, de la guerre du Golfe au conflit yougoslave*. La Documentation Française, 1995, pp.203-214

⁵ Hatto, R. (2013) *L'Union européenne, l'Otan et la gestion des crises yougoslaves* in Dossier « Les Balkans et l'Europe ». Articles dans la revue citée, *Questions internationales*, n° 23, op.cit, pp.44 à 50
Voir aussi témoignage d'Élisabeth Claverie, anthropologue au CNRS ancienne experte au TPIY (Tribunal pénal international pour la Yougoslavie) à la journée d'étude de Paris I (Etudes sur la guerre. CNRS) présentée le 11 janvier 2013 au Panthéon-Sorbonne

Enfin la constitution d'une mission d'interposition a pour but d'alléger les souffrances des populations civiles. La création dès le 22 février 1992 de la Forpronu formée de divers contingents de « Casques bleus » ne règle pas tous les problèmes ; l'extension du mandat de la Forpronu s'impose dès le printemps 1993 et le concours de l'Otan devient nécessaire pour protéger les 3 zones de sécurité.

2.2.2. Le rôle croissant de l'O.T.A.N et l'implication des Etats-Unis. Les accords de Dayton. (Novembre 1995)

Les prises d'otages et les attaques contre les casques bleus par les Serbes au printemps 1995, puis l'ampleur des violences contre les civils à Sarajevo achèvent de convaincre les chancelleries occidentales de l'urgence d'une coordination plus efficace afin de mettre fin au conflit.

A partir de juin 1995, la création de la Force de réaction rapide (FRR) proposée par le nouveau président français Jacques Chirac est une étape décisive. L'utilisation des forces aériennes de l'O.T.A.N et de l'artillerie de la FRR permettent le « cessez le feu » dès le début d'octobre et l'ouverture des négociations de paix qui organisent un partage territorial complexe sur lequel on reviendra, par l'Accord du 21 novembre 1995 à Dayton dans l'Ohio aux Etats Unis⁶. Au cours de cette période conflictuelle, les enjeux n'ont pas toujours été convergents pour les différents acteurs concernés.

Les organisations internationales ont toutes fait référence à la notion de sécurité, concept global qui a été décliné par les différents acteurs en fonction de différents arguments, question évoquée avec clarté par Bertrand Badie⁷.

Cette crise multiforme dans les Balkans est l'occasion d'un débat important en droit international sur la mission de forces d'interposition. Le problème juridique est débattu à l'O.N.U institution pionnière qui, dès 1956, avait créé la première force d'interposition au titre du maintien de la paix (OMP) établie pour séparer les belligérants autour de la zone du Canal de Suez. La distinction va se préciser dans l'Agenda de la Paix de l'O.N.U en 1992, définissant les opérations de préservations de la paix « *Peace Keeping* », de maintien de la paix « *Peace Making* » et le rétablissement de la paix « *Peace inforcing* ». C'est la même année, en juin 1992 que l'Union de l'Europe occidentale va également, à Petersberg en Allemagne, définir les mêmes missions pour ses forces.⁸ Sur le terrain la situation est souvent difficile à évaluer. En effet, l'usage de la force prévue pour les missions de rétablissement de la paix est en principe conçue pour des missions interétatiques. Or le cas des conflits dans l'espace balkanique s'apparentait souvent à des combats internes. C'est dans ces conditions que la Forpronu est intervenue de 1992 à 1995 en ex Yougoslavie.⁹

⁶ Hatto, R. (2013), op.cit et Fonds OTAN consultés à Bruxelles, au Siège de l'Organisation, section Archives..

⁷ Badie, B. (2005) *L'adieu au gladiateur ? La mondialisation et le renouveau des relations internationales* » *Relations internationale*, n° 124, hiver 2005, pp. 101-103

⁸ *Dictionnaire des Relations internationales de 1945 à nos jours*, sous la direction de Frank Attar, Paris Seuil, 2009. Rubrique, opérations de maintien de la Paix, pp 707 à 709

⁹ Témoignage du Général Morillon, recueilli à Bruxelles après les conflits dramatiques dans la zone de Srebrenica en 1995

Le 21 novembre 1995, la signature des Accords de Dayton est un tournant dans cette période conflictuelle mais laisse en suspens de nombreuses questions. Si la Croatie retrouve officiellement ses frontières la situation en Bosnie est un compromis puisque le territoire bosniaque est subdivisé en deux entités : l'une serbe, l'autre croato-bosniaque. Le pouvoir central est supervisé par un haut représentant de l'O.N.U et des troupes internationales stationnent dans le pays. Par ailleurs, les accords de Dayton n'ont pas réglé la situation dans la région du Kosovo où s'opposent Serbes et Albanais.

3. DES PREMIERES TENTATIVES DE STABILISATION AUX PERSPECTIVES D'INTEGRATION. L'IMPLICATION CROISSANTE DE L'UNION EUROPEENNE DANS L'ESPACE BALKANIQUE OCCIDENTAL

3.1. Les premières tentatives de stabilisation et leurs limites. « La paix inachevée »

Dès le 1^{er} décembre 1995, une mission de contrôle et de sécurisation est confiée, sous l'autorité de l'O.T.A.N à l'*Implementation Force*, IFOR qui commence à déployer les premiers de ses 60 000 soldats (dont 20 000 américains) en Bosnie-Herzégovine. Ces unités doivent vérifier le respect des engagements militaires : le retrait des forces, l'enregistrement des armes lourdes et le contrôle des arsenaux des dirigeants bosniaques.

L'année suivante, à partir de décembre 1996, la relève est assurée par la SFOR, *Stabilization Force*. Les effectifs limités à 32.000 doivent ensuite être encore réduits. Leurs missions vont du désarmement au déminage. *La Commission internationale sur les Balkans* a publié en 1996 un rapport du titre significatif : « la paix inachevée ». ¹⁰ Parmi les questions sensibles, la situation au Kosovo est au cœur des préoccupations de Leo Tindemans, membre de cette commission qui suggère l'étude du dossier.

En novembre 1997, les ministres des Affaires étrangères allemands et français, Klaus Kinkel et Hubert Védrine tentent une mission diplomatique et envoient à Milosevic une lettre proposant de jeter les bases d'une « paix stable et durable ». Ils préconisent un statut d'autonomie pour le Kosovo mais c'est une fin de non recevoir » qui accueille leur démarche.

Or en 1998, divers incidents éclatent au Kosovo entre Serbes et Albanais (massacre de Raçak où 45 victimes albanais sont recensées...) La France tente une ultime négociation diplomatique et organise, en février 1997, des entretiens à Rambouillet qui ne débouchent pas sur un accord. Après l'échec d'une ultime intervention britannique menée avec Richard Holbrooke, la perspective d'une intervention armée se précise. ¹¹

L'intervention au Kosovo a fait l'objet de nombreuses études qui ne seront pas reprises ici et que nous avons eu l'occasion d'évoquer à Opatija en 2007. Rappelons seulement ici que l'O.T.A.N avait agi sans mandat du Conseil de sécurité de l'O.N.U (pour la première phase de l'opération de mars à juin). Après une première campagne aérienne,

¹⁰ Commission internationale sur les Balkans (historique in www.Balkan-Commission.org (avril 2006)

¹¹ Thorel, J. (2001) *Le couple franco-allemand à l'épreuve de Kosovo* » in *Allemagne d'aujourd'hui* n° 157, juillet, septembre 2001. pp 56-75

le 10 juin la résolution 1244 est finalement adoptée par tous les membres du Conseil de Sécurité sauf la Chine qui s'est abstenue. Dès lors la « Kosovo force » de 50.000 hommes se déploie et l'accord militaro-technique de Kumanovo prévoit le cantonnement des habitants dans diverses zones sous contrôle militaire. A l'issue de cet accord la Mission intérimaire des Nations Unies au Kosovo (Minuk) est chargée du maintien de la paix et de la reconstruction de structures juridiques et économiques.¹² Cette mission était confiée à un représentant spécial de l'O.N.U. Le choix de la personnalité retenue : Bernard Kouchner en fonction de son expérience à Médecins sans frontières, traduit la volonté d'engagement de la France¹³.

Le règlement de la question du Kosovo constitue un tournant pour les acteurs européens. Dès juin 1999, le Conseil de l'Union européenne à Cologne donne la première impulsion puis le Conseil d'Helsinki en décembre de la même année annonce une véritable prise de conscience de l'urgence de doter l'Union européenne de nouveaux moyens d'action. Les conclusions de la Présidence de l'Union européenne précisent la volonté de l'Union : « de se doter de capacités militaires et civiles afin de gérer les crises internationales et d'apporter une aide humanitaire à ceux qui en ont besoin ».¹⁴

C'est le point de départ d'un processus capital au sein de l'Union qui va se doter de nouvelles structures et de nouveaux moyens au titre d'une politique étrangère de sécurité et de défense (P.E.S.D). Dans le cadre des missions civilo-militaires, l'Union va jouer un rôle important et va contribuer à la politique de stabilisation des Balkans occidentaux.

3.2. La coopération organisée des institutions internationales, un rôle accru de l'UE dans le processus de stabilisation des Balkans occidentaux

3.2.1. Une coopération organisée des institutions internationales.

Les relations entre l'Union européenne et l'O.T.A.N avaient été évoquées dès 1996 au sommet de Berlin. A cette époque, les accords de Berlin du 3 juin 1996, appelés désormais « Berlin Plus » stipulaient le principe d'une coopération O.T.A.N / U.E.-U.E.O.

La relève européenne en ex Yougoslavie va reposer sur la conclusion d'un accord cadre entre l'U.E et l'O.T.A.N signé le 16 décembre 2002 et entré en vigueur le 17 mars 2003. Il permettra l'organisation de plusieurs opérations dont la première, l'opération *Concordia* est engagée dans l'ancienne république yougoslave de *Macédoine* sera légitimée par la résolution 1371 du Conseil de Sécurité de l'O.N.U. Cette mission s'achèvera en décembre 2003.

¹² Voir les Actes du colloque de 2007 à Opatija, *L'Union européenne à 50 ans*, notre communication, pp.615 à 625. Publication de l'Université de Rijeka, 2008

¹³ Buffotot, P. (2001), *La défense en Europe* « Un engagement actif de la France ». La Documentation française, 2001

¹⁴ Conseil européen d'Helsinki, 10-11 décembre 1999 « Conclusions de la Présidence ». *Documents d'actualité générale de la Documentation française*. 1^{er} février 2000

Après cette date c'est l'opération de police Proxima qui prendra la relève. Le but de la mission étant d'assurer la stabilité et de contribuer au développement d'un Etat de droit en Macédoine.¹⁵

Pour la *Bosnie-Herzégovine* le processus sera plus long et plus complexe. Les opérations en Bosnie-Herzégovine se déploient aussi grâce à la coopération des institutions internationales. Le 14 juillet 2004, le Conseil de l'Union européenne adopte une action commune nommée *Althea* après avoir reçu l'accord des Nations Unies par la résolution 1551 du Conseil de sécurité de l'O.N.U. Cette action, lancée à partir du 2 décembre 2004, sera marquée par l'engagement de la force européenne EUFOR qui atteindra 7.000 hommes. Les missions d'*Althea* sont bien en relation avec la politique de stabilisation des Balkans occidentaux.

Dans un premier temps il s'agit de protéger les populations des actes de violence et de créer un environnement de stabilité et de sécurité dans la région. Dans cette perspective l'appui apporté au TPIY (le tribunal pénal international pour la Yougoslavie) pour la recherche des personnes inculpées de crimes de guerre traduit cette préoccupation.¹⁶ A plus long terme la mission d'*Althea* est de soutenir les progrès de la Bosnie sur la voie de son intégration à l'Union européenne en contribuant à lui permettre de devenir un Etat stable, viable, pacifique, capable de coopération paisible avec ses voisins. Il s'agit donc de veiller au strict respect des « critères de Copenhague » définis dix ans plus tôt à Petersberg.

3.2.2. Un processus de stabilisation orienté à moyen ou à long terme en direction de l'adhésion à l'Union européenne.

Dès le sommet de Feira en juin 2000, l'Union européenne avait affirmé, sous la présidence portugaise, sa volonté de poursuivre son œuvre « civile » dans la région, elle précise que les Etats des Balkans occidentaux sont des candidats potentiels à l'entrée dans l'UE.

En novembre 2000, en Croatie, se tient le sommet de Zagreb. A cette date, la France présidait l'UE ; elle organise en coopération avec le gouvernement croate une réunion des chefs d'état et de gouvernements des Etats de l'UE et des Balkans occidentaux. Un nouveau programme d'aide financière est adopté pour la période 2000-2006. Par ailleurs la décision principale prise à cette réunion est la mise en perspective des premiers *Accords de stabilisation et d'association (ASA)*. Le premier en vue était celui proposé à l'ancienne République Yougoslave de Macédoine (ARYM).

L'accord d'avril 2001 : L'accord de stabilisation et d'association avec l'ARYM. La préparation et la mise en place de ces accords a été présentée il ya 7 ans au colloque du CEDIMES organisé dans la région même à Ohrid. Nous en rappelons seulement ici les

¹⁵ Voir votre contribution in *l'Union européenne a 50 ans*, p.619, op-cit et voir aussi Ronald Hatto in *Questions internationales* n° 23, pp. 49 à 50, op-it

¹⁶ Voir le témoignage cité plus haut d'Elisabeth Claverie experte au TPIY et Christophe Solioz, *L'après guerre dans les Balkans*, Karthala, Paris 2003 et *Turning Points in Postwar Bosnia Ownership Process and European Integration*, Nomos, Baden Baden, 2° éd ; revue 2007

conclusions.¹⁷ Le modèle suivi est très proche des accords proposés aux Etats d'Europe centrale et orientale. Mais les accords qui prévoient de mettre en œuvre les moyens permettant de respecter les critères de Copenhague précisent aussi, pour l'ARYM et plus tard pour la Croatie, une nécessaire coopération régionale, préalable nécessaire à l'achèvement du processus. Par ailleurs, l'accent est mis sur le renforcement du contrôle par les Etats de la région des flux migratoires clandestins et de la lutte contre la criminalité organisée.

3.2.3. Le processus d'adhésion de la Croatie : un parcours de dix ans

La Croatie a déposé sa demande d'adhésion en février 2003. En juin 2003, lors du sommet UE-Balkans occidentaux, la Commission a précisé : « Le processus de stabilisation et d'association (PSA) demeura le cadre du parcours européen des pays des Balkans occidentaux jusqu'à leur adhésion future. Les progrès des différents pays sur la voie qui les mène vers l'UE dépendront de la manière dont chacun respectera les critères de Copenhague et les conditions fixées pour le processus de stabilisation et d'associations ». (PSA)¹⁸

Dès 2004, le statut de candidat à l'UE était octroyé à la Croatie et les négociations devaient commencer au printemps 2005. Mais des problèmes survenaient en fonction des demandes formulées par le Tribunal pénal international pour la Yougoslavie (TPY). Ce tribunal estimait insuffisants les efforts croates pour capturer le Général fugitif Ante Gotovina accusé par le TPY de crimes de guerre et de crimes contre l'humanité. Cependant le 7 décembre plus tard la police espagnole arrêta Ante Gotovina avec l'aide des gouvernements espagnol et croate. Il était donc transporté à La Haye pour y être jugé. Après l'avis favorable de Carla Del Ponte, procureur général du TPY, les négociations officielles pouvaient reprendre.¹⁹

Dès lors le processus pouvait se poursuivre et la *Croatie s'engageait sur la voie des réformes*. Dès 2007, *L'organisation pour la Sécurité et la coopération en Europe* (O.S.C.E) constatait des efforts concernant l'amélioration du statut des minorités et la question du retour et de l'intégration des réfugiés. En revanche le litige frontalier de la baie de Piran au sud du golfe de Trieste créait d'importantes tensions avec la Slovénie. Ce conflit ne devait être résolu définitivement qu'en 2010 après la ratification de l'accord international par referendum (51,5 % de oui) le 5 juin 2010 en Slovénie. Les chapitres prévus dans la procédure d'adhésion étaient progressivement clos de 2006 au printemps 2011. Lors du Conseil européen du 9 décembre 2011, les 27 chefs d'Etats et de Gouvernement de l'Union, le président de la Croatie Ivo Josipovic et la première ministre croate sortante Jadranka Kosor, signaient le traité d'adhésion de la Croatie à l'Union européenne.

¹⁷ Colloque d'Ohrid, publié en 2007, dans l'ouvrage des Actes du colloque, par Vinko, Kandzija et Andrej Kumar. Voir notre contribution, Publications de l'Université de Rijeka, 2008

¹⁸ Documentation consultée au Centre international sur l'Union européenne de Paris. Rapport de la Commission internationale sur les Balkans. Voir ci-dessus (avril 2006)

¹⁹ *Relations internationales* n° 23, 2007. Article de Grégory Lecomte. « La Croatie après Tudjman ». Voir aussi témoignage d'Elisabeth Claverie citée plus haut (note 16).

Mais ce traité devait être en premier lieu ratifié par les citoyens croates lors d'un référendum. Dans le contexte économique-politique de la fin 2011, c'était une consultation à risque. Le dimanche 22 janvier 2012, les Croates se prononçaient à 66,27 % en faveur de l'adhésion ce qui constituait une réponse très franchement favorable. En revanche le taux de participation n'était que de 43,51 %.²⁰

La ratification par les autres partenaires devait intervenir au cours de l'année 2012 et au début de l'année 2013 dans un climat aggravé par les tensions politiques et économiques particulièrement dans les Etats du Sud de l'Europe. Mais à la mi avril 2013, tous les partenaires avaient ratifié le traité qui devait entrer en vigueur le 1^{er} juillet 2013.

Au XIXe siècle, les Balkans relevaient, aux yeux des diplomates de la « question d'Orient » formule qui concernait le déclin puis le démembrement de l'Empire Ottoman. Sur le plan géopolitique la situation des Balkans a évolué en terme de rapports avec les grandes puissances régionales. Intégrées à l'Empire Ottoman, il y a deux cents ans, ou partiellement intégrées à l'Empire des Habsbourg, les populations de ces territoires ont tenté d'obtenir leur autonomie ou leur indépendance. La question d'Orient posée après 1800 ne concernait pas que la péninsule balkanique mais cet espace en fut l'enjeu principal parce qu'elle était la plus proche de l'Europe.

C'est de Sarajevo, ville où fut commis un attentat contre le prince héritier de la Double Monarchie d'Autriche-Hongrie, que surgit la crise diplomatique qui engendra la Première Guerre mondiale en juin 1914.²¹ Alors que la date anniversaire de l'évènement suscite déjà de très nombreuses manifestations, l'évocation des évènements beaucoup plus récents qui ont affecté cet espace balkanique méritait un réexamen des enjeux des conflits récents et une réflexion sur le rôle des principaux acteurs concernés.

L'étude présente a souligné l'importance des enjeux politiques pour les nouveaux Etats issus d'une recombinaison de l'ancienne fédération de Yougoslavie. Les acteurs internationaux et nationaux ont œuvré en faveur d'une transition démocratique durable avec en perspective l'association ou l'intégration à l'Union européenne. Parmi les questions posées les relations entre les communautés qui ont été affectées par les conflits récents restent un enjeu essentiel. Les enjeux sécuritaires évoqués au long de la période mettent en évidence les tergiversations des institutions internationales concernées. Si ce constat d'échec relatif a suscité une relance de la politique européenne de sécurité et de défense les progrès enregistrés sont trop modestes.²²

Plusieurs voix européennes se font entendre pour rappeler l'urgence de la publication par l'Union, bientôt élargie officiellement à 28, grâce à l'entrée en vigueur de

²⁰ Informations disponibles au Centre d'information de l'Europe de Paris, sur ces résultats commentaire de Guy Legras ancien Directeur Général de l'Agriculture à la Commission Européenne 4 avril 2013

²¹ Garde, P. « De la question d'Orient à l'intégration européenne » in Les Balkans et l'Europe. *Questions internationales* n° 23 op.cit (pp. 6 à 15)

²² Voir la récente publication de l'Académie de Géopolitique de Paris *Géostratégiques* n° 31, « Complexités balkaniques » 2^e semestre 2011 sous la direction de plusieurs auteurs dont Jacques Barrat, Jean-Paul Bled, Yves Lacoste.

l'intégration de la Croatie, d'un texte renouvelant celui de Javier Solana. Le haut représentant pour la PESC avait en effet, en mai 2003, proposé la mise en œuvre d'une stratégie de sécurité pour l'Union européenne.

Ce nouveau texte est attendu par tous ceux qui, en Europe et hors d'Europe, souhaiteraient voir mieux définie la nouvelle identité européenne de défense.²³

REFERENCES

- Archives nationales France Caran, Fonds François Mitterrand, consultés par nous, à Paris, prochainement consultables au nouveau site de Pierrefitte. Site en ligne de l'Union de l'Europe occidentale, Western European Union (WEU) à Bruxelles.
- Badie, B. (2005) L'adieu au gladiateur ? La mondialisation et le renouveau des relations internationales » *Relations internationale*, n° 124, hiver 2005, pp. 101-103
- Buffotot, P. (1995), La défense en Europe, de la guerre du Golfe au conflit yougoslave. La Documentation Française, 1995, pp.203-214
- Buffotot, P. (2001), La défense en Europe « Un engagement actif de la France ». La Documentation française, 2001
- Colloque d'Ohrid, publié en 2007, dans l'ouvrage des Actes du colloque, par Vinko, Kandzija et Andrej Kumar. Voir notre contribution, Publications de l'Université de Rijeka, 2008
- Commission internationale sur les Balkan (historique in www.Balkan-Commission.org (avril 2006)
- Conseil européen d'Helsinki, 10-11 décembre 1999 « Conclusions de la Présidence ». Documents d'actualité générale de la Documentation française. 1er février 2000
- Dictionnaire des Relations internationales de 1945 à nos jours, sous la direction de Frank Attar, Paris Seuil, 2009. Rubrique, opérations de maintien de la Paix, pp 707 à 709
- Documentation consultée au Centre international sur l'Union européenne de Paris. Rapport de la Commission internationale sur les Balkans. Voir ci-dessus (avril 2006)
- Documentation Française, Questions internationales n° 23, Paul Garde « De la question d'Orient à l'intégration européenne » pp 16 à 19
- Garde, P. « De la question d'Orient à l'intégration européenne » in *Les Balkans et l'Europe. Questions internationales* n° 23 op.cit (pp. 6 à 15)
- Hatto, R. (2013) L'Union européenne, l'Otan et la gestion des crises yougoslaves in Dossier « Les Balkans et l'Europe ». Articles dans la revue citée, *Questions internationales*, n° 23, op.cit, pp.44 à 50
- Hatto, R. (2013), op.cit et Fonds OTAN consultés à Bruxelles, au Siège de l'Organisation, section Archives..
- Informations disponibles au Centre d'information de l'Europe de Paris, sur ces résultats commentaire de Guy Legras ancien Directeur Général de l'Agriculture à la Commission Européenne 4 avril 2013
- Relations internationales* n° 23, 2007. Article de Grégory Lecomte. « la Croatie après Tudjman ». Voir aussi témoignage d'Elisabeth Claverie citée plus haut (note 16).
- Témoignage du Général Morillon, recueilli à Bruxelles après les conflits dramatiques dans la zone de Srebrenica en 1995
- Thorel, J. (2001) Le couple franco-allemand à l'épreuve de Kosovo » in *Allemagne d'aujourd'hui* n° 157, juillet, septembre 2001. pp 56-75

²³ DU MOULIN André, MATHIEU Raphaël, SARLET Gordon, *La politique européenne de sécurité et de défense. De l'opération à l'identitaire*. Bruxelles : Bruylant 2003

Védrine, H. (1996) Les mondes de François Mitterrand, Paris, Fayard 1996, p.61. Hubert Védrine futur ministre des Affaires étrangères est alors Secrétaire Général à l'Élysée.

Voir aussi témoignage d'Élisabeth Claverie, anthropologue au CNRS ancienne experte au TPIY (Tribunal pénal international pour la Yougoslavie) à la journée d'étude de Paris I (Etudes sur la guerre. CNRS) présentée le 11 janvier 2013 au Panthéon-Sorbonne

Voir la récente publication de l'Académie de Géopolitique de Paris Géostratégiques n° 31, « Complexités balkaniques » 2e semestre 2011 sous la direction de plusieurs auteurs dont Jacques Barrat, Jean-Paul Bled, Yves Lacoste.

Voir le témoignage cité plus haut d'Elisabeth Claverie experte au TPIY et Christophe Solioz, L'après guerre dans les Balkans, Karthala, Paris 2003 et Turning Points in Postwar Bosnia Ownership Process and European Integration, Nomos, Baden Baden, 2° éd ; revue 2007

Voir les Actes du colloque de 2007 à Opatija, L'Union européenne a 50 ans », notre communication, pp.615 à 625. Publication de l'Université de Rijeka, 2008

Voir votre contribution in l'Union européenne a 50 ans, p.619, op-cit et voir aussi Ronald Hatto in Questions internationales n° 23, pp. 49 à 50, op-it

Alain Redslob
Université Panthéon-Assas (Paris II), Paris, France

UNION EUROPEENNE, CAP SUR 2020. AMBITIONS ET CONTRAINTES

RESUME

En 2010, l'Union européenne adoptait une stratégie à l'horizon 2020 destinée à promouvoir la croissance et l'emploi. Pour mener à bien les priorités que rappellent les épithètes « intelligente, durable et inclusive » adjointes au terme de croissance, plusieurs objectifs ont été cernés, puis divisés en initiatives-phares, enfin connectés à des impératifs gouvernementaux pour satisfaire les attentes des citoyens. Comme les perspectives financières 2007-2013 touchent à leur terme, il a semblé opportun de s'interroger sur l'adéquation des ressources prévues dans le cadre financier pluriannuel 2014-2020 aux objectifs antérieurement édictés.

***Mots-clés** : Stratégie Europe 2020, cadre financier pluriannuel 2014-2020, gouvernance*

***JEL Classification**: E6, F15, F42, H6.*

1. INTRODUCTION

Au terme de longues consultations publiques, la Commission européenne dévoilait en mars 2010 la stratégie économique qu'elle entendait mener à l'horizon 2020 en partenariat avec tous les Etats membres. Intitulée « *Europe 2020 : une stratégie pour une croissance intelligente, durable et inclusive* », elle a été adoptée par le Conseil européen trois mois plus tard, succédant ainsi à celle arrêtée dix ans avant à Lisbonne. L'amélioration de la gouvernance grâce à un resserrement de la coordination entre politiques nationales et visées européennes a formé le cœur de cette orientation nouvelle. Après en avoir rappelé les principaux tenants et aboutissants, la pertinence de cette stratégie au regard des contraintes imposées par le cadre financier pluriannuel 2014-2020 sera débattue.

2. LES AMBITIONS D'UNE STRATEGIE

Dans un contexte de ralentissement si marqué que d'aucuns l'ont dénommé la Grande contraction 2008-2009, l'Europe a cherché à apporter des réponses à des défis structurels aussi épineux que ceux du tarissement des ressources, du vieillissement de la population ou encore des contrecoups de la mondialisation, pour ne citer qu'eux.

L'essence de sa stratégie a résidé dans l'articulation de deux volontés, celle de hisser les performances en matière d'expansion, d'emploi et d'environnement, et celle d'accroître la compétitivité de l'Europe dans le monde. Trois priorités ont été affichées : un essor économique rivié à la connaissance et à l'innovation, un développement soucieux de l'état d'épuisement des ressources et du maintien du cadre naturel, une évolution tournée vers l'inclusion sociale. Pour les mener à bien, plusieurs objectifs ont été cernés, divisés en initiatives-phares, puis connectés à des impératifs nationaux propres à satisfaire les attentes des citoyens et de leurs gouvernements.

2.1. Les objectifs

Ces objectifs, au nombre de cinq, s'inscrivent dans une perspective d'une économie innovante, moderne et lucide : innovante car sobre sur le plan énergétique, moderne au vu de la place concédée au numérique et lucide en faisant la part belle à l'éducation et à la formation. Concrètement, le premier se propose de *relever le taux d'emploi* de 69 à 75% de la population âgée de 20 à 64 ans ; augmentation de la main d'œuvre féminine, participation plus active des travailleurs âgés et migrations mieux intégrées devraient contribuer à l'atteindre. Le deuxième objectif consiste à *favoriser la recherche-développement*, l'idée étant de porter son effort à 3% du produit intérieur brut de l'Union. Quant au troisième, il vise à davantage *préserver l'environnement* ; l'accroissement de 20% de l'efficacité énergétique, la contribution à hauteur de 20% des énergies renouvelables dans la consommation finale et la réduction des émissions de gaz à effet de serre de 20% par rapport au niveau enregistré en 1990 sous-tendent sa réalisation. En quatrième lieu, il s'agit d'*améliorer le niveau d'éducation* en portant à 40% la proportion des personnes âgées de 30 à 34 ans disposant d'un diplôme de l'enseignement supérieur et en luttant contre le décrochage scolaire. Cinquièmement enfin, il importe de *favoriser l'inclusion sociale* en faisant en sorte qu'à terme vingt millions de personnes ne relèvent plus de la pauvreté et de l'exclusion.

Par-delà leur quantification, ces objectifs comportent deux caractéristiques. D'un côté, ils n'engendrent aucun partage de charges puisqu'ils résultent d'une adroite combinaison de mesures tant européennes que nationales, tandis que, de l'autre, ils sont mutuellement interdépendants, parce les progrès éducatifs participent à la résorption de la pauvreté, les percées innovantes économisent les ressources et génèrent des emplois, les technologies d'avant-garde ouvrent de nouveaux débouchés tout en ralentissant le changement climatique...

Par souci d'efficacité, ces objectifs ont été dans un deuxième temps divisés en *initiatives-phares*.

2.2. Les initiatives-phares

Sept axes sont ici repérables. L'*innovation* formant un choix majeur, les conditions d'éclosion et de financement doivent être encouragées pour exercer un effet de levier sur la formation de capital dans l'Union. L'accentuation de la *mobilité des jeunes* exige une amélioration de la performance des études et leur internationalisation. Afin d'éviter tout retard dans un domaine qui évolue rapidement, un *agenda numérique* s'efforce de créer un espace unique lié à un Internet à haut débit. Pour augmenter *le rendement des*

ressources et préserver l'environnement, efficacité énergétique, modernisation des transports et énergies renouvelables sont avantagés. La conception d'une *politique industrielle* apte à simplifier la réglementation dans laquelle évoluent les acteurs économiques, entre autres les PME, sera de nature à consolider un socle propre à affronter la concurrence mondiale. De leur côté, l'*affinement des compétences tout au long de la vie et l'activation de l'emploi* assainiront et assoupliront un marché du travail à maints égards sclérosé. Finalement, dans une perspective d'affermissement de la cohésion sociale et territoriale, la construction d'une *plate-forme européenne de lutte contre la pauvreté* restituera de la dignité en limitant l'exclusion.

Objectifs et initiatives-phares ainsi déclinés sont à leur tour connectés à des stratégies nationales, l'enjeu étant de clarifier la gouvernance européenne tout en la rendant plus efficiente. En sorte que la Commission a demandé à chaque Etat de penser et de mettre en place un programme de réformes qui lui soit propre, étant entendu qu'elle se réserve le droit d'en suivre l'évolution, voire d'admonester d'éventuels contrevenants dans l'accomplissement de leurs propres chantiers. Ainsi, implications des délocalisations, rôle de la finance, situation du marché de l'emploi et sauvegarde du système de protection sociale forment-ils les principales cibles incluses dans la contribution française à la stratégie de l'Union européenne 2020.

Mais comme il n'est pas de stratégie fiable sans financement durable, qu'en est-il au juste ?

3. LES CONTRAINTES DE FINANCEMENT

Pour apaiser les tensions entre institutions, une programmation pluriannuelle des dépenses, qui a pour but d'améliorer le déroulement de la procédure budgétaire, a été conçue dès 1988. Sur une base septennale, les priorités budgétaires sont encadrées en forme de *perspectives financières* qui, avec le temps, ont pris le nom de *Cadrage financier pluriannuel*.

3.1. Les usages

Les ressources couvertes par le premier cadrage, appelé « *Paquet Delors I* », ont accompagné la mise en place de l'Acte unique tandis que les celles de la période suivante (1993-1999), formant le « *Paquet Delors II* », ont balisé la marche à la monnaie unique. Ensuite, intervint « *Agenda 2000* » qui, grâce à la mise en œuvre de chantiers prioritaires, a répondu à un triple question - l'approfondissement et ses problèmes, l'élargissement et ses effets, l'accompagnement financier des deux - à l'horizon 2006.

Ensuite, l'accord portant sur la période 2007-2013 a décliné cinq thèmes : compétitivité pour la croissance et pour l'emploi, cohésion pour la croissance et pour l'emploi, conservation et gestion des ressources naturelles, citoyenneté européenne et action extérieure. Ambitieuses et novatrices, réalistes et rassurantes, les perspectives financières qui s'achèvent en 2013 ont apporté une réelle valeur ajoutée au regard des trois critères que sont *l'efficacité* en prouvant que seule l'Union était en mesure

d'apporter certaines solutions, *l'efficience* en optimisant le ratio coût/efficacité des interventions, et *la synergie* en soulignant le caractère déterminant des décisions.

3.2. Les modalités

Les dépenses sont évaluées d'une part en calculant des plafonds par rubrique et par an, et, d'autre part, en limitant les dépenses communautaires à 1,24% du revenu national brut communautaire (RNB) ; un double plafonnement s'établit ainsi, celui des dépenses catégorielles comme celui de la dépense globale. Sans pénétrer plus avant dans des détails touchant l'étanchéité des rubriques ou les marges pour imprévus, force est de reconnaître que le respect de la discipline budgétaire s'en est trouvé renforcé.

Chaque année, la Commission procède néanmoins à des ajustements d'un côté pour maintenir le pouvoir d'achat de chaque dépense vu qu'elles sont exprimées à prix constants dans le cadre financier, de l'autre pour intégrer les variations du RNB de l'Union étant donné que le plafond de ressources propres en est un pourcentage.

3.3. Les procédures

Politiquement, l'accord qui intervient d'abord au sein du Conseil européen doit y être ratifié à l'unanimité. Postérieurement, ce dernier, le Parlement et la Commission doivent s'entendre : l'accord devient interinstitutionnel, étant entendu que toute correction sous forme d'un recadrage des ressources propres exige l'unanimité du Conseil ainsi que l'assentiment de tous les Etats. De même, à la suite d'une adhésion ou d'un retard survenu dans la programmation des dépenses structurelles, une adaptation du cadre financier devient opportune ; la Commission doit alors, sous le plafond des ressources propres, saisir de ses propositions les autres membres de l'autorité budgétaire que constituent le Conseil et le Parlement.

Actuellement, le cadre financier pluriannuel 2014-2020 est encore en débat. Présentées dès juin 2011, les propositions liminaires de la Commission se sont heurtées à deux difficultés, le montant de l'enveloppe globale et la création d'une taxe sur les transactions financières. Sur le premier point, elle suggéra 5% d'augmentation des dépenses, proposition fustigée par des parlementaires qui la jugeaient très en-deçà des obligations de l'Union et rejetée tout aussi fermement par les gouvernements, notamment de pays du nord, l'estimant au contraire exagérée eu égard aux restrictions budgétaires enclenchées au plan national. Quant à la perception de ressources neuves, d'aucuns l'ont saluée en se réjouissant que l'Union puisse bénéficier de ressources propres, d'autres l'ont au contraire conspuée arguant qu'il n'y avait pas d'urgence financière et qu'il était choquant de revenir sur un privilège régalien. Après moult discussions, la Commission a finalement livré une version corrigée. D'un montant de 1 033 milliards de crédits d'engagement, l'enveloppe se ventile en cinq rubriques : croissance intelligente et inclusive (48%), croissance durable et ressources naturelles (37%), Europe dans le monde (7%), Administration (6%), Sécurité et citoyenneté (2%). Ces propositions furent à leur tour rejetées en novembre 2012, le Conseil se séparant sur un constat de désaccord, certains pays réclamant des coupes beaucoup plus sévères, d'autres, à l'inverse, inclinant vers une redistribution plus généreuse. A ce stade de confection du cadre pluriannuel, quelle est l'épure retenue ?

4. LE CADRAGE FINANCIER 2014-2020¹

D'évidence, les pays préconisant la rigueur budgétaire l'ont emporté. En effet, en février 2013, le Conseil est parvenu à un accord sur un total ramené à 960 milliards d'euros, somme dont la ventilation a été légèrement modifiée au profit de la deuxième rubrique (+ 2%), au détriment des rubriques 1 et 3 (- 1% chacune), les rubriques 4 et 5 restant inchangées.

Ainsi, les montants des plafonds d'engagements s'élèvent à 1,00 %, et non plus 1,08 %, du revenu national brut (RNB) de l'UE² tandis que ceux des crédits de paiements ne dépassent pas 0,95 %, au lieu de 1.03 %, du RNB de l'UE³. Tentons d'en avoir une vue d'ensemble avant que d'en dévoiler des aspects plus circonstanciés.

4.1. Structure d'ensemble

Se fixant pour priorité la sortie de l'Union européenne de la crise, les dépenses actées en février 2013 se trouvent « *mobilisées au service de la croissance, de l'emploi, de la compétitivité et de la convergence, dans le droit fil de la stratégie Europe 2020 ...* » tout « *en conjuguant un assainissement budgétaire intelligent qui préserve l'investissement dans la croissance future et des politiques macroéconomiques saines* ». En outre, il est spécifié dans les attendus que la qualité des dépenses ne doit pas être occultée : adéquation des instruments financiers, meilleure gouvernance des politiques, ciblage idoine des fonds et simplification des procédures sont expressément sollicités à cette fin. Restera naturellement à la charge de la Commission d'informer les autres membres de l'autorité budgétaire au moyen de rapports réguliers traitant du cadre stratégique commun (CSC). Enfin, une structuration rénovée du cadre financier pluriannuel a été retenue et se présente dorénavant comme suit :

- rubrique 1 : Croissance intelligente et inclusive :
 - sous-rubrique 1a : Compétitivité pour la croissance et l'emploi ;
 - sous-rubrique 1b : Cohésion économique, sociale et territoriale ;
- rubrique 2 : Croissance durable : ressources naturelles ;
- rubrique 3 : Sécurité et citoyenneté ;
- rubrique 4 : Europe dans le monde ;
- rubrique 5 : Administration ;
- rubrique 6 : Compensations.

C'est bien évidemment au travers de cette nomenclature que percent les ambitions qu'il convient à présent de détecter.

¹ Tel qu'arrêté par le Conseil et entériné par la Commission. Pour se traduire dans les faits, il lui faudra obtenir l'aval parlementaire.

² 1,12% du CFP pour la période 2007-2013.

³ 1,06% du CFP pour la période 2007-2013

Tableau 1 : Cadre financier pluriannuel 2014-2020

Crédits d'engagement	2014	2015	2016	2017	2018	2019	2020	Total 2014- 2020
1. Croissance intelligence et inclusive	60 283	61 725	62 771	64 238	65 528	67 214	69 004	450 763
1a. Compétitivité pour la croissance et l'emploi	15 605	16 321	16 726	17 693	18 490	19 700	21 079	125 614
1b. Cohésion économique, sociale et territoriale	44 678	45 404	46 045	46 545	47 038	45 514	47 925	325 149
2. Croissance durable ressources naturelles	55 883	55 060	54 261	53 448	52 466	51 503	50 558	373 179
dont: dépenses de marché et paiements directs agricoles	41 585	40 989	40 421	39 837	39 079	38 335	37 605	277 851
3. Sécurité et citoyenneté	2 053	2 075	2 154	2 232	2 312	2 391	2 469	15 686
4. L'Europe dans le monde	7 854	8 083	8 281	8 375	8 553	8 764	8 794	58 704
5. Administration	8 218	8 385	8 589	8 807	9 007	9 206	9 417	61 629
6. Compensations	27							27
Total crédits d'engagement	134 308	135 328	136 056	137 100	137 866	139 078	140 242	959 988
en % du RNB	1,03	1,02	1,00	1,00	0,99	0,99	0,98	1,00

Note : Millions d'euros, prix 2011

Source : Conseil européen.

4.2. Aspects détaillés

Dissocions les mesures prises en faveur de la croissance et de l'emploi de celles concernant les ressources naturelles, puis de toutes les autres enfin, sachant que les deux premières rubriques absorbent à elles seules pas moins de 85% du total des dépenses envisagées.

4.2.1. Croissance et emploi

Cette rubrique est subdivisée en deux volets. Examinons-les tour à tour.

4.2.1.1. Compétitivité

Les programmes définis visent tous à réaliser la stratégie Europe 2020. Un accent particulier est porté sur différentes formes d'intelligence telles la recherche, l'innovation, les compétences humaines, les technologies de pointe. Dans ce but, les programmes Horizon 2020 et Erasmus verront leurs dotations croître substantiellement. Le maître-mot en est *l'excellence* : en sous-tendant la politique européenne de la recherche, elle créera des groupements (*clusters*) de nature à atténuer les disparités de performances régionales.

L'institution d'un *mécanisme pour l'interconnexion* en Europe est pertinente, tant l'interopérabilité des réseaux réels et virtuels est décisive. Les investissements infrastructurels de diverses sortes, outre qu'ils renforceront la compétitivité de l'Union, devraient satisfaire les objectifs assignés par la stratégie Europe 2020, en particulier dans le domaine de l'énergie et du climat avec le pari 20/20/20 déjà exposé. En sorte que 29 milliards sont alloués au fonctionnement de ce mécanisme, somme qui résulte pour l'essentiel d'un transfert en provenance des fonds de cohésion.

Les fonds destinés aux projets Galileo, ITER et GMES et au déclassement de centrales nucléaires en Lituanie, Slovaquie et Bulgarie ressortissent également à cette sous-rubrique.

4.2.1.2. Cohésion

Le rôle dévolu à la politique de cohésion dans le lissage, voire l'éradication des disparités régionales en Europe est connu, et central. De pair avec les politiques nationales de réformes structurelles, cette politique active la croissance et épaulé l'emploi. En s'appuyant conjointement sur le Fonds européen de développement régional (FEDER), le Fonds social européen (FSE) et le Fonds de cohésion (FC), elle s'assigne deux objectifs, la stimulation de la croissance et de l'emploi et la coopération territoriale. Pour ce qui est du premier, régions en retard, régions en transition, régions développées et régions ultrapériphériques bénéficient de crédits de 313 milliards étalées sur le septennat. Quant au second, près de 9 milliards lui sont alloués dans la cadre d'une coopération à la fois transfrontalière, transnationale et interrégionale. Bien que subsidiaires, aides au renforcement des capacités administratives et soutien à un développement urbain durable ne sont pas pour autant oubliés.

Il est utile, en la matière, de connaître les critères d'éligibilité. Du côté de l'investissement pour la croissance et l'emploi, sont réputées moins développées, en transition ou développées les régions dont le PIB par habitant est respectivement inférieur à 75, compris entre 75 et 90, et supérieur à 90% du PIB moyen de l'UE-27. Au regard des fonds de cohésion, la règle consiste à établir l'existence d'un revenu national par habitant inférieur à 90% du RNB moyen par habitant de l'UE-27 pendant la période 2008-2010. Dans le domaine de la coopération territoriale, des critères de niveau sont affinés au plan technique, à l'exception de la coopération interrégionale qui relève du soutien du FEDER sur tout le territoire de l'Union. Les méthodes de détermination des montants, au reste fort précises, sont assorties de plafonds de transferts fixés à 2,35% du PIB de chaque Etat membre, de filets de sécurité conçus pour ne pas provoquer de rupture brutale lorsque les régions changent de catégorie, et de dispositions favorables d'une part aux régions de pays de la zone euro qui ont été plus touchés par la crise et, de l'autre, à celles appartenant à des économies insulaires. Ajoutons qu'une *clause de réexamen* est prévue de telle façon qu'en 2016 la Commission fera le point et, d'ailleurs, ajustera le sommes à verser sitôt qu'une divergence cumulative de +/- 5 % se fera jour.

Il n'est pas anodin non plus de se pencher sur les taux de cofinancement concédés. Sans entrer dans le détail, il oscille entre 50 et 85% en fonction du type d'opérations conduites, quelques rares majorations pouvant intervenir en cas de phase d'assainissement budgétaire du pays bénéficiaire.

Pour clore, retenons que l'aide aux plus démunis élargera à hauteur de 2,5 milliards au Fonds social européen et que l'initiative pour l'emploi des jeunes, autre dossier sensible, est dotée de 6 milliards prioritairement affectés à l'apprentissage et à la formation dans les pays où leur taux de chômage excède 25%.

4.2.2. Croissance et ressources

La *politique agricole commune* (PAC) est l'épicentre du second grand volet de la programmation budgétaire. Enoncé des principes poursuivis et décryptage des piliers qui la fondent l'éclaircissent.

4.2.2.1. Principes

Les objectifs qu'elle poursuit, clairement affichés, sont rappelés par le Conseil en ces termes : « *accroître la productivité de l'agriculture en favorisant le progrès technique et en assurant le développement rationnel de la production agricole ainsi qu'une utilisation optimale des facteurs de production, notamment de la main-d'œuvre ; assurer ainsi un niveau de vie équitable de la population agricole, notamment par le relèvement du revenu individuel de ceux qui travaillent dans l'agriculture ; stabiliser les marchés, garantir la sécurité des approvisionnements et faire en sorte que les produits parviennent aux consommateurs à des prix raisonnables* ».

En s'assurant de la viabilité de la production, de la durabilité des ressources et de l'équilibre des territoires, cette orientation s'inscrit pleinement dans la stratégie Europe 2020¹.

4.2.2.2. Piliers

Dotée de plus de 373 milliards, elle continue de reposer sur les deux piliers que forment, d'un côté, les aides directes et les mesures de marché (*pilier I*), et, de l'autre, la compétitivité et la préservation de la diversité de même que la préservation de la qualité de vie et de l'environnement (*pilier II*).

Au titre du premier pilier, le déclin du niveau moyen des paiements directs en prix courants à l'hectare se poursuivra en visant la somme de 196 euros en 2020 tout en tenant compte des contrastes géographiques et historiques au sein de l'Union. De surcroît, un plafonnement des aides aux grandes exploitations est prévu cependant que chaque ferme agricole doit intégrer une surface d'intérêt écologique sous réserve qu'elle ne mène ni à une restriction des terres cultivées ni à une amputation du revenu de ceux qui les cultivent. Enfin, dans la limite de 15% de leurs montants, des Etats sont autorisés à octroyer au financement des paiements directs des sommes initialement allouées par le FEADER au développement rural.

Le second pilier, quant à lui, est entièrement dédié au développement rural. Au vu des performances et selon des critères d'attribution stricts, les crédits sont concédés aux pays en fonction des moyens budgétaires. D'une manière générale, le taux de cofinancement du FEADER est dégressif de leur niveau de développement, avec un seuil de 20%.

Enfin, la lecture du soixante-seizième alinéa des conclusions du Conseil européen de février 2013 est sans équivoque : « *les fonds structurels et le fonds de cohésion s'inséreront, avec le fonds européen de développement rural (FEADER) et le fonds européen pour les affaires maritimes de la pêche (FEAMP) dans un cadre stratégique commun afin de maximiser leur efficacité et d'optimiser les synergies* ». A partir de là a été dressée une liste de thèmes liés à la stratégie Europe 2020 à propos desquels la Commission adresse des recommandations aux Etats et, en cas d'irrespect, suspend tout ou partie des engagements ou paiements en cause. Ces recommandations touchent les grandes orientations des politiques économiques, l'emploi, les déficits excessifs et les procédures liées, le soutien financier à moyen terme des balances des paiements, l'assistance apportée en vertu du mécanisme de stabilisation financière. Il est clair que ces dispositions affermissent le lien entre la politique de cohésion et la gouvernance économique de l'Union.

4.2.3. Autres rubriques

Mentionnons brièvement les trois sujets qui les composent.

¹ La politique commune de la pêche (PCP) relève aussi de cette rubrique.

4.2.3.1. Sécurité et citoyenneté

Ensemble de programmes destinés à améliorer la sécurité et le sentiment d'appartenance, cette ligne absorbe 15,5 milliards. Demandes d'asile, mouvements migratoires, sécurité des personnes et des biens, justice, diversités linguistique et culturelle, santé publique et protection des consommateurs en relèvent. Tous ces sujets partagent en commun le fait d'impliquer la quotidienneté des habitants de l'Union.

4.2.3.2. Europe dans le monde

Désireuse d'assumer les responsabilités régionales et internationales qui lui incombent et encline à défendre ses propres intérêts, l'Union veille à consolider toutes les formes de coopération. Les cibles assignées, ambitieuses, s'énoncent de la sorte : « *promouvoir les valeurs de l'Union à l'étranger ; présenter des politiques visant à relever les principaux défis mondiaux ; amplifier l'impact de la coopération au développement, investir dans la prospérité et la stabilité à long terme des pays du voisinage ; soutenir le processus d'élargissement ; accroître la solidarité européenne à la suite de catastrophes naturelles ou d'origine humaine ; améliorer les préventions et la résolution des crises ; lutter contre le changement climatique* ».

Sous le plafond imparti, soit 59 milliards sur le septennat, l'Union accordera son aide sous réserve de réels progrès accomplis au regard des engagements déclarés, en particulier en matière de démocratie, de gouvernance ou de droits de l'homme. A noter également que l'Union s'engage à concéder 0,7% de son PIB dès 2015 à l'aide publique au développement.

4.2.3.3. Administration

En raison des efforts nécessaires d'assainissement des finances publiques, toutes les institutions sont invitées à gérer les fonds dont elles ont la gestion dans un souci d'équilibre géographique et de professionnalisme. Près de 62 milliards sont dévolus à ce titre. Limité, ce montant appelle des réductions sensibles d'embauches, une adaptation des salaires et des retraites, une révision des statuts et une répartition équitable des efforts demandés entre les diverses administrations de l'Union.

Abondés par des ressources spécifiques, l'instrument de flexibilité, le fonds de solidarité, le fonds européen d'ajustement à la mondialisation, la réserve d'aide d'urgence et le fonds européen de développement² sont placés hors cadre financier pluriannuel.

4.3. Financement

Simplicité, transparence et équité sont les principes qui président à la levée des fonds. Effectuons néanmoins certaines remarques : 1/ quoiqu'inchangé, le système de perception des ressources propres traditionnelles permettra aux Etats, dès 2014, de retenir 20% des montants perçus à titre de défraiement ; 2/ au motif de l'équité, un

² Il est toutefois suggéré une intégration du FED dans le budget général à compter de 2021.

nouveau système de collecte de la ressource TVA pourrait être imaginé ; 3/ une coopération renforcée en matière de taxation des transactions financières est mise en place sans porter préjudice aux Etats qui ont souhaité s'en dispenser ; 4/ plusieurs pays - Grande-Bretagne, Allemagne, Pays-Bas, Suède, Danemark, Autriche - continuent à bénéficier de mécanismes de ristourne.

5. CONCLUSION

Deux observations cloront ces propos. Du point de vue technique, on ne peut que se réjouir que la Commission et le Conseil marquent conjointement leur attachement aux règles constitutives des budgets, même si on déplorera la multiplication des exemptions au principe d'unité. Par contre, que ces deux membres de l'autorité budgétaire aient voulu porter l'accent sur les clauses de bonne gestion financière et de transparence est un fait du meilleur augure.

Sur le plan politique, il est désormais établi qu'une orchestration des dépenses en symbiose avec les priorités répertoriées dans la stratégie *Europe 2020* est possible et ce, dans un esprit de rigueur financière adapté aux circonstances. Sans lui dénier son droit d'amendement, au Parlement, à présent, de faire montre de discernement³.

REFERENCES

- Conseil Europeen (2013), *Conclusions sur le cadre financier pluriannuel*.
- Commission Européenne (2010), *Europe 2020 : une stratégie pour une croissance intelligente, durable et inclusive*.
- Kumar A. & Kandzija V. Eds, (2010), *Economic integration: competition and cooperation*, Ljubljana & Rijeka universities.
- Redslob A. (2012), *Problèmes économiques contemporains*, éd. EdL, 9^e édition.
- Redslob A. (2012), *L'Union européenne en dix leçons*, éd. EdL, 10^e édition.
- Redslob A. (2010), *La politique régionale de l'Union européenne*, in *Problems of economic development of regions : lessons of world economic crisis*, éd. de l'Université d'Etat de Gorno-Altajsk (Russie).
- Web : l'UE, *Cadre financier pluriannuel 2014-2020*.

³ Avec une très forte majorité, le Parlement européen a signifié son désaccord sur le projet exposé dans ces lignes le 13 mars 2013. Vu qu'il ne sera appelé à se prononcer définitivement qu'en juillet prochain, il faut interpréter ce rejet comme un mouvement d'humeur. Sous réserve de certains aménagements de nature technique (transferts de crédits facilités) et politique (définition de ressources propres), il n'est pas improbable qu'il inverse son vote.

Mohamed Bouhezza

Université Sétif, Faculté des Sciences Economiques, Commerciales et Sciences de Gestion, Laboratoire PIEEM, Sétif, Algérie

Salah Salhi

Université Sétif, Faculté des Sciences Economiques, Commerciales et Sciences de Gestion, Sétif, Algérie

LE PARTENARIAT AVEC L'UE: CAS DE L'ALGÉRIE

RESUME

A l'instar des autres pays de la rive sud du bassin méditerranéen, en particulier les pays du Maghreb (la Tunisie et le Maroc), à l'exception de la Lybie et en ajoutant la Jordanie, l'Algérie a signé son accord de partenariat en avril 2002 à Valence (Espagne). Ce dernier est rentré en application le 1er septembre 2005.

Cet accord qui a été précédé par certains accords et ce, après l'indépendance de l'Algérie, on peut le considérer comme une plateforme. Nous voulons par la présente communication faire un constat des lieux avant et après la signature, puis faire une évaluation de cette période du partenariat à ce jour.

Cependant, nous nous pencherons sur:

- *l'historique des différents accords avant l'accord de partenariat ;*
- *le contenu de cet accord UE-Algérie en bref ;*
- *l'évolution du partenariat UE-Algérie durant cette période ;*
- *les retombées de ce partenariat sur l'économie algérienne.*

Mots-clés : l'UE, partenariat, Algérie, échanges commerciales, intégration

JEL Classification : F15

1. INTRODUCTION

A l'instar des autres pays de la rive sud du bassin méditerranéen, en particulier les pays du Maghreb (la Tunisie et le Maroc), à l'exception de Libye et en ajoutant la Jordanie, l'Algérie a signé son accord de partenariat en avril 2002 à Valence (Espagne). Ce dernier est rentré en vigueur en septembre 2005.

Les premières relations officielles entre l'Algérie et l'UE ont commencé juste après l'indépendance, en gardant les facilitations commerciales permettant à l'Algérie d'écouler sur le marché européen ses produits agricoles. Ces relations ont été consolidées par les accords qui se sont succédés dont l'accord de coopération de 1976, conclu, en même temps, avec deux autres pays du Maghreb (la Tunisie et le Maroc), et la déclaration de Barcelone en 1995 instaurant le partenariat euro-méditerranéen.

A travers ce papier, nous voulons présenter l'état des lieux avant et après la signature de l'accord en abordant les étapes précédentes qui ont permis la concrétisation de l'accord de partenariat en 2002. Ensuite, son contenu est exposé, en privilégiant le volet économique. Enfin, ses répercussions sur l'économie algérienne sont mises en relief.

2. L'HISTORIQUE DES DIFFERENTS ACCORDS QUI ONT PRECEDE L'ACCORD DE PARTENARIAT

Le partenariat de l'Algérie avec l'Union Européenne ne date pas d'avril 2002 avec la signature de l'accord de partenariat, entré en application le 1^{er} septembre 2005, mais remonte loin dans le temps ; il existe depuis l'indépendance de l'Algérie en 1962. Les relations entre la Communauté Européenne et l'Algérie ont commencé au lendemain de l'indépendance du pays. Il s'agissait à cette époque d'un accord bilatéral, commercial et préférentiel, permettant à l'Algérie de continuer à écouler sur le marché européen ses produits agricoles, particulièrement le vin (Document UE-Algérie).

Les années 1970 sont caractérisées par l'orientation de la Communauté Européenne de l'époque vers ses partenaires de la rive sud de la méditerranée concrétisée par l'élaboration d'un cadre général de coopération englobant tous les pays de la région dont la Jordanie et à l'exception de la Libye. La politique globale méditerranéenne, née en 1972, a maintenu les accords préférentiels en leur ajoutant un volet financier sous forme d'aide octroyée par la commission européenne et des prêts de la Banque Européenne d'Investissement (B.E.I) (Khaladi Mokhtar, 2007).

Les relations de l'Algérie avec la Communauté européenne, ont depuis évoluées en même temps que les politiques des deux parties. L'accord de coopération signé en avril 1976 avec l'Algérie est entré en vigueur en 1978 (Document UE- Algérie).

L'Algérie a participé à toutes les réunions régionales, dont celle de Barcelone, qui s'est tenu les 27 et 28 novembre 1995. Le processus de Barcelone, qui en découle, a pour objectif de préparer le terrain à la réalisation d'une zone de libre-échange euro-méditerranéenne pour faire de toute la Méditerranée un espace commun de paix, de stabilité et de prospérité en renforçant le dialogue politique et sécuritaire, le partenariat économique et financier et le partenariat social, culturel et humain à travers les accords d'association que l'UE a signé, séparément et à des dates différentes avec chacun des pays du sud méditerranéen (Khaladi Mokhtar, 2007).

Ce processus est basé sur trois volets prédominants (toute leurope.eu) :

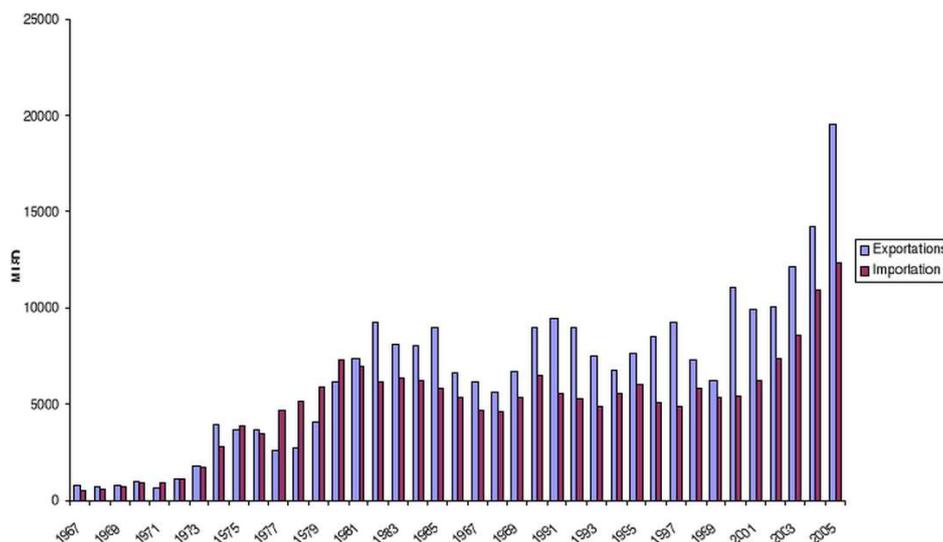
- le volet politique et de sécurité, avec la définition d'un espace commun de paix et de stabilité ;
- le volet économique et financier, pour permettre la construction d'une zone de prospérité partagée ;
- le volet social, culturel et humain, afin de développer les ressources humaines, favoriser la compréhension entre les cultures et les échanges entre les sociétés civiles.

Comme il a mis en place deux dimensions principales (Document UE-Algérie):

- *Une dimension bilatérale* qui a permis à l'Algérie, depuis 1995 de bénéficier des fonds MEDA I et MEDA II, ainsi que de l'instrument financier de voisinage et de partenariat, fonds qui ont été utilisés pour soutenir les réformes économiques, sociales et de gouvernance initiées par le gouvernement algérien, à travers des programmes de coopération.
- *Une dimension régionale* à travers le partenariat euro-méditerranéen qui a permis la mise en place de toute une série de projets et d'initiatives, afin de mettre en contact et faire travailler ensemble les partenaires des deux rives de la Méditerranée.

La figure n°1 montre l'évolution des échanges commerciaux de l'Algérie avec l'UE durant cette période.

Figure 1 : Evolution des échanges commerciaux



Source : CEPII- Base de Données CHELEM, cité par Farid MAKHLOUF.

D'après le graphique de la Figure n°1, on constate que ces échanges sont plutôt faibles, voire même stables fin des années 1960 et début des années 1970, puis ont connu une augmentation caractérisée par des fluctuations durant les années 1980 et 1990. A partir des années 2000, on assiste à une augmentation remarquable.

Ce que nous remarquons aussi, c'est que les exportations de l'Algérie vers l'UE sont toujours supérieures à ses importations à l'exception de la fin des années 1970, et que ces importations sont proportionnelles à l'évolution des exportations des hydrocarbures, cela veut dire que l'économie algérienne est entièrement dépendante des recettes provenant presque entièrement des produits fossiles.

3. LE CONTENU DE L'ACCORD DE PARTENARIAT ALGERIE-UE EN BREF

Tenant compte des deux accords précédents, et dans le cadre de l'intégration des pays du Maghreb arabe, l'Algérie a signé l'accord d'association avec l'UE en avril 2002, qui est rentré en vigueur le 1^{er} Septembre 2005. Ce dernier est venu plus tard que nos voisins (la Tunisie le 01/03/1998 et le Maroc 01/03/2000).

En jetant un coup d'œil sur le journal officiel de l'Union européenne, ainsi que le journal officiel de la République Algérienne Démocratique Populaire, on trouve dans leurs premiers articles les objectifs de cet accord qui sont définis comme suit (J O de l'UE et de l'Algérie):

- Fournir un cadre approprié au dialogue politique entre les parties afin de permettre le renforcement de leurs relations et de leur coopération dans tous les domaines qu'elles estimeront pertinents,
- Développer les échanges, assurer l'essor de relations économiques et sociales équilibrées entre les parties, et fixer les conditions de la libéralisation progressive des échanges de biens, de services et de capitaux,
- Favoriser les échanges humains, notamment dans le cadre des procédures administratives,
- Encourager l'intégration maghrébine en favorisant les échanges et la coopération au sein de l'ensemble maghrébin et entre celui-ci et la communauté et ses Etats membres.
- Promouvoir la coopération dans les domaines économique, social, culturel et financier.

Ces objectifs sont pour chacun des trois volets de l'accord comme suit (Accord d'association Algérie-UE) :

- Le volet politique, avec la mise en place d'un dialogue régulier, politique et de sécurité sur les questions d'intérêt commun.
- Le volet commercial, avec l'objectif de réaliser progressivement, sur une période de 12 années, une zone de libre échange entre l'Algérie et la Communauté européenne. A cet effet, l'accord stipule le démantèlement, par l'Algérie, de tous les droits de douane et autres taxes à l'importation sur les produits industriels originaires de la Communauté, selon le calendrier suivant :
 - La 1^{ère} liste comprend les produits à démantèlement tarifaire immédiat, c'est-à-dire, dès l'entrée en vigueur de l'accord (annexe 2).
 - La 2^{ème} liste inclut les produits dont le démantèlement tarifaire s'étend, après deux années de l'entrée en vigueur de l'accord, sur une période de cinq années (i.e. le 1^{er} Septembre 2007). Ces produits sont énumérés dans l'annexe 3 de l'accord.
 - La 3^{ème} liste comprend tous les produits, autres que ceux mentionnés dans les annexes 2 et 3, et dont le démantèlement tarifaire se fera sur une période de 10 années, après 2 ans de l'entrée en vigueur de l'accord.
- le volet économique et financier, où la communauté européenne s'engage, en contrepartie du démantèlement tarifaire ci-dessus mentionné, à mettre en place, en faveur de l'Algérie, une coopération économique qui concerne plusieurs secteurs

d'activité. La partie européenne s'engage à apporter son assistance financière à l'Algérie.

- L'accord comprend un certain nombre de dispositions. Celles relatives à la coopération sociale et culturelle. Il se distingue aussi par le fait qu'il réserve un titre à part aux questions relevant du domaine de la justice et affaires internes. Enfin, il énonce un certain nombre de règles relatives aux aspects institutionnels.

D'après ces objectifs, on constate que cet accord est basé particulièrement sur le libre échange et les échanges commerciaux.

4. L'EVOLUTION DU PARTENARIAT ALGERIE - UE DURANT CETTE PERIODE

Cet exposé porte essentiellement sur le volet économique en s'intéressant aux démantèlements progressifs des droits de douanes, que se soit pour les produits industriels ou agricoles.

Avant d'aborder ce point, il est préférable de rappeler la période précédant l'entrée en vigueur du partenariat en septembre 2005.

4.1. Le programme MEDA

En parallèle avec la signature avec chaque pays séparément, l'UE a mis en place un dispositif de mesures, d'octroi d'aides à fonds perdus et de crédits octroyés par la Banque Européenne d'investissement (BEI), pour alléger les pertes que subiront ces pays. En ce qui concerne l'Algérie, ce programme d'aides est divisé en deux tranches, MEDA I et MEDA II.

4.1.1. Le programme MEDA I

Ce programme d'un montant de 3.435 milliards d'Euro étalé sur une période de cinq ans, allant de 1995 à 1999, est réparti entre les pays de la rive sud de la méditerranée, comme le montre le tableau n° 1 ci-après :

Tableau 1 : Engagements et paiements MEDA I (en million d’Euro)

Pays	Engagements	Paiements	En%
L’Egypte	686	157	22.88
Le Maroc	656	127	19.35
La Tunisie	428	168	39.25
La Turquie	375	15	4.00
La Jordanie	254	108	59.34
Le Liban	182	1	0.5
L’Algérie	164	30	18.29
La Palestine	111	54	48.64
La Syrie	99	0	0,00
Les programmes régionaux	480	230	47.91
TOTAL	3435	890	25.90

Source : Mokhtar Kkalladi, op. cit.

D’après le tableau, le montant total, réparti entre les pays indiqués, est destiné à la mise à niveau de leurs structures économiques, et pour la réalisation de programmes régionaux favorisant la coopération sud-sud. Toutefois ces derniers n’ont pu mobiliser qu’une partie de ces montants, pour différentes raisons.

En ce qui concerne l’Algérie, la somme utilisée, durant la seconde moitié des années 90, est destinée au financement des réformes économiques, au développement du secteur privé et l’émergence d’une société civile, soit en bref (Document de stratégie 2007-2013 et programme indicatif national 2007-2010):

- Appui aux réformes économiques : accompagner l’ajustement structurel, appui aux réformes du commerce extérieur, privatisation des terres agricoles, logement et filet social.
- Développement du secteur privé : promotion PME, appui à la restructuration industrielle et à la privatisation, modernisation du secteur financier, appui à la réforme des télécommunications et des services postaux.
- Equilibre socio-économique et environnement : appui aux associations algériennes de développement, dépollution industrielle, bonifications d’intérêt d’un prêt BEI, appui aux journalistes et aux médias algériens et modernisation de la police.

Malheureusement, l’Algérie n’a utilisé que 30 Millions d’Euros sur les 164 millions engagés, ne représentant que 18,4 % de la somme alloué. Ce montant est considéré comme maigre par rapport aux ambitions attendues. Cette enveloppe est répartie, durant ce programme, dans le tableau suivant :

Tableau 2 : Les engagements et les paiements MEDA I pour l'Algérie durant la période (1995-1999) (en million d'Euro)

Année	Engagements	Paiements	Eng./Paiem. en %
1995	-	-	-
1996	-	-	-
1997	41	-	0
1998	95	30	31,6
1999	28	0,20	0,7
Total	164	30,2	18,4

Source : Instrument européen de voisinage et de partenariat, p. 19.

4.1.2. Le programme MEDA II

Le montant de ce programme est de 5.350 Milliards d'Euros réparti entre les mêmes pays, allant de 2000 à 2006, soit une période de sept ans. Pour l'Algérie, la moyenne des engagements est toujours modeste. Elle est inférieure à 50 millions d'euros sur cette période répartis comme indiqué par le tableau n°3 :

Tableau 3 : Les engagements MEDA II (en million d'euros)

Année	Engagements	Paiements	Eng./Paiem. en %
2000	30,2	0,4	1,3
2001	60	5,5	9
2002	50	11	22
2003	41,6	15,8	38
2004	51	42	82,4
2005	40	39,4	98,5
2006	66*	-	-
Total	338,8	114,1	33,7

Source : Instrument européen de voisinage et de partenariat, p. 19. *estimation

Les engagements du MEDA II sont consacrés, essentiellement, à la modernisation de l'administration, ainsi que les secteurs suivants : Management de l'économie, facilitation du commerce, accompagnement de l'accord, appui aux organisations non gouvernementales, appui à la police rurale de proximité, appui à la libéralisation et à la réforme du secteur des transports, transport et gestion de l'eau.

4.2. La libéralisation des produits industriels

Le démantèlement tarifaire des produits industriels est fixé différemment pour chaque liste, comme le montre le tableau suivant :

Tableau 4 : Calendrier de libéralisation des produits industriels

Produits	Référence	Nombre de ligne tarifaires	Date d'entrer d'effet	Taux de réduction
Produits visés à l'article 9 paragraphe 1	Annexe 2	2034	A partir du 1 ^{er} Septembre	100%
Produits visés à l'article 9 paragraphe 2	Annexe 3	1995	01/09/2007 01/09/2008 01/09/2009 01/09/2010 01/09/2011 01/09/2012	20% 30% 40% 60% 80% 100%
Produits visés à l'article 9 paragraphe 3	Autres produits que ceux des annexes 2 et 3	1860	01/09/2007 01/09/2008 01/09/2009 01/09/2010 01/09/2011 01/09/2012 01/09/2013 01/09/2014 01/09/2015 01/09/2016 01/09/2017	10% 20% 30% 40% 50% 60% 70% 80% 90% 95% 100%

Source : Construit à partir du texte de l'accord d'association, et la déclaration du Ministre du commerce algérien.

D'après le tableau n° 4 ci-haut, et d'après l'accord, dans son article 9, ses paragraphes 1, 2 et 3, portant chacune sur une liste de produits, préalablement définie, le processus se déroulera dans le temps selon un calendrier pour atteindre le taux zéro en 2017. Le calendrier se compose de trois étapes (Khaladi Mokhtar, 2007).

1^{ère} étape : Elle est de deux années, dans laquelle il est procédé au démantèlement d'une liste de 2034 lignes tarifaires (assujetties aux droits de douanes de 5 et 15%). Cette liste touche les matières premières ou produits bruts, ainsi que les matières non produites localement et destinées à l'outil industriel (demi-produits ou semi-finis) de l'industrie chimique, métallurgie, textile, matériaux de construction et céramique.

2^{ème} étape : Elle est de cinq années, commençant à la 3^{ème} année de l'entrée en vigueur de l'accord, porte sur liste de biens d'équipement agricole et industriel, ainsi que les produits pharmaceutiques, pneumatiques, équipements mécaniques, équipements électriques et électroniques hors électroménagers, matériel pour le transport ferroviaire, automobile et pièces détachées, instruments et appareils.

3^{ème} étape : Cette étape d'une durée de dix ans, partant de la 3^{ème} année de l'application de l'accord, parachève le démantèlement du reste des produits inscrits au tarif douanier (produit fini). Soit 1860 lignes tarifaires.

Il faut rappeler que ce calendrier a un caractère indicatif, il peut être révisé, partiellement, en cas de difficultés. De même, des mesures exceptionnelles de durée limitée peuvent être appliquées par l'Algérie aux industries naissantes ou à certains secteurs en restructuration.

Après les pertes causées par le démantèlement tarifaire avec l'UE, les autorités algériennes ont demandé la renégociation des calendriers de la libéralisation des produits industriels et agricoles. Ces négociations ont abouti à un accord fixant un nouveau schéma de démantèlement. Le but de cette opération est de récupérer le manque à gagner pour l'Algérie, et d'instaurer, à l'avenir, un partenariat gagnant-gagnant. L'opération a touché deux des trois listes (la 2^{ème} et la 3^{ème}) de l'accord, vu que la première a été démantelée dès la mise en œuvre en septembre 2005 avec une liste de 2034 lignes tarifaires.

Comme résultat de la renégociation, la deuxième liste a connu des modifications avec le report du démantèlement de 82 lignes tarifaires jusqu'en 2016, ainsi que 185 lignes tarifaires gelées jusqu'en 2018. Concernant la troisième liste, les deux parties se sont mises d'accord pour la prolongation de trois ans de 174 lignes tarifaires, et en même temps le gel de 617 lignes tarifaires durant la période allant de 2015 à 2017, avec une prorogation de trois ans jusqu'à l'an 2020.

4.3. La libéralisation des produits agricoles

En ce qui concerne les produits agricoles, l'accord prévoit l'élargissement des concessions à de nouveaux produits agricoles, aux produits agricoles transformés et aux produits de pêche et ce, pour une période de cinq ans, à l'issue de laquelle les deux parties se retrouvent pour franchir une nouvelle étape à la libéralisation. Ces produits sont indiqués dans le tableau suivant :

Tableau 5 : Calendrier de libéralisation des produits agricoles

Produit	Référence	Nombre de lignes tarifaires	Date d'entrée d'effet	Taux de réduction
Produits visés à l'article 14, 2 (produits agricoles)	Protocole 2	75	01/09/2005	20-50 ou 100% selon la nature du produit
Produits visés à l'article 14, 4 (produit de pêche)	Protocole 4	112	01/09/2005	25 ou 100% selon la nature du produit
Produits visés à l'article 14, 5 (agricoles transformés)	Protocole 5. Annexe 2. Liste 1. Concessions immédiates	168	01/09/2005	20-25-30 ou 100% selon la nature du produit
Produits visés à l'article 15	Protocole 5. Annexe 2. Liste 2. Concessions différées	112	01/09/2010	Non encore fixés

Source : Construit à partir du texte de l'accord, et la déclaration du Ministre du commerce algérien.

D'après ce tableau, il y a quatre sortes de concessions, qui sont les suivantes :

- accès en franchise de droits de douanes,
- accès avec réduction partielle de droits de douane,
- accès en franchise de droit de douane avec des quotas tarifaires ou quantités de référence,
- accès en exemption de droits de douane mais avec un droit spécifique pour les produits saisonniers qui sont soumis à des calendriers, et les exonérations concernant uniquement la partie droits de douane.

Comme les produits industriels, certaines modifications ont été apportées pour les produits agricoles. Ces dernières ont conduit à l'annulation de 25 contingents, la réouverture de 9 contingents en 2010, et la fermeture de 36 contingents agricoles et agro-alimentaires.

Il faut signaler que les échanges commerciaux, que ce soit pour les produits industriels ou agricoles, entre l'UE et ses partenaires méditerranéens sont souvent plus concurrents que complémentaires, et le volume des échanges entre les deux parties reste encore très faible.

4. LES RETOMBÉES DE CE PARTENARIAT SUR L'ÉCONOMIE ALGÉRIENNE

L'impact de cet accord de partenariat sur l'économie algérienne, concernant la libéralisation de l'économie, le commerce extérieur, les secteurs et les branches productifs, le mouvement des capitaux, les investissements étrangers et la mobilité des personnes, est traité dans les paragraphes suivants.

4.1. Les effets de l'accord de partenariats sur le secteur du commerce extérieur

Il est possible de souligner les effets les plus importants et les répercussions positives ou négatives à travers l'analyse de l'évolution des exportations et des importations algériennes avec l'UE.

Les relations commerciales multilatérales dans le commerce des biens se sont développées avec de nombreux produits tels que, les biens industriels, les produits agricoles, le textile, les vêtements, etc....

Pour ressortir les effets, positifs ou négatifs, de cet accord sur l'économie nationale, l'évolution de la structure des exportations et des importations algériennes avec leurs partenaires européens est analysée dans les paragraphes suivants.

4.1.1. Effets de l'accord de partenariat sur les exportations

L'Algérie, en vertu de ses politiques économiques actuelles, ne peut, à court et à moyens terme, changer la structure de ses exportations, en mettant de nouveaux produits compétitifs et hors hydrocarbures sur les marchés étrangers. Pour couvrir des besoins en produits de consommation en augmentation continue, elle reste donc tributaire de la surexploitation de ses ressources énergétiques. Les recettes des exportations algériennes, se sont certes améliorées, depuis la signature de l'accord d'association, mais, elles restent, malheureusement, dépendantes des hydrocarbures, comme le montre le tableau ci-après :

Tableau 6 : Evolution des exportations algérienne et la composition structurelle des biens (en million de \$US)

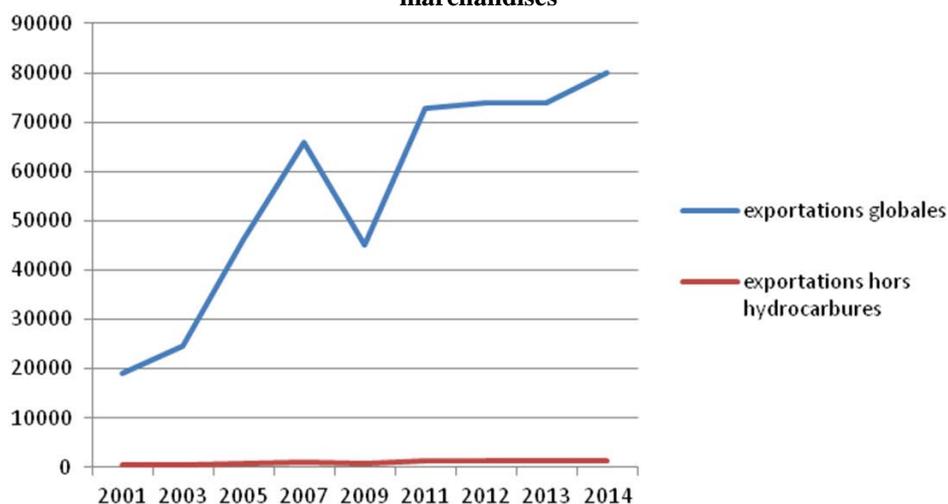
	2001	2003	2005	2007	2009	2011	2012	2013*	2014*
Exp. globales	19 090	24 470	46 330	65 850	45 186	72 883	73 981	74 000	80 000
Exp. hors hydrocar.	560	470	740	980	766	1221	1258	1184	1200
Taux des Exp. des hydrocar.	98	98	98	98,4	98,3	98,3	98,3	98,4	98,5

Note : * des estimations

Source : Effet des programmes d'investissements publics sur la croissance économique et l'intégration sectorielle 2001-2014, colloque évaluation des investissements publics, mars 2013.

La part des hydrocarbures a atteint en 2001 le taux de 98% du total des exportations des biens et services, alors que les exportations énergétiques ne sont pas concernées par l'accord de partenariat. Il faut signaler que les exportations hors hydrocarbures vers l'UE n'ont, en moyenne pas dépassé un milliard \$US. Cette évolution est présentée par la courbe suivante :

Figure 2 : Evolution des exportations algérienne et la composition structurelle des marchandises



Source : Données du tableau n° 6

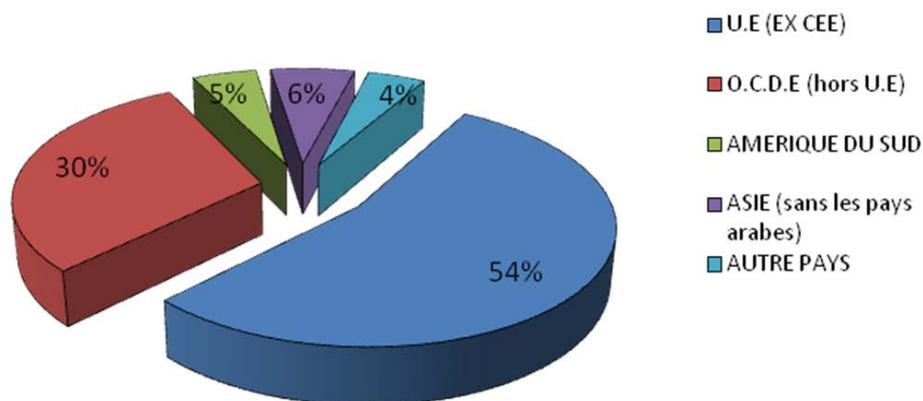
Il faut savoir que l'adhésion de l'Algérie à la zone de libre-échange avec l'UE est justifiée par les mesures facilitant l'accès aux marchés, offrant des débouchés sur le marché international. Et comme les produits pétroliers et gaziers ne sont pas concernés par les clauses contenues dans l'accord de partenariat, cela signifie que 98% des exportations algériennes ne bénéficient pas des avantages offerts par cet accord. Comme les pays importateurs sont des acheteurs monopolistiques, ils imposent des taxes élevées sous prétexte de rationaliser la consommation et incitent à chercher d'autres ressources.

Cela signifie que l'Algérie ne bénéficie pas, dans ses relations avec l'UE, des avantages offerts par l'ouverture du commerce des biens et services avec des exportations hors hydrocarbures ne dépassant pas, dans les meilleurs des cas, le taux de 1,8% du total des exportations de biens et services.

Par conséquent, il faut s'attendre à une intensification de l'exportation des richesses énergétiques pour maintenir un niveau de recettes suffisant pour couvrir des importations en progression continue. Pour changer la structure des exportations au profit des produits hors hydrocarbures, l'Algérie est tenue d'adopter une stratégie de développement de solutions alternatives aux exportations énergétiques pour permettre à son économie de bénéficier de ses relations avec ses partenaires.

De plus, les exportations à destination des pays de l'UE ne représentent que 54% des exportations globales algériennes, comme le montre la figure n°3 ci-dessous :

Figure 3 : Les exportations algériennes par région économique



Source : Direction générale des douanes, Ministère des Finances, 2012

4.1.2. Effets de l'accord de partenariats sur les importations

L'accord de partenariat, dans sa partie biens et services a, dans un avenir prévisible, un effet négatif sur l'économie algérienne, sauf remise en cause des politiques économiques actuelles. Ces effets sont causés par:

- le flux des importations en provenance de l'UE;
- la baisse des recettes douanières ;
- l'augmentation du prix de certaines importations et l'effet de l'inflation importée.

4.1.2.1. Les effets causés par le flux des importations en provenance de l'UE sur l'économie Algérienne

Avec l'amélioration des revenus pétroliers, les importations ont augmenté de manière significative, comme le montre le tableau :

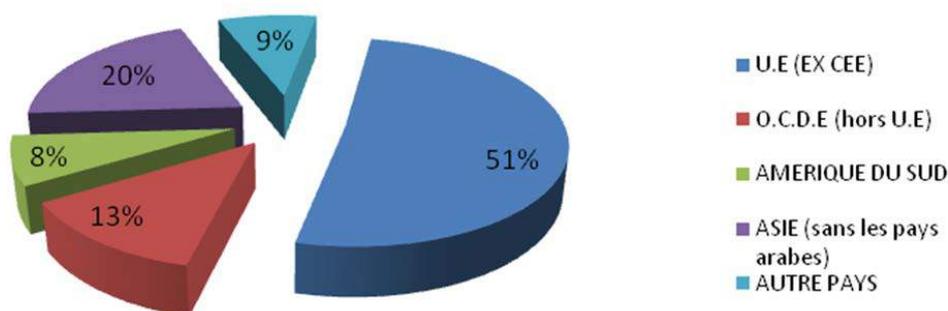
Tableau n° (7) : L'évolution structurelle des importations au cours de la période 2001-2012 (en million de \$ US)

	2001	2003	2005	2007	2009	2011	2012	% du total
Alimentation	2346	2516	3357	4656	5512	9261	8983	19,19
Energie et Lubrifiants	97	41	186	205	516	1094	1887	04,00
Produits Bruts	445	607	688	1245	1128	1676	1824	04,00
Demi-produits	1747	683	3743	6678	9557	10047	10370	22,1
Biens d'Equipements Agricoles	154	121	149	137	219	364	329	0,70
Biens d'Equipements Industriels	3293	4654	7872	9361	14141	17074	13453	28,74
Biens de consommation (non-alim.)	1400	1984	18863	3546	5 868	7 328	9 955	21,27
Autres	-	716	704	420	462	517	-	-
Total	9482	13322	19567	26348	37403	47247	46801	100

Source : Construit par les auteurs à partir des statistiques du commerce extérieur de l'Algérie, CNIS, Algérie, et Bouhezza Mohamed, Bradji Sabah, Colloque Sétif Algérie, 2013.

Les chiffres du tableau précédent, sur les importations de différents groupes de marchandises et de matériaux, montre que les importations alimentaires et des biens de consommation non alimentaires sont dominants, atteignant un taux d'environ 40% du total. Ces dernières ont, durant cette période, quintuplé, passant de 10 à 46 milliards de \$ US. Cette tendance s'est accélérée, après l'entrée en vigueur de l'accord. La part de l'UE, dans les importations algériennes, est passée à plus de 51%, présentée par le graphique ci-dessous.

Figure 4 : Les importations algériennes par région économique



Source : Direction générale des douanes, Ministère des Finances, 2012

D'après la structure des importations, et la part importante provenant de l'UE, bénéficiant du démantèlement tarifaire, la facture des importations algériennes va progresser freinant ainsi le développement de produits alternatifs, et étouffant le système productif national.

L'abolition par l'Algérie de toutes les restrictions quantitatives à l'importation et la réduction considérable des tarifs douaniers, en particulier dans la phase finale du démantèlement douanier, qui est entré en vigueur en septembre 2012, a poussé les importations vers le haut. Cette concurrence continue et non équilibrée, induite par les termes de l'accord d'association, ne favorise pas le développement des principales activités productives, au vu des conditions économiques internes médiocres, elle va aggraver encore plus la situation bilantaire des entreprises nationales qui trouvent des difficultés à améliorer l'efficacité et l'efficience de leur gestion et la qualité de leurs produits. Ce climat est favorable au développement d'activités marginales voire parasitaires, moins risquées et caractérisées par une courte période de récupération, aux dépens d'activités productives stratégiques et compétitives. L'absence actuelle d'une stratégie visant à promouvoir l'économie nationale ne favorise pas le développement d'économie productive basée sur un système institutionnel intégré et cohérent.

4.1.2.2. Effets dus à la baisse des recettes douanières

L'adhésion à la zone de libre échange avec l'UE et les obligations qui en découlent, induit une baisse considérable des recettes douanières du pays, sans que l'économie algérienne, dans son état actuel, puisse combler le manque à gagner par d'autres débouchés. Ces pertes sont provoquées par (Salhi, 2013):

- la réduction des taxes douanières, qui sont estimées, actuellement, entre 1 à 3 milliards de \$ US par an. Le cumul des pertes depuis l'entrée en vigueur de l'accord de partenariat à la fin de l'année en cours (2013), sont estimées à 20 milliards \$ US.
- l'élimination des restrictions quantitatives et ses implications liées à l'augmentation de flux des importations qui dépasse la capacité de consommation de l'économie algérienne d'une part, et l'augmentation du gaspillage des recettes d'exportation de biens stratégiques nationaux représentés par les hydrocarbures, en particulier, par l'importations de biens de consommation de luxe.

4.1.2.3. Les effets causés par les prix de certaines importations et par l'inflation importée

Les pertes résultant de prix élevés des matières premières de base et du transfert de l'inflation. Sachant que l'Algérie se base sur les sources externes pour répondre à ses besoins de consommation, son économie productive nationale est dans un état de dégradation avancée, enfin, son agriculture dépend de changements des conditions climatiques. Ces deux facteurs d'influence, d'une part, des prix de plus en plus élevés de produits de consommation de base, provenant essentiellement de l'importation ; et d'autre part, un secteur industriel national en panne ; autant de contraintes qui vont approfondir encore plus la dépendance de l'économie et la détérioration des termes de l'échange.

Cette situation va coûter au trésor public entre 2 à 3 milliards de \$ US de manque à gagner, peut être plus avec l'amélioration du pouvoir d'achat du consommateur algérien ; et par l'augmentation soutenue de coûts résultant de transferts sociaux pour atténuer les effets du chômage et l'augmentation de la pauvreté pour calmer le front social et contenir leurs troubles.

4.2. Les effets de l'accord de partenariat sur les secteurs et les branches productifs

Les répercussions sur les branches productives sont négatives. Pour illustrer ce phénomène, nous nous concentrons sur l'évolution de l'indice de la capacité de production et le taux de croissance de l'industrie manufacturière au cours des dernières années.

4.2.1. Effets de l'accord de partenariat sur la croissance des branches industrielles manufacturières

Les industries manufacturières de transformation jouent un rôle important dans les économies développées ainsi que dans les économies des pays émergents. Les politiques publiques contribuent au développement d'un environnement favorable aux affaires. Par contre, Les politiques de libéralisation, le démantèlement hâtive et la levée du soutien aux entreprises économiques, accompagnant l'accord de partenariat, ont détruit la complémentarité et la cohésion des structures productives nationales et provoqué la régression continue des taux de croissance des branches industrielles manufacturières de transformation comme le montre le tableau suivant :

Tableau 8 : Evolution du taux de croissance réelle des industries manufacturières au cours de la période 2001-2012 (en %)

	2001	2003	2005	2007	2009	2011	2012*
Les industries agroalimentaires	-12,5	-20,6	14,4	-2,1	-9,1	21	18
Les mines	-2,8	0,6	12,4	-3,9	3,4	-9,5	0,1
l'Energie et les Eaux	5	6,6	9,9	8,0	7,2	8,2	8
L'industrie chimique	10	8,9	-4,1	-8,9	9,2	-3,4	0,4
L'industrie du textile	-1,3	-10,6	3,9	-4,4	2	-5,5	0,6
L'industrie des cuirs	-14,7	-2,4	0,6	-15	1,2	-13,1	0,14
L'industrie des matériaux de construction	-0,5	-7,7	-18,4	-4,8	-10,3	-9,4	0,10
L'industrie de bois et de papier	0,3	-7,3	4,8	2,7	-1	-3,2	0,3
Autres	-13,1	-6,3	-15,9	-6,8	-21,4	-11,8	0,12
La moyenne de l'industrie manufacturière	-1	3,5	-4,5	-3	-4,5	3,5	-1

Source : Salah Salhi, op. cit, * les chiffres de l'année 2012 ne sont pas définitifs

Les chiffres précédents montrent les limites des effets positifs attendus des relations participatives avec l'UE sur le développement des branches et des activités dans les

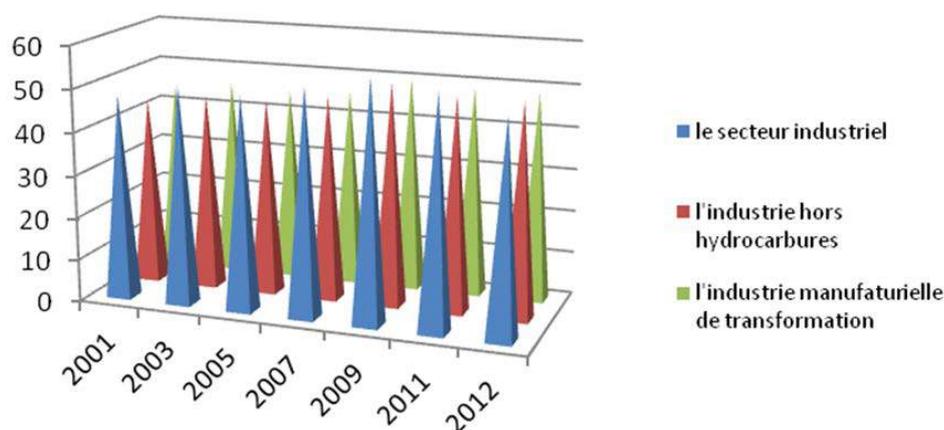
industries manufacturières de transformation. La plupart des branches ont, plutôt, enregistré des taux de croissance négatifs.

Certaines branches industrielles, comme l'industrie manufacturière agroalimentaire, ont développé leur production, mais la plupart de leurs intrants industriels sont importés.

4.2.2. Indice d'utilisation des capacités de production

En effet, la rigidité de l'appareil productif et la récession dans la plupart des branches du secteur industriel, coïncident avec l'utilisation non économique des capacités productives, comme illustré dans la figure suivante :

Figure 5 : Le taux d'utilisation des capacités de production industrielle au cours de la période 2001-2012



Source : Salah Salhi, op. cit.

Cette situation économique complexe apparaît encore plus, lorsqu'on observe l'indice de l'évolution de la production. Il montre l'absence d'impact des opportunités offertes par l'accord de partenariat sur le développement de la production industrielle en Algérie, comme le montrent les chiffres suivants :

Tableau 9 : L'évolution annuelle de l'indice de la production industrielle au cours de la période 2001/2011 (en %)

	2001	2003	2005	2007	2009	2011
Le secteur industriel	90	92	90	93	87	85
L'industrie hors les hydrocarbures	79	79	73	77	74	75
Les industries manufacturières de transformations	50	54	52	59	63	66

Source : ONC, l'activité industrielle 2001-2009, Statistique ECO n° 70, 9/2012, p. 22.

4.3. Effets de l'accord de partenariat sur la libre circulation des capitaux, l'investissement et la mobilité des personnes

Ces effets sont traités dans les titres suivants :

4.3.1. Effets de l'accord de partenariat sur la libre circulation des capitaux et des investissements

Les effets de cet accord sur la libre circulation des capitaux et des investissements sont limités. Certains investissements se sont orientés de façon sélective vers les secteurs des gisements primaires. Par contre, les investissements dans les secteurs productifs importants sont maigres, et les aides n'ont pas contribué dans le cadre du programme MEDA I, MEDA II, à obtenir la réhabilitation économique nécessaire.

A cet effet, les montants alloués par l'UE aux pays méditerranéens, sous forme d'IDE ou autres formes (dons ou prêts de 3 milliards de \$ par an), restent en deçà des besoins, qu'ils soient européens ou en provenance du reste du monde. Si l'on effectue une comparaison avec les autres pays en développement, la zone méditerranéenne est celle qui bénéficie le moins d'IDE européens, comme le reste de l'Afrique Sub-saharienne.

La capacité d'attraction des IDE par ces pays diffère. A titre d'exemple, Israël et l'Egypte capitalisent à eux seuls 42% des IDE de la zone ; alors que la Jordanie, le Liban et la Syrie comptabilisent uniquement 2% de ces IDE (Dominique Delaunay, 2009).

Dans un rapport « Doing business 2010 », la Banque Mondiale a établi un classement de l'attractivité de 183 pays. Ce classement a pris en compte un certain nombre de critères. Les pays de la zone Euromed se classent comme suit :

Tableau 7 : Le classement des pays sud méditerranéens bénéficiaires des IDE provenant de l'UE

Pays	Rang
Israël	29 ^{ème}
Tunisie	69 ^{ème}
Turquie	73 ^{ème}
Jordanie	100 ^{ème}
Egypte	106 ^{ème}
Liban	108 ^{ème}
Maroc	128 ^{ème}
Algérie	136 ^{ème}
Territoires Palestiniens	139 ^{ème}
Syrie	143 ^{ème}

Source : Dominique Delaunay, 2009.

4.3.2. Effets de l'accord de partenariat sur la mobilité des personnes

L'accord a approuvé, dès le début, le cadre dans lequel est autorisé le mouvement de la main d'œuvre soumis aux restrictions administratives. Par conséquent, la zone de libre échange est dès le début entravée par ces conditionnalités concernant la liberté d'action et de mouvement des personnes. On peut dire donc, que cette zone ne peut être concrétisée sur le terrain, et que, pour l'UE, l'objectif est d'amener l'Algérie à jouer le rôle de gendarme dans la région, pour bloquer l'émigration clandestine et le trafic de drogue provenant du Sud de la méditerranée.

5. CONCLUSION

D'après ce papier, on constate que la coopération entre l'Algérie et l'UE date de l'indépendance de l'Algérie. Ce partenariat a pris certaines appellations et certaines formes jusqu'à la signature de l'accord de partenariat en avril 2002, entré en vigueur en septembre 2005.

Malgré ses différents volets (politique, commercial, économique et social, culturel et humain), l'accord s'est intéressé particulièrement à la dimension économique et particulièrement la libéralisation des échanges commerciaux. L'accord a fixé un calendrier de libéralisation de certains produits industriels et agricoles en provenance de l'UE, par un démantèlement tarifaire progressif étalé sur une période de douze ans, arrivant en 2017 à un taux 0%. Cet accord, dans son volet économique, est soutenu par des aides et prêts financiers qui se sont concrétisés par la mise en place du programme MEDA (I et II) ainsi que des prêts de la BEI venant en aide à certains secteurs, dont la mise à niveau des PME/PMI, sans atteindre les objectifs déclarés.

Cependant, la balance commerciale des échanges effectués entre les deux parties sont d'apparence en faveur de l'Algérie. Les exportations sont financées à plus de 98% par les exportations des hydrocarbures. Les termes de l'accord et le mode de financement des échanges ont détruits la capacité productive industrielle nationale. Les effets à long terme sur l'économie algérienne sont négatifs.

Les effets de l'accord sur les exportations en provenance de la production nationale sont faibles et même négatifs. Les exportations hors hydrocarbures ne dépassent pas les 1,8%, alors que les importations, en provenance de l'UE sont, durant la période d'étude, 20 fois supérieures aux exportations.

Les effets de l'accord sur les secteurs et les branches productives, sont hautement négatifs, en provoquant une baisse significative du volume de production et l'indice d'utilisation des capacités de production. Quant à la circulation des capitaux pour les investissements, elle est insignifiante, et orientée principalement vers les hydrocarbures. Enfin, la mobilité des personnes, ne s'est concrétisée.

BIBLIOGRAPHIE

- Centre national de l'informatique et des statistiques (CNIS).
- Commission européenne : document de stratégie 2002-2006.
- Commission européenne : le processus de Barcelone, cinq ans après.
- Directeur générale des politiques externes de l'union, département thématique, bilan des relations commerciales entre l'union européenne et les pays méditerranéens (22/09/2009).
- Directeur Générale du Commerce Extérieur, Ministère du Commerce.
- Direction générale des douanes, Ministère des Finances.
- Delaunay D., (2009), Bilan des relations commerciales entre l'UE et les pays méditerranéens, Direction Générale des Politiques Extérieures de l'Union.
- Makhlouf F., (2006), Les Politiques commerciales de l'Algérie et son intégration à l'Europe, Master 1 Economie des Affaires Européennes et Internationales, Université de Pau et des Pays de l'Adour.
- Impact de l'accord d'association sur les échanges de l'Algérie avec l'UE, 2010.
- Instrument Européen de voisinage et de partenariat, Algérie, Document de stratégie 2007-2013 et programme indicatif national 2007-2010.
- Le journal officiel de l'UE n°L265/3 du 10.10.2005.
- Le journal officiel de RADP n°31 du 30.04.2005.
- Bouhezza M., Bradji S. (2013), « L'impact du programme des investissements publics sur les variables du carré de Caldor sur l'économie algérienne de la période 2001 – 2009 », Colloque Internationale sur : Evaluation des effets des programmes d'investissements publics 2001-2014 et leurs retombées sur l'emploi, l'investissement et la croissance économique, Faculté des Sciences Economiques, Commerciales et Sciences de Gestion, avec la collaboration du laboratoire PIEEM, Université Ferhat Abbas Sétif 1, Algérie, les 11-12 mars 2013.
- Khaladi M., (2007), « l'accord d'association Algérie-UE : un bilan critique », séminaire à Rabat, Maroc. www.gate.cnrs.fr/unica07/.
- Office national de statistique (ONS), Algérie
- ONC, l'activité industrielle 2001-2009, Statistique ECO n° 70, 9/2012, p. 22.
- Salhi S., (2013), « Effet des programmes d'investissements publics sur la croissance économique et l'intégration sectorielle 2001-2014 », Colloque Internationale sur : Evaluation des effets des programmes d'investissements publics 2001-2014 et leurs retombées sur l'emploi, l'investissement et la croissance économique, Faculté des Sciences Economiques, Commerciales et Sciences de Gestion, avec la collaboration du laboratoire PIEEM, Université Ferhat Abbas Sétif 1, Algérie, les 11-12 mars 2013.
- Supplément : 50ème anniversaire de l'indépendance. www.gate.cnrs.fr; eeas.europa.eu/délégation/Algeria/ 50ème annif-fr.pdf.
- www.algerian-embassy.be

Jean-Paul Guichard

l'Université de Nice Sophia Antipolis, Nice, France

LE SCENARIO DE LA FIN DES FIRMES MULTINATIONALES

RESUME

Les firmes multinationales (FMN) semblent effectuer aujourd'hui une ascension irrésistible; paradoxalement, les beaux jours qu'elles vivent pourraient bien constituer le prélude de leur déclin. Les FMN ont tendance à s'autonomiser de plus en plus de leur environnement économique et social d'origine en même temps que s'accroît leur puissance. Cette "montée" pourrait être contrariée, à l'avenir, par l'accession de la Chine à l'hégémonie mondiale du fait que ce pays est doté d'un système totalitaire; les firmes géantes que celui-ci engendre risquent fort d'absorber les FMN existantes (ou de provoquer leur déclin) qui n'ont pas, comme elles, le soutien d'un Etat extrêmement fort. Ces firmes géantes chinoises auront bien, comme les FMN actuelles, une stratégie et une organisation conçues à l'échelle du monde ; toutefois, c'est une différence essentielle, leur management demeurera, comme aujourd'hui, sous l'influence de l'Etat Chinois et du parti Communiste Chinois (PCC) aux sections largement implantées en son sein.

Mots-clés : les firmes multinationales, Chine, FMN

JEL Classification : F23

1. INTRODUCTION

Les firmes multinationales semblent effectuer aujourd'hui une ascension irrésistible ; paradoxalement, les beaux jours qu'elles vivent pourraient bien constituer le prélude de leur déclin. Pour en juger, il convient de préciser ce qu'est une firme « multinationale » ; à l'origine, il y a toujours une firme « nationale » (entendons par là une firme qui est née et qui a grandi dans un pays donné) dont les activités, en croissance, s'étendent progressivement dans le monde de sorte que sa stratégie et son organisation sont, de plus en plus, conçues à l'échelle mondiale ; de ce fait, la firme tend à s'autonomiser de son environnement économique et social d'origine en même temps qu'elle acquiert une puissance de plus en plus grande.

Cette « montée » des firmes multinationales pourrait bien être contrariée, à l'avenir, par l'accession de la Chine à l'hégémonie mondiale ; non point que l'existence d'une hégémonie constitue, en tant que telle, un obstacle au développement des FMN – l'exemple des Etats-Unis montre bien qu'il n'en est rien – mais parce que le prétendant à la domination mondiale, la Chine, est doté d'un système totalitaire. Les firmes

géantes que celui-ci engendre risquent fort d'absorber les FMN existantes (ou de provoquer leur déclin) qui n'ont pas, comme elles, le soutien d'un Etat extrêmement fort. Ces firmes géantes chinoises qui pourraient bientôt, peut-être (l'avenir n'est pas fixé à l'avance), dominer l'économie mondiale, auront bien, tout comme les FMN actuelles, une stratégie et une organisation conçues à l'échelle mondiale : toutefois, leur management, il s'agit là d'une différence essentielle, demeurera tout comme aujourd'hui, sous l'influence de l'Etat Chinois et du Parti Communiste Chinois (le PCC) aux sections largement implantées en son sein.

2. LES FMN ET L'EMERGENCE DE LA CHINE

En cette année 2013 au cours de laquelle on pourra saluer le sixième anniversaire de la crise, n'importe quel observateur un peu averti peut discerner clairement que la Chine ne fait désormais plus guère mystère de ses ambitions hégémoniques à relativement court terme, notamment en matière monétaire¹. Il ne peut manquer de constater par ailleurs que les énormes déficits commerciaux des Etats-Unis et de la plupart des pays de la vieille Europe, notamment avec la Chine, ne peuvent que conduire ces pays à une situation économique et sociale de plus en plus périlleuse et à l'affaiblissement continu de leur puissance débouchant, d'une manière ou d'une autre, sur leur vassalisation. Malheureusement, bien peu nombreux sont ceux qui ont une telle lucidité ! Les bons apôtres de la mondialisation, et même ceux, altermondialistes, qui lui adressent quelques critiques, s'accordent pour ne pas voir le danger du processus en cours. Il y a un consensus dans le déni sur les mécanismes duquel il faudrait s'interroger.

Comment donc a pu émerger cette formidable puissance capable de faire vaciller aujourd'hui, simultanément, le géant américain et l'Europe ?

Cette puissance a un nom, la Chine ; toutefois celle-ci seule, malgré toute sa force – qui est immense, on le verra – ne pourrait pas obtenir ce résultat. Il y a autre chose en plus : il y a en effet aussi les firmes multinationales qui se sont autonomisées de leurs substrats sociétaux d'origine et qui constituent désormais, avec l'hyper-capitalisme totalitaire chinois, et sous la direction de fait de celui-ci, un pouvoir sans foi ni loi en mesure de mettre le monde entier en coupe réglée.

Mais que sont donc cet "hyper-capitalisme" chinois fonctionnant sous la direction du Parti Communiste Chinois (PCC) et cet ensemble d'entreprises multinationales fonctionnant en symbiose avec lui ? Certes, la puissance des firmes multinationales n'est pas nouvelle comme l'atteste une très volumineuse littérature économique ; elle est toutefois renouvelée en ce sens qu'elle s'est affranchie d'une certaine influence des Etats de leurs pays d'origine respectifs ainsi que, plus largement, de celle qui était non négligeable de leurs substrats sociétaux d'origine respectifs. La puissance chinoise, elle, est "émergente" : à l'échelle de l'histoire contemporaine, son ascension a été fulgurante ; en l'espace de trente ans en effet, un pays arriéré et ruiné par des soubresauts révolutionnaires calamiteux est devenu la première puissance industrielle

¹ De façon très officielle, la Chine a annoncé que 2015 serait l'année de la "convertibilité" du yuan ; il faut "traduire" cela et comprendre qu'en 2015 les dirigeants chinois pensent que le yuan aura remplacé le dollar comme monnaie du monde.

et économique du monde, devant les Etats-Unis. L'alliance politique nouée par les Présidents Nixon et Mao, entre les gouvernements des Etats-Unis et de la Chine, contre l'Union Soviétique et le Vietnam d'alors, est devenue par la suite une alliance très forte entre le pouvoir totalitaire chinois – il est à la fois politique et économique – et celui des firmes multinationales dont il assure la prospérité, au moins pour un temps.

A l'échelle planétaire, c'est l'écrasement du monde du travail : une gestion impitoyable de celui-ci à l'intérieur de la Chine, un chantage permanent à l'emploi, pesant sur les salaires et remettant en question les "acquis sociaux", en Occident. Quelle déconvenue pour les "optimistes" de l'année 1989 qui rêvaient d'une ère nouvelle faite de démocratie et d'"avancées sociales"! On oubliait, tout simplement, que ces "avancées", qui nous paraissent si naturelles, furent en réalité le résultat d'âpres luttes sociales. On s'imaginait que le capitalisme aboutissait nécessairement à la démocratie en oubliant que seuls les systèmes sociétaux basés sur des pouvoirs et des contre-pouvoirs pouvaient limiter le pouvoir du capital et donc ses capacités de nuisance alors que les systèmes totalitaires offraient au contraire à celui-ci un boulevard pour son développement.

Les grandes firmes occidentales (les autres aussi, japonaises notamment), dont les profits étaient bloqués à un certain niveau dans leurs pays d'origine respectifs par le pouvoir des salariés, trouvèrent en Asie l'opportunité de contourner cet obstacle : un pouvoir totalitaire mettait en Chine, à leur disposition, des centaines de millions d'esclaves, une aubaine pour les profits !

A partir du retour de M. Deng aux affaires, allait progressivement se constituer le système infernal qui régit le monde d'aujourd'hui. La caste dirigeant la Chine, tout en maintenant solidement l'organisation totalitaire du pays, abandonnait le système collectiviste de l'économie pour ouvrir celle-ci à de multiples partenariats avec les capitaux étrangers. Un véritable eldorado s'offrait aux firmes multinationales ; de nombreuses entreprises "joint ventures" furent mises sur pied et, surtout, il s'agit de l'élément le plus significatif, par l'intermédiaire de la foire de Canton au début, on assista à une véritable éclosion de contrats de sous-traitance industrielle qui firent rapidement de la Chine "l'atelier du monde".

3. DES PROFITS ELEVES GRACE AU SYSTEME TOTALITAIRE CHINOIS

L'organisation totalitaire n'y était pas pour rien ; grâce à elle, les salaires pouvaient être maintenus à des niveaux dérisoires et les travailleurs pouvaient continuer à être privés de droits sociaux ; grâce à elle aussi, un contrôle des changes drastique permettait à la monnaie chinoise d'être très largement sous-évaluée, donnant ainsi au pays une compétitivité sans égale, un avantage stratégique considérable dans la compétition mondiale. Là réside le secret de cette solide alliance entre, d'une part, le Parti Communiste Chinois et les patrons de Chine, communistes eux aussi, et, d'autre part, le management des firmes multinationales très largement intéressé aux profits réalisés par celles-ci. Plus la main-d'œuvre chinoise est exploitée de façon éhontée, plus les profits réalisés en Chine par les entreprises, chinoises ou étrangères, sont élevés ; plus la monnaie chinoise est sous-évaluée, plus les profits des firmes occidentales qui sous-

traitent leurs productions en Chine, Apple par exemple, sont élevés, et plus les entreprises chinoises exportatrices sont compétitives².

Le droit du travail et ses contraintes, les cotisations sociales pour le chômage, la retraite, l'assurance maladie, les obstacles divers à la flexibilité du travail, notamment les syndicats : tout cela grèvent les profits dans les pays dotés de telles avancées sociales. Quoi de mieux, pour assurer un niveau élevé aux profits, que de développer les productions au sein d'un système totalitaire dans lequel les travailleurs n'ont quasiment aucun droit ? Que signifie, dans une telle perspective, la démocratie, sinon une entrave, un boulet dont il faut se débarrasser ?

Force est de constater la cohérence du projet chinois : le Parti Communiste de ce pays refuse, à juste titre si l'on peut dire, d'envisager toute évolution démocratique du régime. En 1989, on s'en souvient, les étudiants manifestaient sur la place Tiananmen pour l'instauration d'un système démocratique en Chine : leur mouvement fut sévèrement réprimé. Si le régime avait accepté d'opérer ce virage à cent quatre-vingt degrés, cela aurait inmanquablement abouti à la mise en place de syndicats, de vrais syndicats, et à celle de contre-pouvoirs au sein des entreprises ; cela aurait suscité des hausses de salaires intempestives ainsi que la mise en place d'instruments de protection sociale, toutes choses qui eussent gravement amputé les profits.

Le maintien du statu-quo totalitaire était nécessaire, non seulement pour reproduire dans le temps le pouvoir du Parti Communiste mais aussi pour reproduire, à une échelle sans cesse élargie, le niveau des revenus d'une caste capitaliste insatiable et en plein essor.

Cela correspondait parfaitement aux intérêts des entreprises étrangères en relation d'affaires avec des firmes chinoises et à ceux des dirigeants de celles-ci. Dans la mesure où les firmes multinationales se sont affranchies de la tutelle, ou au moins de l'influence, de leur environnement sociétal d'origine, notamment des Etats de leurs pays d'origine respectifs, leur souci principal est désormais le niveau de leurs résultats financiers consolidés à l'échelle du monde ; la pérennité des emplois de leurs établissements ne les intéresse pas en tant que telle ; elles recherchent les bas et même très bas salaires, la flexibilité du travail, l'absence de mouvements sociaux ; l'existence éventuelle de systèmes démocratiques dans les pays où elles sont présentes, loin d'être un avantage, constitue plutôt pour elles un handicap dans le grand jeu de la concurrence mondiale tel qu'il fonctionne aujourd'hui sous l'égide de l'Organisation Mondiale du Commerce (OMC).

Dans ces conditions, il n'y a rien d'étonnant dans le fait que ces firmes investissent de moins en moins dans les pays développés ; ce n'est pas du tout une question de "taille des marchés" (le grand marché chinois en très forte croissance, ceux encore très importants des pays développés qui sont toutefois en décroissance) puisque ces

² Jusqu'à une époque récente, ces entreprises chinoises exportatrices étaient des sous-traitantes de firmes multinationales ou même d'entreprises plus modestes des pays développés : elles n'étaient donc pas concurrentes ; les choses sont en train de changer, rapidement : des firmes géantes chinoises apparaissent désormais sur de nombreux marchés, à l'image de Huawei, numéro deux mondial dans son domaine, derrière Ericsson.

entreprises, qui produisent en Asie, et surtout en Chine, arrosent de leurs produits l'ensemble des économies développées, à l'image de ce que fait Apple – première capitalisation boursière du monde – dont 100% des fabrications sont effectuées en Chine³ ; si elles investissent moins, et parfois plus du tout, dans les pays développés, c'est bel et bien parce que les conditions de production, en Chine principalement ainsi que dans quelques autres pays, y sont bien plus attractives, du point de vue de leurs profits.

Conséquence de tout cela : on pourrait dire, en forçant le trait, que tout se passe comme si cette grande confédération mondiale de fait de patrons et de managers, communistes ou non, chinois ou occidentaux, pouvait désormais se passer des travailleurs des pays développés, y compris de ceux qui sont qualifiés et très qualifiés ; les firmes occidentales, au moins les multinationales, n'ont plus besoin, ou presque plus, d'investir en Occident : c'est bien plus profitable en Chine et, éventuellement, dans quelques autres pays.

Ce phénomène, qui commence à peine à être perçu, n'est malheureusement absolument pas compris ; une anecdote permet de prendre la mesure de cette incompréhension. A un journaliste soulignant, lors d'une émission de télévision, que la France avait importé de Chine, en 2011, pour une valeur de 37 milliards d'euros, alors qu'elle n'avait exporté que pour 12 milliards seulement, un ancien Premier Ministre avait rétorqué, en substance : « Je vous arrête ! C'est vrai, nous avons un déficit, mais si vous considérez les investissements des entreprises, l'avantage est pour nous : il y a bien plus d'entreprises industrielles françaises en Chine que d'entreprises industrielles chinoises en France ! ».

En somme, en poursuivant ce raisonnement stupide, l'idéal serait que la totalité des entreprises françaises puissent faire la totalité de leurs investissements en Chine pour que tout soit pour le mieux en France : le volume de l'emploi tendrait alors asymptotiquement vers zéro et les français n'auraient alors d'autre solution que d'essayer de se faire embaucher à l'étranger – on se souvient de l'affaire Moulinex – et, notamment, en Chine ; certainement pas sur la base des salaires actuels de ceux que l'on appelle les “expats” !

4. LA FIN DES MULTINATIONALES ?

Alors même qu'elles affaiblissent les sociétés et les Etats des pays développés⁴ qui se débattent, pour beaucoup d'entre eux, dans des difficultés de plus en plus insurmontables, les firmes multinationales, aujourd'hui prospères, pourraient bien connaître à terme de grandes difficultés, elles aussi. Tout se passe en effet comme si, en

³ Apple fait appel à un sous-traitant de Taïwan, Foxconn ; toutefois, sur les 1,5 million d'emplois que compte le groupe, environ un million sont localisés en Chine, dont près d'un demi million à Shenzhen ; la filiale chinoise de Foxconn, qui produit notamment pour Apple, est très probablement dans une situation de large dépendance de l'Etat chinois.

⁴ Les FMN affaiblissent les sociétés et les Etats des pays développés du fait qu'elles délocalisent leurs productions et diminuent la sous-traitance qu'elles commandent localement ; la désindustrialisation qui en résulte alimente la montée du chômage et les coûts sociaux qui lui sont liés.

affaiblissant leurs Etats, elles sciaient dans le même temps la branche sur laquelle elles avaient bâti leur prospérité et qui leur assurait une certaine protection. Un détour explicatif est ici nécessaire.

Tout d'abord, il faut souligner que c'est une grave erreur que de croire, comme le font de nombreux gouvernants, en particulier ceux qui sont aux commandes dans l'Allemagne de l'année 2012, que ce qui est bon pour "nos" grandes firmes est nécessairement aussi bon pour "notre" pays ; on le sait, les pays occidentaux sont en crise alors même que "leurs" grandes firmes – qui échappent à leur contrôle – sont prospères et réalisent des profits insolents, retrouvant la norme du 15% du début des années 2000 dont parlait si bien M. Peyrelevade⁵ ; les naïfs n'en demandent pas plus : puisque ces firmes semblent être en bonne santé, cela doit signifier que, d'une manière ou d'une autre, les fondamentaux des économies des pays d'origine sont bons ! On ne remarque pas un fait qui a son importance : le décrochage entre les profits et la bourse ; après les émotions de 2008, les profits ont beau être de retour, la confiance n'est pas pour autant au rendez-vous : la bourse demeure relativement basse, ce qui signifie que, quelque part, les "marchés" anticipent des difficultés. Quelles pourraient être celles-ci ?

Il faut revenir sur les modalités de la mondialisation, à partir des années 1970 ; à ce moment-là on assiste, après l'abandon des principales dispositions de Bretton Woods, à un double processus de libéralisation : du commerce et de la circulation des capitaux. Au cours d'une première période, approximativement de 1970 à 1990, pendant laquelle l'influence de la Chine est relativement marginale, les firmes multinationales ont développé leur capacité à échapper à l'impôt, grâce en particulier aux places financières "offshore" ; toutefois, les phénomènes de concurrence déloyale et de délocalisation des productions restaient d'une ampleur relativement limitée de sorte que, malgré les pertes de revenus occasionnées par les fuites fiscales, la mondialisation était, en quelque sorte, "gérable", sinon "heureuse". A partir des années 1990 et, plus encore, de l'année 2001 qui est celle de l'entrée de la Chine à l'OMC, le mouvement prend de l'ampleur ; des pans entiers des industries manufacturières des pays développés disparaissent : principalement au profit de la Chine, alors même que l'évaporation fiscale de ces pays se fait de plus en plus intense, en relation non plus seulement avec les places financières offshore mais aussi, désormais, avec le déclin des productions manufacturières.

Les Etats, dès avant le déclenchement de la crise en cours, sont alors affaiblis et de plus en plus démunis pour pouvoir exercer une influence notable sur "leurs" grandes firmes ; celles-ci, grâce à la mondialisation et à la libéralisation du commerce et de la circulation des capitaux, ont renforcé leur caractère multinational et, de ce fait, leur indépendance par rapport aux Etats et aux forces sociales de leurs pays d'origine respectifs. Cette liberté, qui leur permet aujourd'hui de tirer pleinement parti de la mondialisation et d'obtenir les merveilleux résultats financiers que l'on observe, risque bien, par le corollaire qui est le sien – la rupture du lien avec les Etats – de les affaiblir à leur tour demain, face à la concurrence que leur feront alors les firmes géantes chinoises en train de se constituer qui seront, elles, fortement appuyées par leur Etat, comme elles le sont déjà aujourd'hui.

⁵ Jean Peyrelevade, «Le capitalisme total», Seuil, 2005.

Nous n'en sommes pas encore là mais c'est bien ce qui est en train de se dessiner. Certes, la compétitivité de la Chine par rapport aux pays développés est, principalement pour l'instant, le produit de l'action des firmes multinationales, avec leurs technologies, et des conditions de production extrêmement favorables en Chine pour ces firmes et leurs sous-traitants.

Toutefois, dans chaque secteur industriel, la Chine entend bien développer, de façon autonome comme c'est déjà le cas dans le domaine militaire, des "champions du monde" : des firmes géantes aptes à dominer le marché mondial. La "grande alliance" dont il est question ici, celle des firmes multinationales et du Parti Communiste de Chine (PCC) en tant qu'il fédère les entreprises chinoises et l'Etat chinois, n'est nullement "Chinamerica", comme certains l'ont cru⁶, une alliance à long terme pour la direction du monde entre la Chine et les Etats-Unis ; contrairement à certaines idées reçues, l'hégémonie ne se partage pas : la situation de multipolarité du monde est seulement l'indice d'une transition d'un système hégémonique à un autre, certainement pas une situation stable, à la différence de ce que croyaient ou croient encore aujourd'hui de nombreux politiciens ou intellectuels médiatiques⁷, thuriféraires de ce qu'on nomme "la pensée unique".

Lors de la réunion du "G20" de Séoul, au cours de laquelle le Président Obama a essayé de faire admettre par la communauté internationale la règle selon laquelle les pays réalisant des excédents commerciaux dépassant 4% de leur PIB devaient revoir leur politique économique, on vit bien que la Chine, fortement hostile à un tel projet et confortée en cela par le Gouvernement allemand, n'était nullement sur la même longueur d'onde que les Etats-Unis ; cette divergence exprimait bien davantage un antagonisme (même si, officiellement, les deux pays sont des "partenaires") qu'une symbiose.

Cette grande alliance dont il est question ici n'est pas plus une alliance entre les firmes multinationales et les seules firmes chinoises avec lesquelles elles sont en affaire ; dans cette sorte de mariage, il y a en effet quelqu'un d'autre : l'Etat chinois et le PCC. Les firmes chinoises, même celles qui ressemblent aux firmes multinationales par leur taille et leur envergure mondiale sont différentes de ces dernières : leurs dirigeants, qui sont affiliés au PCC⁸, ne sauraient prendre des décisions allant à l'encontre des intérêts du Parti ou de l'Etat (que celui-ci contrôle) et donc des directives que ces instances peuvent lui adresser⁹.

Dans la stratégie mercantiliste qu'il met en œuvre, le PCC n'a pas oublié un élément décisif de l'efficacité du projet mercantiliste de conquête du monde – tel qu'il est exposé dans l'ouvrage de William Petty « L'arithmétique politique » – qui est l'étroite

⁶ Handel Jones, « Chinamerica: the uneasy partnership that will change the world », Mac Graw Hill, 2010.

⁷ Citons par exemple : J. Chirac, J. Delors, V. Giscard d'Estaing, H. Védrine, etc.

⁸ Ces dirigeants peuvent même, d'un point de vue formel, se payer le luxe de ne plus être membre du PCC : cela ne change rien car, dans ce cas, ils continuent à être obéissants et disciplinés vis-à-vis du Parti.

⁹ Il est assez peu question, dans la présente réflexion, de la composition du capital des entreprises chinoises : entreprises publiques ou privées ; il n'est pas question de soutenir que cela n'a aucune importance, toutefois, pour ce qui concerne notre propos, ce point est relativement secondaire.

solidarité et la complémentarité entre les entreprises et l'Etat ; cette solidarité est d'ailleurs, dans le cas de la Chine, particulièrement aboutie du fait du système totalitaire organisé par le PCC. Elle sera, pour les "champions chinois", un facteur décisif dans leur conquête des marchés du monde quand, de receveurs d'ordres dans des relations de sous-traitance, elles seront devenues au contraire, cela est en train de se faire, des donneurs d'ordres. Ayant à leur disposition, pour les appuyer, un Etat à la puissance inégalée, elles auront alors la possibilité d'éliminer ou de prendre le contrôle de leurs rivales occidentales, japonaises ou autres, qui elles, ont perdu en grande partie ce lien fort qui les unissait à leur Etat et à leur milieu social d'origine.

5. CONCLUSION

Bref, cette grande alliance des firmes multinationales et du capitalisme totalitaire chinois (l'Etat et les entreprises fédérés par le PCC) est provisoire. En l'absence de réaction de défense des Etats des pays concernés par cette avancée chinoise destructrice de leurs économies, les firmes multinationales, obnubilées par la recherche de profits à court et moyen termes, risquent fort de passer entièrement dans l'orbite du pouvoir chinois, comme cela devrait se produire sous peu pour l'américain Motorola.

Les profits extraordinaires que réalisent ces firmes, aujourd'hui, et les gratifications qui en résultent pour leurs dirigeants, plongent ceux-ci dans une sorte d'ivresse qui élimine en eux toutes les barrières de l'éthique et de la responsabilité, leur faisant perdre le sens du réel. Ayant de l'argent à ne savoir qu'en faire, peut-être finissent-ils par se prendre pour des dieux, alors même qu'approche l'heure ... du crépuscule!

BIBLIOGRAPHIE

Handel J. (2010), « Chinamerica: the uneasy partnership that will change the world », Mac Graw Hill,

Peyrelevade, J. (2005), «Le capitalisme total», Seui

PART VII

INTEGRATION
POLICIES: CASE
STUDIES

Srdjan Redzepagic

Institute of Economics Sciences, Belgrade, Serbia

Xavier Richet

Université Sorbonne nouvelle, Paris, France

Vinko Kandžija

University of Rijeka, Faculty of Economics, Rijeka, Croatia

CATCHING-UP AND INTEGRATION IN NEW AND FUTURE EU MEMBER STATES THROUGH FDI

ABSTRACT

The experience of the recent enlargement within the European Union is unique if we consider both the number of countries, the population, the level of economic development, the systemic characteristics of most of these countries, the speed and the cost. Those countries have supported in less than twenty years, three major shocks: a systemic shock with the implosion of the socialist system, an economic shock with the adjustment to the new market environment, an institutional shock with the membership to the European Union (EU) for those who have applied to become members. A fourth shock, for some last comers and further EU members has been the violent disintegration of the Former Yugoslavia, which has delayed and hampered negotiations for future membership of the former Republics involved in the conflict (Croatia, Serbia...)

The EU enlargement to 12 new members, of which 10 were communist economies under the control of the Soviet Union, took place in 2004 (10) and in 2007 (2), it has been the outcome of a long transformation process which started right after the fall of the Berlin wall in 1989. During this process, the leaders of those economies had to handle and manage to reach two main objectives: the transition from a socialist economy to a market economy, on the one hand and the upgrading of these economies in order to allow them to become future members of the EU on the other hand.

Following the June 2003 EU summit in Thessaloniki other candidates are crowding in at the door, all, except Turkey, from the Western Balkans (ex-Yugoslavia States, Albania), some being very close to the requirement to become a member (Croatia will officially join in January 2013), other have been admitted as "accession States" and are discussing with the European Commission the fulfilment of conditions and the timing to become officially members.

Keywords: *EU enlargement, integration, FDI*

JEL Classification: *F15, F21*

1. INTRODUCTION

The round of new membership had strong impact on the functioning of the European economy, both in terms of regulation, distribution of resources, place of economic and regional development, catching up policies (converging policies). The structural and regional imbalance among «old» and «new» member states, the need to re-industrialize many regions in order to create new jobs and wealth are real issues. Regional GDP per head among the 271 EU regions (NUTS 2) displays a very high disparity with the poorest region in eastern Bulgaria scoring 27% against 332% for Inner London. In the same time, as it can be witnessed in some regions of Central and Eastern Europe (The Bratislava region, Western Hungary, Warsaw region and Southern Poland), there are strong movements of industrial development, relocation of new industries, even in countries and regions which didn't have specific advantages in this field under the socialist system (see the car industry in Slovakia).

This goes along with an important flow of foreign capital pouring in the region where the rate of domestic accumulation is still very low and would never match investment requirements to develop a strong industrial base. This raises the question of the development of “a capitalist economy without capitalists” which has been underlined earlier at the beginning of the transition. On the other hand, it highlights the fact that industrial recovery and economic growth are fuelled by foreign investments in the region. FDI has contributed to create a new industrial landscape in the region, it has also created a new economic dependency of these countries: most of them are today the host of big transnational corporations which have a strong impact on domestic industrial structure, specialization, ownership, developing strong links with Western European economies.

Today Eastern European economies appear to be a backyard for Western Economies which, taking advantage of proximity, low costs, qualified labour, have relocated businesses which account, in some countries, for the main parts of fixed capital, added value, exports. These investments have contributed to create strong linkages between western Multinational corporations and their regional subsidiaries. On the one hand, they have taken advantage of existing competencies inherited from the former socialist system (Radosevic, 2004). On the other hand, their presence has contributed to the catching up, the development of new specialisations. In this contribution, our aim is to highlight the transformation of these economies with their linkage through their new specialization, control to EU-15 economies through the strong presence of Western Multinational Corporation (MNC).

Section 2 presents the main components of transforming policies conducted in the region; section 3 assesses the role of FDI in the region has a driver of sectoral adjustment and catching up. Even for Balkan 'late comers' countries that have lately adjusted, Section 4 concentrates on the development of a new industrial area illustrating the impact of FDI and the linkage strategy with Western companies which has resulted.

2. A WIDE ENLARGEMENT STRATEGY

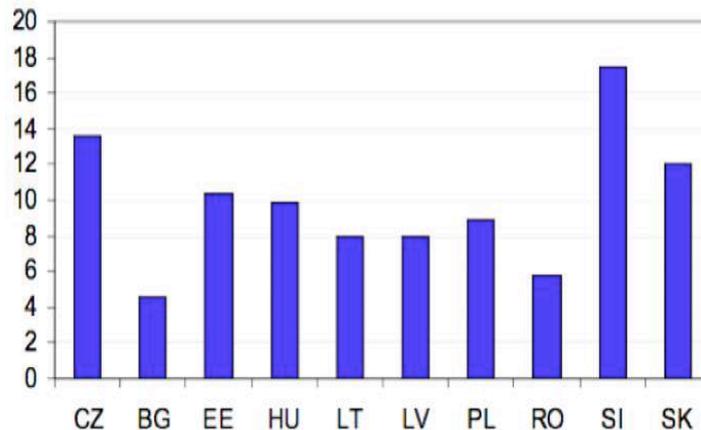
2.1. A Difficult Adjustment

Considering the size, the population, history, level of development, the last wave of enlargement, which has taken place in 2004 and 2007, is exceptional if we consider the history of the EU expansion since the foundation of the Common market in the late fifties.

The number of new members entering in one row: up to now, earlier enlargements consisted of the entry of up to three countries, generally of same economic level which had no difficulty to adjust to the new institutional and economic environment as they were already developed market economies (with the notable exception of Spain, Portugal and Greece).

Difference in living standard and income distribution. All the new members, even the most economically advanced (Slovenia, Czech Republic) are still far behind the mean level in the EU-15. With the exception of Cyprus and Malta, the 10 countries from Central and Eastern European countries have a mean GDP per head which is 50% compared to EU-15. The collapse of the former socialist industries has created strong regional inequalities and a high level of unemployment.

Figure 1: GDP per head (1000 €), 2010



Note: 70%-80% of EMU average: Slovenia, Czech Republic, Slovakia
50%-60% of EMU average: Estonia, Hungary, Poland, Lithuania, Latvia
Around 40% of EMU average: Bulgaria, Romania
Source: Eurostat

A systemic dimension. It is the first time that the EU integrates former socialist countries with noticeable differences among them: 3 countries (the Baltic States) were part of the Former Soviet Union, one in the former pro-market Yugoslavia (Slovenia), other belonged the COMECON and had partly specialized their economies in order to

serve the Soviet economy and developed an autarkic economies with low specialization and limited exchanges with the world economy. In all cases, those countries had to develop market mechanisms, and then adjust to the standards of the EU to be able to support the competitiveness from the other members' states as stipulated by the EU regulations.

A new geopolitical environment. With this new wave of enlargements, the frontiers of the EU are moving eastward and southward raising new questions: security, political and economic cooperation. The European Commission and the EU leaders have set up a new neighbourhood policy which has to match different aims: assure the integration of the new members without deepening the gap with countries that are not yet members and that will join the EU one day (West Balkans countries), set up specific mechanisms to develop economic cooperation with other countries (especially from the South of Europe, Middle East and North Africa countries), fill up the strategic partnership with Russia, securing peaceful development in the region. The opening of official discussions with Turkey illustrates a sharp question discussed in the EU concerning where up to close the frontier of Eastern border of the EU.

2.2. Managing the transition

Integrating the EU is the last step of the long process of transformation. A precedent step has been the transition from non-market to a market economy. This has required from policy makers a set of tools and policies in order to speed up and deepen the process of transformation. Consensus, among decision-makers with the population, has been reached in some countries on the different objectives to match; in other countries, dispenses prevailed and have limited both the scope and the pace of reforms.

In spite of these differences, all former socialist countries shared among them common characteristics concerning the industrial organisation, the control of firms, their financing, their level of technology, their specialisation in basic industries (military, heavy industries), their poor records in intermediary and consumer goods, the total absence of a financial industry, the under-development of services industries. This has shaped what we could call a "bad industrialisation" if we refer to the mode of allocation of resources among sectors in market economies, to the low rate of innovation, to the under-capitalisation of firms, and, finally to the rigidity of the whole economic system. A socialist company has never been considered has an autonomous centre of decision-making, managing its material, and human and financial assets, following a strategy among competitors. On the contrary, the system had low or even inexistent incentives, the State had a paternalist attitude towards companies, providing finance, capital goods, parts, creating a permanent shortage situation, leading large parts of the population either to "live on the beast" or to enter in illegal (but often tolerated) activities of the unofficial economy. Finally, the autarkic organisation of foreign trade, at the level of the former COMECON, has contributed to develop many comparative disadvantages among the economies of the region.

Transition is not a *tabula rasa*, although that many industries have been difficult to turn around and to adjust and that many "industrial cemeteries" filled up the landscape in countries which had concentrated their industrial development in sector finally difficult

or impossible to adjust.

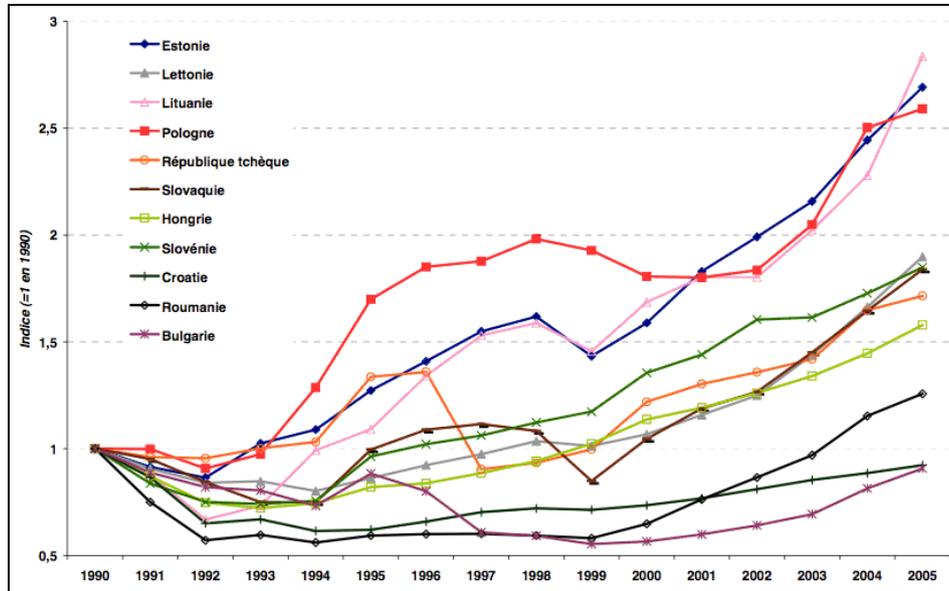
2.3. The Great Transformation

How to go to the market? How to adjust and restructure such economies, how to change the behaviour of workers and consumers confronted with a new environment such as unemployment, strong inequalities, insecurity concerning the future of important fractions of the population? How to create, often from scrape, a market economy? Did privatisations and the right to create new businesses are sufficient to promote entrepreneurship? Is it possible to jump from an administrated economy towards an institutional capitalism, economising on entrepreneurial capitalism which has played a crucial role in the early step of capitalist development in shaping the industry through the growth of big industrial groups? What kind of institutional compromise can be reached in order to control efficiently new private companies? Does a strong financial system is preferable to monopolies, *chaebols* or *keretsu* types of organisation in order to foster growth, fill the technological gap with western developed economies?

The post-socialist transition has focused around four set of policies, each set having specific aims to reach on the one hand, the four set being interlinked, on the other. Concretely, this means that government which have committed themselves, let say only on two sets leaving apart or paying less attention to the two others (which is the reason in the delay of some countries to join the EU) have failed to adjust rapidly their economies and to create the new market environment necessary to support competition in an open economy.

- *Macro stabilisation* for containing deficits and curbing inflation by reducing subsidies, increasing interest rates, introducing competition through liberalisation of foreign trade. Partial convertibility (before total liberalisation) has created a strong incentive to adjust, to relocate resources in more productive sectors with export prospects. Almost all governments have followed strict macro-policies.
- *Implementation of market institutions* and adoption of new regulation assuming property right and protection of private investments, establishment, economic laws on companies, for competition, for labour; creation of financial markets, of a two tier banking system.
- *Re-entering into the world economy*, lowering tariffs and other entry barriers, promoting the development of new specialisations: in few years, all countries will have switched their exports towards Western markets, beneficiating of price advantage but also of specialization of their exports on higher added value segment in part thanks to re-exporting strategies of MNC towards Western markets.
- *Privatisation and restructuring* former state-owned enterprises in order to de-monopolise big industrial groups by breaking them down through direct selling or through mass privatisation (free distribution to the population or to workers of the units concerned).

Figure 2: Changes of the manufacturing production in CEES (1990-2005)



Another dimension of the privatisations strategy, privatisations “from below”, has been the right to new entrepreneurs to enter the market and to establish their businesses (SME), it has also facilitated the entry of foreign enterprises on these new markets through majority acquisition (through privatisations), new investments (Greenfield investments) or joint-ventures following opportunities, risks, legal environment.

In all cases, new owners (external, former managers and workers, depending on how privatisation has been implemented) had to reshape very quickly their businesses by investing in order to avoid the loss of value of their new assets or to be stuck by strong insiders opposing the necessary restructuring. Corporate governance has become an important issue in the region, along with the development of competition policies and of financial markets.

2.4. Transition and integration

Besides the building up of a new institutional environment, privatisation, the search of new competitive advantage concentrating on industries and services which could compete with EU-15 has been the main economic policy objective. The task has been made difficult as there were no more central bodies to promote and finance industrial policies at sectoral levels, there were no managing competencies available, the financial and economic environment was not clear. In the same times, the former specialisations of Central European economies have disappeared with the collapse of the Former Soviet Union as exports destinations shrank.

Price competition, in the first step has played an import role in re-switching exchanges towards Western markets, then, quality effect has taken the lead, mostly thank to the

role of FDI in the region which have been attracted by market prospects, low labour cost and high quality of human resources, quality of human resources. Restructuring has pushed non-performing companies to leave the market. Market opportunities have attracted foreign companies, leading to a strong connection with EU-15 economies both in inter and intra trade, the latter showing the level of integration with EU economies (Table 1).

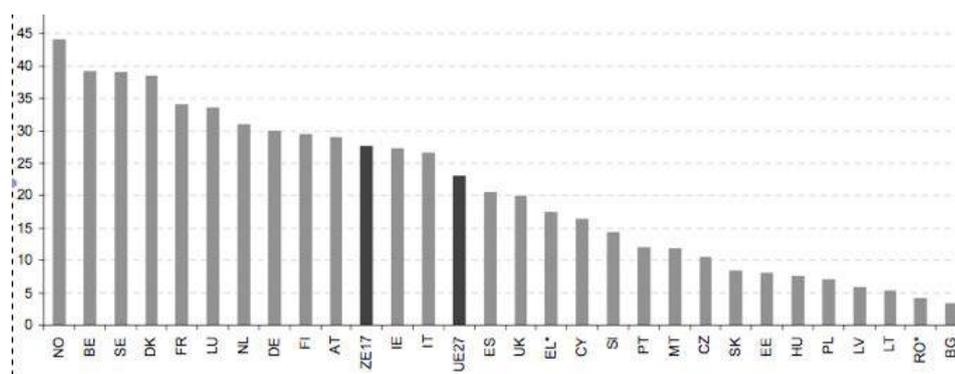
Table 1: Foreign trade structure with the EU according to the nature of the specialization, early years of the transition (in %)

	Intra-Industries Trade			Inter industrial
	Horizontal	Vertical	Total	
Poland (1998)	6.3	25.5	31.8	68.2
Hungary (1998)	7.4	39.1	46.5	53.5
Czech Rep. (1998)	10.9	47.0	57.9	42.1
Slovakia (1996)	5.7	19.7	25.4	74.6
Spain (1995)	19.5	34.2	53.7	46.3
Portugal (1995)	10.5	22.1	32.6	67.4
Greece (1995)	4.6	9.0	13.6	86.4
EU (1995)	19.2	42.3	61.5	38.5

Source: Conjoncture, BNP, September 2004, n° 8,

Concerning labour, new member countries have relied on two advantages: the low cost of labour compared to EU and other developed market economies, on the one hand (figure 3), and the quality of the work force on the other, which, both have played a major role in attracting foreign investment in the region.

Figure 3: Estimated Work Force Hourly Cost in manufacturing in the EU

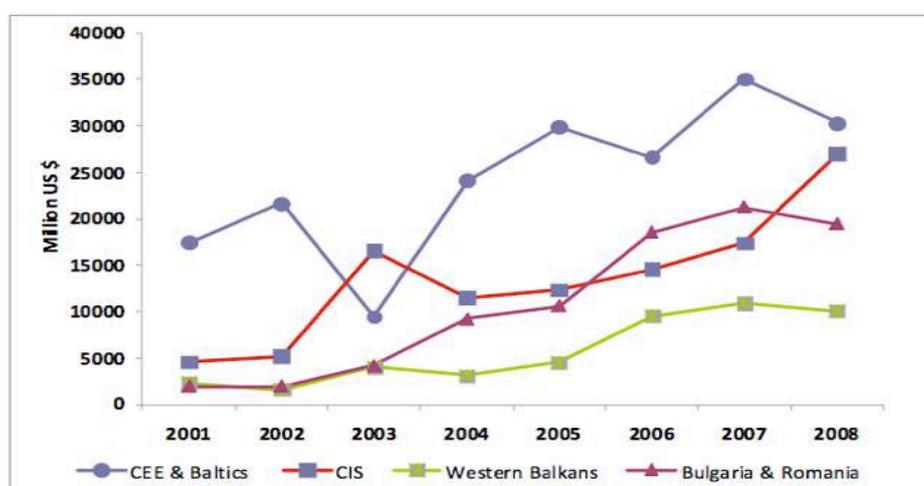


Source: Eurostat

3. FDI, AN ENGINE FOR ECONOMIC GROWTH AND REGIONAL SPECIALISATION

The combination of the different measures implemented during the 90s (stabilisation, institutions building, opening to the world economy, privatisation/restructuring of enterprises) has led to a new competitive environment in the region which shows higher rate of growth than in the EU-15

Figure 4: FDI in transition countries



Source: EBRD

Besides these measures, FDI has played the role of a real growth engine; bringing in capital, markets access, management know-how; it has also contributed largely to the spreading of new businesses in the region, often upstream, downstream and around the businesses that has been acquired or created through greenfield investments.

Although the level of FDI is not so important compared to other destinations (around 6% of total world FDI), nonetheless it accounts for a non neglect able share of GDP, of exports in some countries. Completing the transformation has began to attract big amount of foreign capital in countries which had been reluctant at the beginning of the transition to welcome foreign investment (Czech Republic, Poland). Countries which had been left behind and had not been able to join the first wave of new membership are getting substantial share of FDI, both Bulgaria and Romania, but also West Balkan countries (Figure 4).

3.1. Attractivity policies: size, proximity, commitment

Among the different reasons which explain attractivity of countries to FDI (market access, factor costs, there are specific reasons concerning this particular region.

- Proximity: most FDI outflows come from EU-15 companies (European or affiliates of US companies), quite few directly from overseas countries (Japan, South

Korea).

- Regional integration and division of labour. The proximity factor reduces risks and entry costs, facilitates the development of regional strategies (“linkage”) among invested companies in the region. For instance, Skoda-VW, in the Czech Republic assembles its cars and exports parts and components to other assembling units of the group. In the same time, it integrates parts and components produced in Germany or else where among the group’s partners. Another impact of the presence of Western companies is to push suppliers (first and second tier) to invest near the new facilities in host countries in order to produce bigger volumes by reducing cost (economies of scale), take advantage of the new markets. Almost all suppliers of big car assemblers have invested near the newly acquired and invested firms in the region. Thus FDI create positives externalities by upgrading existing companies with strong impacts upstream and downstream the business, creating many spill over through the economy.
- Labour cost and qualifications: The low cost of labour plays an important role in attracting FDI especially in manufacturing industries which requires a qualified manpower. With equivalent training and productivity, the gross cost of the work force in the region was around one/fifth of labour cost in Germany at the start of the transformation. Costs are rising but convergence with Western wages level could take a very long time. Taxation is another issue: the flat tax policy applied by many countries in the region makes a big differential with taxation in the EU raising the accusation of a taxation dumping and retaliation measures from the EU commission.

Finally, mixing proximity, labour cost, workforce qualification and productivity, institutional reform and attractivity policies, country size, the distribution of FDI within the region as favoured both “early reformers” countries (Hungary), biggest countries, even last comers (Romania). Very small countries (Estonia) have taken advantage of powerful neighbourhood (Sweden, Finland) to turn around their economies.

Besides wage costs, high qualification in some manufacturing sectors require very qualified workers, technicians and engineers. Some member States are attracting investments requiring high tech manufacturing (electronics), in high added-value sectors. Big companies relocates some of there research facilities in the region. Nokia and Ericsson have R&D facilities in Hungary, Japanese, Korean and Indian companies are investing in clusters in the Czech Republic. As a result, the content of added-value products in export is increasing.

In less than 15 years Central and East European Economies (CEEE) have deeply changed their economic structure, specialisation and have matched the condition to join, for the majority of them, the EU. They have become fully fledged market economies, able to sustain competition among European economies. Some of them have been able to enter the EMU (EU-17) and adopt the euro as their national currency.

In this adjustment process, socially and economically costly, FDI has played an import role, as a kind of “uninvited guest”. Some Western companies have acted as first mover and made a strategic move in future markets with growth potential linked to the former

specialization. Other has taken advantage of 'discount prices' of assets in the privatisation.

Table 2: Growth of Inward Stock and Flow of FDI, 2002-2012

Countries	Inward FDI Stock, (€ Millions)		Inward FDI Stock per capita, €		Inward FDI stock as % of GDP, (%)		FDI inflow as % of Gross Fixed Capital Formation (%)	
	2002	2010	2002	2010	2002	2010	2002	2010
Bulgaria	3927	35901	500	4784	23,1	99,6	31,5	19,4
C. Republic	36884	97191	3615	9238	46,1	67,0	41,0	16,8
Estonia	4035	12269	2975	9156	51,9	84,6	13,3	44,3
Hungary	34575	68522	3409	6856	48,8	69,6	19,5	6,4
Latvia	2676	8250	1148	3713	27,0	45,9	11,4	8,2
Lithuania	3818	10166	1103	3134	25,4	37,1	25,3	10,8
Poland	46139	138000	1207	3600	22,0	39,0	11,1	10,0
Romania	7482	52396	344	2442	15,4	43,0	11,7	9,7
Slovakia	8563	37000	1592	6800	33,0	56,1	61,9	3,0
Slovenia	3948	11242	1979	5492	16,1	31,2	30,4	7,8
NMS-10	152046	470938	1480	4610	29,8	51,4	23,5	11,0
Albania	-	3600	-	1100	-	39,5	7,9	28,5
B&H	799	5700	209	1500	11,3	45,2	-	1,6
Croatia	5794	25725	1304	5800	20,6	56,0	19,1	4,4
Macedonia	1161	3300	574	1600	29,0	47,9	16,9	16,2
Montenegro	81	4060	131	6429	6,0	135,3	38,4	70,6
Serbia	776	15780	104	2164	4,8	54,1	26,3	14,3
SEE	8610	58065	400	2700	14,0	54,5	21,5	12,4

Source: WIIW Database on 2011 Foreign Direct Investment in Central, East and Southeast Europe

Programmes across the region. Other, finally, waited for a more safer institutional environment to invest in more secure markets. First movers have been able to negotiate good deal, holiday taxes, even subsidies to control partially or totally strategic assets. Thus they get a strategic advantage, buying market shares, building (temporary) barriers to entry against followers.

Privatization foreign investments have been a hot issue in some countries (Hungary). In both cases, as market mechanisms were not implemented, foreign companies have generally realized good deals fuelling, in some countries, a national resentment against the process of privatisation (selling the crown jewels..)

Table 3: Investments Entry and Risk Assessment

Action	Strategy	Examples
First Mover	Entry before the setting of reliable market institutions	VW in the Czech Republic
Opportunistic	Privatisation foreign invested firms	Sanofi, Suez, Hungary
Secured	In the framework of a well established institutional market environment	Tesco, Carrefour, all countries

Levels of risk have been linked to the progress of the economic transformation, to the opening up, to the institutional measures, which have been implemented.

Among the main factors that have accelerated or hampered the entry of FDI, the pace of macro-stabilisation and institutional reforms has played the major role. Except Hungary, all the other countries, at different degrees and for different reasons have hindered policies encouraging FDI entry either frightened by the control of the industry by foreign companies, or willing to keep direct or indirect control on state assets either between the hands of the States, or for possible private appropriation. Countries which have postponed FDI entry have delayed their adjustment but have not closed the door to entry: Bulgaria, Romania, Western Balkan countries are also recipients of FDI which contribute to the up-grading of their economies and to their integration in the new European industrial network. Countries which have the first opened their economies to FDI have benefited of a rapid adjustment and regional integration.

Obviously, there is a strong correlation between institutional changes and the growth of FDI in the region as shown in Table 2 some countries taking the lion's share as they have advanced in their adjustment but also benefited of their size (Poland, Romania) of their proximity (Czech Republic, Hungary, Slovakia).

The sectorial distribution of FDI illustrates both the weakness of some industrial sectors under the former socialist system and their growth potential in the framework of a market economy. Most of sectorial FDI among NMS-10 have been directed towards specific sectors: manufacturing (28.8%), trade (13.1%), financial intermediaries (18.8%), real estate, business activities (19.4%) followed by electricity, gas, water (5.8%), transport, communication (6.8%). This distribution can be explained both by the 'competitive advantage' (cost, work force qualifications) inherited from the former socialist system which was an asset for investors and by the weak development of other sectors essential for the normal functioning of market economy (trade, finance, transport). FDI distribution among 'late comers' confirms the privileged destination of foreign investors.

Finally, FDI sectorial distribution in the region highlights two interesting points:

- FDI is allocated towards sectors following restructuring or Greenfield investments, are supporting adjustment and up-grading to Western standards to beneficiary companies in order to allow them to integrate industrial networks.
- FDI brings in the flow of capital necessary to develop under-developed or non-existent sectors (trade, consumer, finance).

Proximity is another dimension of the specificity of CEES attractiveness to FDI. Most FDI in the region originate from EU-15 countries with three majors countries: Austria, Germany, and Netherland¹. Some countries (Italy, France) have a strong presence thanks to big investment in one sector (car industry) or in the financial sector (Austria). Proximity effect can be seen from the case of Austria massively present in neighbour courtiers as Sweden, or Germany. Major investments in specific industries (car, real estate, trade) result in the development of new industrial rings (Western Hungary, Bratislava region, Warsaw, Southern Poland) with cluster effects and strong spin off.

4. DELOCALISATION, SPECIALIZATION AND CONTROL: CEE ECONOMIES AS THE BACKYARD OF WESTERN ECONOMIES?

4.1. Up-grading and the role of foreign companies

Proximity, as it has been under lined has been a factor which has accelerated the pace of FDI entry in the region. Once institutional barriers have been remove and that transition has neared its completion, FDI has spread in different sectors of host economies even among late EU comers and even, now, the last applicants to become members. Institutional reforms have paved the way and broaden attractiveness to foreign companies to invest. Investments, as we have pointed out, have been directed in two directions: sectors where they were an obvious need to fill up the gap with the requirements of a standard market economy, particularly to supply new needs (consumer, financial services), to up-grade underdeveloped infrastructures (communication, trade).

Besides, FDI have been directed towards sectors which presented potential competitive advantages linked to proximity, to a growing domestic demand, to the qualification and the low cost of the domestic work force. It has been quiet easy for Western managers, once they have taken the control of former socialists companies to turn them around and make them work rapidly on the same standards than in the West.

Case studies have shown that adjustment of those companies have been realized very quickly, often in less than one year, often at a high cost when Western companies have been obliged to post numerous managers in the new facilities to build up the management and organisational system, both inside and outside de firm (networking building). 'Friendly policies' towards foreign investors have helped ("holiday taxes", weak protection of labour. Growth potential of domestic markets, on the one hand, economic stagnation and high wages in Western economies, on the other have contributed to the rapid development of FDI and fuelled, in some countries, relocation of capital in these economies².

¹ Netherland is a special case: many European headquarters are located in the Netherland for taxation purpose

² In the reality the frontier is not always clear between new investments and relocation: in the first case, there is a net investment when it doesn't have impact on local jobs (country origin).

Table 5: Largest foreign investors in CE – 2010

Company	Sector	Origin
1 Volkswagen	Car	Germany
2 E.ON	Energy	Germany
3 Metro	Distribution	Germany
4 RWE	Energy, Water	Germany
5 OMV	Energy	Austria
6 Samsung Electronics	Electronics	South Korea
7 Lukoil	Oil and Gas	Russia
8 Tesco	Distribution	UK
9 Deutsche Telekom	Communication	Germany
10 Arcelor Mittal	Steel	UK-Luxemburg
11 Foxconn	Communication	Taiwan
12 Nokia	Telecommunication	Finland
13 France Telecom	Telecommunication	France
14 Renault	Car	France
15 Fiat	Car	Italy
16 REWE	Distribution	Germany
17 Kaufland	Distribution	Germany
18 BP	Oil	UK
19 British American Tobacco	Tobacco	UK
20 Philips	Electronics	Netherland
21 Eni	Oil	Italy
22 Shell	Oil	UK-Netherland
23 U.S. Steel	Steel	US
24 Carrefour	Distribution	France
25 Lidl	Distribution	Germany

Source: Deloitte, 2011

Another driver for the development of FDI in the region has been opportunity for Western MNC to realise both horizontal and vertical investments. Horizontal investments, through investments in new facilities to gain market shares (answering local and regional demand), vertical (vertically disintegrated) by transferring parts of the value chain of the process in different locations in the area. As a consequence, the whole productive organization at the European level has been deeply modified with some positive impacts (job creation in host countries) and negative (job losses in original countries).

The outcome of these strategies by European MNC has been the reshaping of the industrial landscape by realizing huge investments in some industries consuming capital and labour (automobile). Table 5 shows the relocation movement in the region. The bulk of FDI comes from Western Europe (81%°, the remaining parts from North America and Asia (Japan, South Korea). Three sub areas have come up from this movement of relocation: a first one in the Baltic with FDI from Nordic States, the

biggest one eastward of Germany with Poland, the Czech Republic, Hungary, a third one with Balkan countries.

Figure 5: Stocks of foreign investments in million USD (1990-2007)



The reshaping of the Central and East European economies in the framework of enlargement policies had three consequences: a linkage effect, a hierarchical effect and domination effect.

4.2. Linkage effect

The linkage effect is highlighted by the car industry. Almost inexistent under the former socialist system (only Czechoslovakia had an original and historic car industry; East Germany tried to develop an ersatz of the historic VW, the Trabant), other countries (with the exception of Bulgaria and Hungary barred from the URSS to develop their own industry) mainly Romania and Poland have relied of industrial cooperation and FDI (Fiat, Renault) in to develop cars which never matched the standards both in production (quality, volumes) of Western makers. Hungary was specialized in assembling buses; Slovakia has no car industry at all.

In few years, almost all the biggest European car makers have entered the market, either through acquisition, revamping all facilities (Skoda) either by Greenfield, often both, with the exceptionally growth of the sector (figure..). General Motors came in through its German partner Opel; Asian countries (Japan, South Korea) have also invested in the framework of a larger strategy encompassing other countries (Russia, Central Asia countries).

Western producers have linked these new facilities to parent companies in different way, by designating specific functions, or specializing specific tasks. For instance, Renault develops its low cost car in Romania, where different functions, even R&D have been relocated. It's from the Romanian headquarter that the regional strategy is set up, to enter new markets, to monitor new investments. The Clio car made in Slovenia by Renault is distributed in Southern Europe, Italy, and the South of France. VW has set up a regional division of labour with some companies producing and assembling whole cars (Skoda), other making motors (Győr, in Hungary), gearboxes (Slovakia), develop jointly a new product (PSA and Toyota making light trucks in the Czech Republic). Skoda produces components for the other group's facilities, in the same time, the company has access to other companies' products. Thus complementarities and economy of scales are two dimensions to the integration with the group. In the same time, first and second tier component suppliers (almost 15 by car makers have located in the area) have set up around the new facilities in order to supply local assembly companies by reducing cost. R&D facilities are developing locally or regionally. Component makers produce for all assemblers in the region. Finally, competition among enlarged car maker group lead to develop best practices. As a result, better equipped, better managed, many of these companies show a better efficiency and competitiveness.

Table 6: Largest Foreign car maker's investors in CE

Rank	Top 500 Rank	Company name	Country
1	4	Skoda	Czech Republic
2	7	Fiat	Poland
3	14	Audi Hungaria	Hungary
4	28	Volkswagen Slovakia	Slovakia
5	48	Automobile Dacia	Romania
6	55	Toyota Peugeot Citroën Automobile Czech	Czech Republic
7	59	PCA Slovakia	Slovakia
8	62	Volkswagen	Poland
9	71	Kia Motors Slovakia	Slovakia
10	82	Magyar Suzuki	Hungary

Source: Deloitte, 2011

Today, according to the latest data, the production in the region of light vehicle (including Russia, the biggest market) account for 576352 units, nearly half of Western European (12 179938) itself equals to the US (12280019), but far behind Asia (34210699). Almost from scratch, FDI has contributed to the development of the automobile industry in the region. There are fears, of course that the present economic crisis will have negative impact on the growth of the sector. Competition from Russian (a much bigger market for which Western maker show a big appetite) and Asia are real and could lead to a durable stagnation even a decline of this sector.

4.3. Hierarchical and Domination Effects

All governments, international institutions support the role of FDI as a tool for modernizing, catching up and linking backward economies. Removing barriers, setting up attractiveness policies have been set up and have contributed to the adjustment of Central and Eastern economies. The presence of FDI, with the benefits of integration, has contributed to sustain economic growth in the region. Even late comers countries (Bulgaria, Romania) have benefited from entry of FDI, showing that there was still room, and opportunities in the region to welcome foreign capital.

Although it is not a frequent question, an issue with the massive presence of FDI in the region concerns the hierarchical and domination effect. In other words, CE economies have moved from a domestic accumulation of capital strategy (under the socialist system) to a model of international control of domestic assets by foreign investors. Opening up policies and privatizing public assets had to consequence in terms of control of domestic assets. First, big domestic monopolies (energy production and distribution, telecommunication network, some insurance and banking) have been kept under the hand of local governments. In other sectors (car, distribution, telecommunication, technology), big foreign companies have build up a dominant position (ranking, market shares) with the exception of former national monopolies (telecommunication, energy distribution) which were not offered for sale during the round of privatization of State property.

Hierarchy control can be considered from two views point. First, through the linkage effect which analysed above Western companies have both a strategic and organizational advantage (OLI) which is not eroded over the time. Does local companies, either by their initial level of technology, by the learning curve, by the relocation of R&D facilities, can become equal players with Western MNC and compete with them? Secondly, through the control effect (capital control, property rights, protection of intellectual property rights) do host country companies further autonomy appear difficult to get. Case studies in different countries of the region (Stephan, 2012) have concluded to interesting conclusions: embedness of technologies in acquired companies, the supply of qualified workforce (intermediate level, university graduates) in certain sectors are source of local technology diffusion and autonomy and constitute a comparative advantage..

Table 7: Foreign companies, by country among the 500 first companies in Central Europe

Status 2010	Non CE private sector	CE private sector	State owned	Total
Bosnia and Herzegovina	/	/	1	1
Bulgaria	11	1	2	14
Croatia	3	7	7	17
Czech Republic	48	14	11	73
Estonia	5	/	1	6
Hungary	50	8	5	63
Latvia	4	2	/	6
Lithuania	1	6	2	9
Poland	97	42	41	180
Republic of Macedonia	1	/	/	1
Romania	26	1	5	32
Serbia	6	2	4	12
Slovakia	17	5	7	29
Slovenia	5	11	2	18
Ukraine	12	19	8	39
Total	285	116	96	500

Source: Deloitte (2011)

Finally, there is a wide consensus on the positive role of FDI in the region both in terms of growth, of catching up, integration. But the question which remains is to which extent the positive externalities created by the presence of FDI can expand? How local companies, subcontractors, SME can beneficiate of the positive impact of FDI in the region?

Table 8: Sectoral breakdown by ownership

Status 2010	Non CE private sector	CE private sector	State owned	Total
Consumer Business and Transportation	91	46	20	157
Energy and Resources	63	31	54	149
Life Sciences and Health Care	15	9	-	23
Manufacturing	79	28	10	116
Public Sector	-	-	5	5
Real Estate	9	2	-	11
Technology, Media and Telecommunications	30	4	5	39
Total	287	119	97	500

Source: Deloitte (2011)

5. CONCLUSION

In this paper we have discussed three important points which make CEECs integration and up grading a particular case.

First, the magnitude of the last rounds of enlargement and integration to which the EU has faced and the importance of the institutional shocks to which new comers have been confronted. Speed (less than 15 years for the most advanced countries) and deepness of changes that have occurred (economic adjustment, opening up, development of market mechanisms) at a relatively low cost (for the EU budget) have been the main characteristics of this round of enlargement.

The process of enlargement and integration has been almost continuous with further integration of 'late comers' (Bulgaria, Romania), and further acceding countries from Western Balkans.

The role of FDI has played an important role in the region to transform, adjust, specialized industries, creating jobs, increase exports of higher added value products, and reconstruct an industrial network linking industries of the region with Western companies and markets.

Mostly, the driver to enter these countries has been opportunities for market growth, for competitive advantages (getting good and cheap domestic assets). It has been also an opportunity to deeply reshaping the European industry, introducing a new division of labour through specialisation along the regional value chain.

Entry of Western Balkan still has a positive impact on regional growth both in term of economic adjustment of new specialization. Although the linkage factor in less evident, FDI is pouring in the region, and, at a lesser pace, contribute to the economic transformation of the region.

REFERENCE

- Boillot J.J. (2003): *L'Union européenne élargie. Un défi économique pour tous*, Les études de la Documentation française
- Brunat E & X. Richet (2001): "Asset specificity, restructuring and industrial policy in transforming economies: The Russian experience", in D. Giannias, L. Maroudas, Y. Rizopoulos (eds.): *European Integration & Economies in Transition*, East-West Conference Proceedings, East-West, University of Crete, CD-ROM
- Deutsch Bank Research: "Offshoring to New Shores. Nearshoring to Central and Eastern Europe", *Economics* 58, August 14, 2006
- Deutsch Bank Research: "Offshoring to New Shores. Nearshoring to Central and Eastern Europe", *Economics* 58, August 14, 2006
- Drouet M. et X. Richet (eds.) (2007): *Vers l'élargissement de l'Union européenne à l'Europe de l'Est*, PUR, Rennes
- Dyker D (ed.) (1998): *The Technology of Transition. Science and Technology Policies for Transition Countries*, CIE, Budapest,

- EBRD: *Transition Report 2007*, EBRD, London,
- EBRD: *Transition Report 2009*, EBRD, London
- Ernst & Young (2005, 2006): *European Investment Monitor 2005 Report*
- Estrin S, X. Richet and Josef C. Brada (2000): *Foreign Direct Investment in Central Eastern Europe : Case Studies of Firms in Transition (Microeconomics of Transition Economies)* N.Y, M.E.Sharp
- Financial Times (2005): "Special report: Reinventing outsourcing", June 2, 2005
- Guerraoui D. and X. Richet (1997): *Les investissements directs étrangers. Facteurs d' attractivité*, Les Editions Toubkal, Casablanca and l' Harmattan, Paris
- Guerraoui D. and X. Richet (2001): *Economies émergentes: politiques de promotion de la PME. Expériences comparées*, L'Harmattan, Paris
- Guerraoui D. and X. Richet (2005): *Intelligence économique et veille stratégique - Défis et stratégies pour les économies émergentes*, 2005, L'Harmattan
- Henriot A. (2004): "L'investissement direct dans une Europe élargie", *Centre d'Observation Economique*, CCIP
- Huchet J.F. and X. Richet (2005): *Gouvernance, coopération et stratégie des firmes chinoises*, L'Harmattan, Paris
- Huchet J-F, X. Richet, J. Ruet (eds.) (2007): *Globalisation in China, India and Russia. Emergence of National Groups and Global Strategies of Firms*, Academic Foundation, New Delhi
- Hunya Gabor (2009): *FDI in the CEES under the Impact of Global Crisis: Sharp Decline*, WIIW, Vienna
- Kaminski B. (2004): "Production Fragmentation and Trade Integration in Enlarged Europe: How MNCs have Succeeded Where CMEA Had Failed?", *Discussion Paper*, University of Maryland
- McKinsey (2006): "The overlooked potential for outsourcing in Eastern Europe", *Research in Brief*
- Meyer K. (1998): "International Production Networks and Enterprise Transformation in Central Europe", *Comparative Economic Studies*, XLII, n° 1, p. 135-150
- Meyer K. & S. Estrin (2000): "Brownfield Entry in Emerging Markets", *Copenhagen Business School*, mimeo, 12 p.
- Meyer K. and S.Estrin (2007): *Acquisition Strategies in European Emerging Markets*, Houndmills, Palgrave
- Michalet C.A. (1999): *La séduction des nations où comment attirer les investissements*, Economica, Paris
- Michalet C.A. (2004): *Qu'est-ce la mondialisation?*, La Découverte
- Michalet C.A. (2007): *Mondialisation, la grande rupture*, La Découverte
- Mollet M. and X. Richet (2003): "Transformations économiques et stratégies de rattrapage en Europe de l'Est. Quelles leçons de l'expérience hongroise pour les économies balkaniques?", *Région et Développement*, n° 2003-18
- Mouhoud El Mouhoub (2006): *Mondialisation et délocalisation des entreprises*, La Découverte, col. Repères
- Neffati H. and X. Richet (2004): "L'attractivité comparée des investissements directs étrangers de la Tunisie et de la Hongrie", *Revue Région et Développement*, n° 19 – 2004
- Redzepagic S. (2007): "The future of the European Economy", *Economic Analysis*, Volume 40; Issue 3-4, Autumn 2007; EA 40(3-4) 1-110 (2007), Institute of economic sciences, Belgrade, 2007, p. 58-67
- Redzepagic, S., Djukic M. (2011): "Serbian place in the process of globalization toward the European integration", in: "Contemporary issues in the integration processes of Western Balkan countries in the European Union", Ljubljana: International Center for Promotion of Enterprises, 2011
- Redzepagic S., Richet X. (2008): "The attractiveness of the Western Balkans for the FDI", *Economic Analysis*, Volume 40; Issue 1-2, Spring 2008; UDC: 327.39:061.1 JEL: E22, 018; EA 40(3-4) 1-110 (2008), Institute of economic sciences, Belgrade, 2008, p. 48-58

- Richet X. (1997): "Firm Adjustment and Barriers to Restructuring in Transition Economies" (with P. Hare), *Cuadernos del Este*, n° 20, p. 155-164
- Richet X. (1998): "L'IDE dans les PECO et leur impact sur le comportement des entreprises", in D. Guerraoui et X. Richet (eds.)
- Richet X. (2001): *Les investissements étrangers dans les PECO*, DREE Revue Elargissement, Spécial IDE
- Richet X. (2004): "Transforming Economies, Technology Transfer and Multinational Corporations Strategies", *Zagreb International Review of Economics and Business*, n° 1, 2004
- Richet X. (2005): "Redes internacionales de producción y nuevas economías de mercado: estrategias de los fabricantes de automóviles en los PECO", *Información comercial española*, n° 818, October-November
- Richet X. and J. Ruet (2006): "The Chinese and Indian Automobile Industry in Perspective. Technology Appropriation, Catching up, and Development", *mimeo*, 30 p.
- Sachwald F (2005): "La localisation de la production en Europe : impact de l'élargissement et de la mondialisation", *IFRI*
- SESSI (2006): *L'industrie en France et la mondialisation*, SESSI, Ministère de l'Economie, Paris
- Stephan J. (2012): *The Technological Role of Inward Manufacturing Foreign Direct Investment in Central East Europe – An Investigation into the Condition of Technology Transfer and Diffusion*, Habilitationsschrift, T.U. Bergakademie, Freiberg, 240 p.
- Stosic I., Redzepagic, S. Brnjac Z. (2012): „Privatization, restructuring and unemployment: The case of Serbia“, in: New challenges in changing labour markets. Belgrade: Institute of Economic Sciences, 2012, p.355-372.
- The Economist (2005): "Outsourcing in Eastern Europe: the rise of nearshoring", Dec. 3
- UNCTAD, *World Investment Report, 2005*, UN, Geneva
- Uvalic M. (2011): "Serbia's transition flaws: why has export-led growth not been achieved?", in Michael Ehrke (ed), *Export-led Growth. Central European Experiences – Magic Formula for the Western Balkans?*, Belgrade: Friedrich Ebert Foundation, pp. 77-90 (ISBN: 978-86-83767-32-8).
- Wolf M. (2004): *Why Globalization Works*, Yale University Press

Ivan Tolić

City of Zagreb, Zagreb, Croatia

Christian Panjol Tuflija

ŠtedBanka d.d., Zagreb, Croatia

Marko Tomljanović

University of Rijeka, Faculty of Economics, Rijeka, Croatia

URBAN POLICIES AND POLICY OF CITY PUBLIC TRANSPORT OF THE REPUBLIC OF CROATIA IN THE LIGHT OF POTENTIAL USE OF EU FUNDS

ABSTRACT

This paper analyzes the European framework for solving transport problems, with special emphasis on the experiences of Hungary during the construction of a new underground line in Budapest. The emphasis of the paper lies on the possibility of withdrawal from the EU funds in the context of financing investments in the urban public transport, which apart from traffic issues, would also have to solve other problems involved in the issues related to the objectives and instruments of URBACT mentioned in the first part of the study. The second subchapter offers a description and parts of the Hungarian transport operational plan which has so far been the only proposal funded by the EU to a significant extent. Line 4 of the Budapest urban public railway was financed with money from the EU because it created a real synergy of different objectives of the URBACT, solving also the problems of social exclusion, cohesion, ghettoization and, as a byproduct, of the urban public transport. These experiences are indicative for Croatia and need to be integrated into the strategy of the politics of urban public transport upon accession of Croatia to the EU.

Keywords: urban policy, Budapest, EU funds, City of Zagreb

JEL classification: F 36; H 54

1. INTRODUCTION

The impression is that Croatian sceptics believe that public expenditures on mass transport often are an unnecessary waste of resources. It is true that in most areas transit has a very small share in daily travel. With the exception of a few areas, the share of transit has declined over the past few decades. Throughout the country the percentage of travel dropped from 12.6 percent in 1960 to 4.7 percent in 2000 (Pucher and Renne 2003). Critics also point to deficiencies in the transit system resulting from the market of wages and contracts as well as from the over-supply on the routes with low number

of passengers in politically important parts of the city (Winston and Shirley 1998). Naturally, the final answer considerably depends on a number of circumstances (for a detailed explication of various circumstances see e.g. Bento et al. 2003; Baum-Snow and Kahn 2000; Taylor and Fink 2003, Delucchi 2004, Lewis and Williams 1999, Holzer et al. 2001, Hensher 1997, De Borger and Wouters 1998 I Van Dender and Proost 2003).

The whole spectrum of assessment may be partly explained by different models of approach (some take into account marginal costs of public means of transport, while others do not, and some take into account the economies of scale of increased frequencies, while others do not). Another important difference factor is the different geographical location of testing. Increased optimum frequency in researches is based on the specific qualities, relative density of urban areas such as Brussels, London and San Francisco. Other researches are based on large metropolitan areas in the U.S. and include also regions where public transport is inefficient (Winston and Shirley 1998). In order to promote its overall and harmonious development, the Union develops and conducts its activities in order to strengthen the economic, social and territorial cohesion. The goal is to reduce differences in the level of development of various regions and to reduce the backwardness of the least developed regions. This primarily refers to rural areas, areas affected by industrial changes, mountainous and border areas and areas affected by natural or demographic difficulties (Kandžija i Cvečić 2011, p. 1054.).

Within the overall cohesion policy, URBACT documents emphasize the fact that in the cities there are most jobs, enterprises and higher education institutions and that their interaction is crucial in achieving social cohesion. According to URBACT (2007), cities are a platform of change based on innovation, entrepreneurial spirit and economic growth. Strategy of urban innovation should serve to strengthen the links between the business sector, research institutions and public sector and at the same time to promote an attractive urban environment.

Economic growth is sustainable when it is accompanied by measures designed to reduce poverty, social exclusion and environmental problems. The issue of sustainable growth character is particularly important in cities which are most exposed to the problems of social exclusion, environmental pollution and spatial spreading. Cities have also recorded significant differences in the economic and social aspect. There are spatial inequalities (between neighbourhoods) or social inequalities (between different groups). Currently, differences include both dimensions. Quality of urban space can also be an attraction factor (URBACT 2007).

Urban and metropolitan areas function as drivers of national and regional competitiveness. Consequently, it is important to ensure growth of strong urban areas and through investments in transportation infrastructure to revive their connections with neighbouring areas and remote rural areas. Strong urban centres have a major role in the transfer of expertise, eliciting growth and stimulation of competitiveness.

Europe is characterized by a polycentric structure of small, medium and large cities. Many of them form metropolitan areas, while many others constitute only urban

centres in the region. Effective management of major urban systems (public transport, energy management, waste management) is necessary if one wants to follow the strategy of sustainable development of urban and metropolitan areas. Balanced spatial development requires careful planning and improvement of connections of urban and rural areas.

For effective urban policy it is crucial to develop and implement models of metropolitan and urban management. With regard to the holistic and multicultural approach that is necessary for effective urban policy there must be engaged all relevant levels of government. Authorities responsible for different spatial levels (regions, departments or districts, cities) should cooperate in an organized manner, if possible on the basis of agreed planning tools. Balanced territorial development, sustainable spatial equilibrium, satisfying connections between urban and peri-urban and rural areas can not be achieved without joint management and planning effort (URBACT 2007).

Challenges that will be encountered vary from city to city. Some cities have to solve the problems caused by population growth, rising property prices, lack of available land, traffic congestion and a too wide range of public services. Other cities suffer from population decline, neglect, insufficient number of jobs and low quality of life. European cities attract investments and businesses. They have many tools at their disposal to enhance their attractiveness. Proposals by the Commission for cohesion policy and Strategic Objectives of the communities for cohesion policy contain many elements that can support these initiatives.

The EC Regulation no. 1083/2006 of July 11, 2006 laying down general provisions concerning the European Regional Development Fund, the European Social Fund and the Cohesion Fund as well as the EC Regulation no. 1080/2006 concerning the European Regional Development Fund, and common strategic objectives related to cohesion, adopted on August 6, specify the role of urban policy in the context of regional and cohesion policy. EU Communication COM (2006) 385 of July 13, 2006 to the Council and the European Parliament concerning "Cohesion policy and cities: the urban contribution to growth and jobs in the region," specifies indicators of strategic objectives and is the basic document for the importance of sustainable urban development in the regional policy of the EU 2007-2013 (URBACT 2007).

2. POSSIBILITIES FOR FINANCING URBAN TRANSPORT FROM EU FUNDS

The topic of financing urban transport from EU funds is quite unexplored because urban transport has so far been financed out of funds as an exception, not as a rule. Aid from the Structural Funds is available to all EU member states and is awarded for every program period. A program period lasts seven years, and the current one is 2007-2013 (Kandžija i Cvečić 2011).

The amount of assistance and funds available shall be determined in accordance with the country's (region's) lagging behind per GDP. The funds are distinguished by three

objectives: Convergence, regional competitiveness and employment and territorial cooperation.

Region (of a member state) whose GDP is less than 75% of the EU 27 average, qualifies for the Objective 1. At the accession of Croatia to the EU all the 3 NUTS regions will be eligible for funding under Objective 1. This is important because Objective 1 offers the possibility of funding those largest projects financed by the Cohesion Fund (Kandžija and Cvečić 2011). Funds available to the EU member states are: ERDF – European regional development fund; ESF – European social fund; Cohesion fund. Objectives and their relation to funds are most clearly shown in the Table 1, shows the distribution of the member states according to objectives.

Table 1: Correlation of EU objectives to funds sources

Objective	Fund		
	ERDF	ESF	Cohesion Fund
Convergence	ERDF	ESF	Cohesion Fund
Regional competitiveness and employment	ERDF	ESF	
Territorial cooperation	ERDF		

Each year Croatia will have at its disposal assistance to a maximum amount of 4% of its GDP. The key fact is that it is the money that is offered, but unfortunately not the money that will be exploited. Capacity of Croatian withdrawal of available funds will determine what part of this amount would really be able to be withdrawn (Kandžija, Cvečić 2011).

With regard to financing of urban transport it should be mentioned that almost the same principle of financing goes for building of a subway and, for example, of a technology park, with a few specifics that will be explained below. The urban transport could be funded from the ERDF or the Cohesion Fund. Project size will determine by which fund it shall be financed. ERDF is used for smaller projects, and the Cohesion Fund for large development projects. Small project is defined to be a project of total value up to 50 million euros, i.e. 25 million euros for environmental projects.

Funds for financing of investment projects are provided in the form of grants and finance up to a maximum of 85% of the total project value. The beneficiary country co-finances at least 15%.

2.1. Defining funding priorities and partnership principle

Resources from the funds are allocated according to the defined operational programs (OP). Operational Program is a document in which a Member State defines how it wants to spend the funds at its disposal (Kandžija, Cvečić 2011). Operational programs are defined in the National Strategic Reference Framework. A member state decides how many and which operational programs it will have. Regarding its OPs in the action plan, Croatia opted for chapter 22.

Each project should be under one of the priorities defined under the OP. Defining priorities is led by the Managing Authority, but it is agreed by consensus in a partner

group at the appropriate level (in the case of large projects, it is the national level). Forming partnerships at national and regional level is one of the requirements of the EU. The principle of partnership is defined in Council Regulation 1083/2006 (Kandžija, Cvečić 2011). Partnership Council is a formal body which must comprise representatives of all the interested parties, i.e. representatives of the public sector, business and civil society must be represented in equal proportion. Large projects are specifically defined in Council Regulation 1083/2006. An indicative list of major projects should be submitted in Brussels separately and containing the following information:

- body responsible for implementation
- financial volume of investment, description of investment and location
- results of a feasibility study
- flow-chart of project implementation
- cost-benefit analysis and risk assessment
- environmental impact analysis
- justification for public contribution
- financing plan and the planned share from the funds and the EIB.

As opposed to small projects (those under 50 million euros), large projects are approved directly in Brussels. They are proposed by a member state, i.e. MA, which is actually a ministry covering the operational program. All listed documents and all studies must be done before submitting the documents for consideration. Since creation of this documentation is also very expensive, under every OP there is a budget amounting to 4% of the value for technical assistance in preparing the documentation. Of course, in practice it does not happen that the EC knows nothing about a large project until it has received a big box containing documentation for a large project. It is very important for all the projects, especially those large ones, to be communicated with the EC in a very early stage.

For approval of a project it is essential to describe the broader impact of a project, i.e. to link a project to other EC priorities such as employment, improvement of social inclusion, etc. For example, a project to build an additional metro line in Budapest will result in connecting the center with a currently problematic part of the city which is now intended to become the new commercial center.

Besides URBACT and initiatives, Civitas deals with problems of urban transport. Civitas is a program co-financed by the EU. It promotes cleaner and better transport in cities - City-VITALity-Sustainability. The main goal is to achieve "clusters" of cities and to promote the creation of sustainable integrated public transport systems. Currently there is in effect CIVITAS II (2005-2009) with 17 cities participating in 4 demonstration projects. 36 cities across Europe will support the EU in the amount of 100 million euros, while the total budget amounts to 300 million. The City of Zagreb signed the document CIVITAS + at the end of October 2008 and in this way got involved in the program. By inclusion into that program, which lasts four years, Zagreb received around three million euros to achieve sustainable mobility and to promote and achieve clean transportation. The funds are distributed to the City (about one million euros), Zagreb Electric Tram (ZET) (1.1 million euros), the Croatian Railways (HZ) (70 thousand euros), Municipal Sanitation Department (Cistoca) (260 thousand euros),

Association Odraž for monitoring the project (about 200 000 euros), Association Bicikl (65 thousand euros) and the Faculty of Transport and Traffic Sciences (about 340 000 euros). Zagreb Electric Tram (ZET) will use the funds for the purchase of biodiesel buses, buses powered by gas, construction and maintenance of an LPG filling station and for the Project of energy return system on new trams.

3. CASE STUDY BUDAPEST – ASSESING THE POTENTIAL IMPACT OF DEVELOPED URBANIZATION OF THE EU CITIES ON URBAN POLICY AND TRANSPORT COMMUNICATION POLICY IN CROATIAN CITIES

Perhaps the best example from the transition countries, comparable to the situation in Croatia, is the one of Budapest. In the pre-transition period not enough attention was paid to the coordination of systems built independently of one another and to the establishment of network connections and traffic capabilities. Urban traffic in major Hungarian cities required thus further development in a variety of ways, both in terms of infrastructure and rolling stock as well as in terms of the level of coordination and traffic management services. General trends indicate an increase in the use of private vehicles and reduction in the share of public transport. The share of private in comparison to public transport in the capital is 60 to 40 percent, which is better than the average European indicator. Similarly to large European cities, private transport in Hungary causes huge traffic jams, noise and air pollution. Lack of intermodality, i.e. of infrastructural conditions and coordination between traffic types, impedes access to the cities from nearby places. In Hungary there are no interoperable systems.

Approximately 22-25 percent of Hungary's population lives in the area of Budapest. A significant part of the population, approximately 600.000 people commute daily to work in Budapest, which is a big burden for suburban traffic networks. Capacity of the roads leading to Budapest is far below the suburban traffic demand. For 360,000 people every day travel by car to work in Budapest and back home becomes increasingly difficult due to huge traffic jams, while at the same time, noise and air pollution continue to worsen the environmental situation. Roads in Budapest are reconstructed more slowly than they are being worn out. In the area of Budapest daily level of public transport is about 3.8 million trips, and that borders with the capacity of currently available technical conditions. Every day, 86,000 passengers come to Budapest by train and 105,000 by bus. There is an increasing demand for commuter rail traffic. Agglomeration accessibility is nevertheless modest on various routes (roads). The need for a rapid rail transport to Ferihegy airport in Budapest is of growing importance. Coming to the city center from the airport can take the same as (or even more time than) the flight from a nearby capital. The average age of the vehicles of public transport in Budapest has been constantly increasing over the past ten years.

Growth and structure of some other cities (like Győr, Pécs and maybe Kecskemét) and the emergence of independent concentrated residential areas as a result of former housing projects anticipate the need for constant transport services over the next few decades. Almost all the vehicles that operate continuously become worn out over the years and need to be replaced. The fact that in some towns the railroad cuts and thus actually divides a town in half, raises concern about the availability and safety of

transportation. Increased use of cars also in provincial towns is a general trend. That causes problems in the organization of public transport lines and services as well as in the coordination of different types of traffic and tariff policies. In most provincial towns there is no integrated traffic control nor passenger information systems. There still have not been established transport associations capable of organizing and coordinating transportation with the aim of improving service levels.

3.2. Connecting the modes of transport, improving the combination of modes of transport and traffic infrastructure of economic centers

The objective of the strategic plan of Budapest and Hungary is to increase intermodality of national and regional traffic, to establish infrastructure for intelligent traffic management, and thus to increase availability in economic terms and, if possible, in a way that complies with environmental requirements. Infrastructure connections between intermodal logistics (and economic) centers located along the routes of international trade are intended to be improved through construction and modernization of access roads and sidetracks of factories connected to the main transport network, by physical and organizational linking of various modes of transport so as to improve accessibility and to increase the use of those types of freight transport that cause less greenhouse gas emissions and consume less energy. Development of transport infrastructure of logistics centers enables business entities operating in Hungary, a country with favourable economic and geographical conditions, increase in export of services through provision of logistics services for carriers (storage, packaging, forwarding, customs services and additional activities). In line with the priorities, there are being preferred environmentally friendly projects. Connecting different types of transportation (enabling the connection of road, rail and river transport by means of, e.g., funding the development of road and rail networks connected with regional airports or connecting the river transport with road and rail traffic by establishing the basic infrastructure of a port) will ensure access of the land's provinces to alternative means of transportation, increase of speed and comfort in transport of goods and travel, satisfying the interests of business entities and tourism.

Funds are provided by submitting a request for these projects: Financing of infrastructure projects that enable connection of different types of transport, where the missing infrastructural element satisfies public interest and ensures accessibility of a specific location for at least one other type of transportation (e.g. construction or development of roads leading to regional airports or construction of basic infrastructure of a port and traffic connections). Development of ports that already started, will also continue; Projects for development of external transport infrastructure of logistics service centers and other economic centers (including agricultural logistics bases). There is missing the connection of elements: access roads, sidetracks of factories and connection of ports.

Planned development contributes to the following goals: increase in proportion of environmentally friendly freight transport in order for that share to be above the EU27 average; increase in the share of combined freight transport; improvement of the efficiency of intermodal (and regional) logistics service centers.

The following objectives of the Hungarian logistics strategy are being supported: use and management of traffic and "backing" of potentials (freight logistics for the Far East countries taking advantages that arise from the changes between wide and standard rail gauges); division of labor between the traffic sub-sectors by limiting the growth of road traffic volume.

Part of the resources will be granted through open tenders. Funds may be granted to intermodal and regional logistics centers, industrial parks, public ports for freight transport and commercial airports for development of transport infrastructure ensuring connection with the main transport network (road connections, industrial railways, infrastructure of ports). The amount of support depends on the development level of a region and impact on the planned development of the surrounding area. Development of environmentally friendly transportation links is likely to get more support. Projects which provide more resources than the minimum required are being preferred. The amount of funds received in the centers and the share of intermodal freight transport will increase as a result of the project. Development also contributes to increase in the volume of rail traffic.

As for other priorities, selected major events that have economic potential of national or regional significance and are in compliance with environmental requirements can be supported in line with the Hungarian logistics strategy (to which UTDS also applies). Such development has been implemented within the framework of economic development program of Záhony region in the northeast of Hungary with the aim of developing small and medium enterprises and human resources as an addition to the development of freight transport infrastructure. Záhony region is a place where goods imported by rail from the Far East, Russia and Ukraine to the European Union are being reloaded. This region has international significance. It supports the development of rail infrastructure in the region (development of wide and standard rail gauges that enable crossing of border when transporting cargo and reconstruction of secondary railway networks that expand capacities of cargo transport). The internal road infrastructure of the region will also be renewed to allow better access to the logistics centers and railroads, creating at the same time a beltway around places in the region. As a result, an 80 percent increase in the volume of freight rail transport is expected in the Záhony region by 2015 (indicator for measuring the volume of freight transport is listed in the Hungarian logistics strategy). Since a substantial increase is expected in the East and Far East trade conducted by rail, and development in the region is realized under a complex development program, a significant increase is planned in the long term. The goal is to transform the Záhony region into an economic and logistics center of international importance.

Development of public ports of international and national importance, in line with the goals of UTDS, can also be one of the major selected projects in accordance with the decision of the Government. Beside being in accordance with the objectives defined by UTDS, for the selection of a project it is also necessary to take into account the relevant provisions of the Act XLII on Water Transport from 2000 and the National Spatial Development Act XXVI from 2003.

3.3. Improvement of urban and suburban public transport

Development will be carried out in Budapest, larger provincial cities and their agglomeration in order to improve accessibility of cities, to solve traffic jams in urban areas and to minimize safety risks in traffic. Development could encourage use of public transport, which would also reduce negative impacts on the environment (air pollution and noise). The goal is to establish public transport that offers a true alternative to private transport, and that would be economically and environmentally sustainable. Metro 4 project is the major project within the group of projects that are planned to be carried out on the basis of the priority axis. The strategic element of Community Strategic Guidelines is a support to the clean urban public transport system. In 2007 this project will be submitted to the Commission for approval in accordance with regulations. The Commission's approval of the current operational programs does not imply any advance conclusion on the possible approval of Metro 4 project or any other of its elements. When applying for projects, the Hungarian authorities undertake to show how a specific project fits into the strategic and spatial agglomeration planning of Budapest. The funds to be granted to Metro 4 project should not call into question the funding of other feasible projects in the zone of clean urban transport as planned by priority axis. As a way to ensure consistency with the above rule, this project will not absorb more than 60% of resources of the indicative allocation of priority axis.

Integrated suburban transport can be efficient and viable only through cooperation of permanent traffic routes (MÁV, BKV and urban transport operators), linked access to transportation services (Volán) and suburban bus transport (local and remote). As long as the network development is taken care of, the primary goal is the modernization of constant traffic routes to ensure the transport of a large number of people in an environmentally friendly way (underground and tram in Budapest, trolleybus and tram in the provincial cities of Debrecen, Miskolc and Szeged) and other forms of development in order to improve the conditions and safety of urban traffic (e.g. creation of intermodal connections P + R (Park & Ride) and B + R (Bike & Ride) parkings, traffic calming, traffic regulation and traffic management). On the majority of intense traffic routes the task is to connect the permanent traffic routes and to establish solutions for changing the types of transport so as to minimize the number of transfers. For routes leading from regional directions to hubs the goal is to achieve complete intermodality, including quick transfer, integrated tariff systems, achievement of adequate services and coordination of timetables for different types of transportation. Establishment and development of intermodal hubs is necessary and justified primarily in the immediate vicinity of very busy railway and underground stations and in points where they meet. Important elements in the development of urban transport are construction of intelligent traffic systems, improvement of comfort and informing of passengers and provision of accessibility.

Completion and modernization of suburban railways based on the existing rail infrastructure are of the utmost importance for Budapest. The beginning of modernization of 14 suburban railway lines leading to Budapest (11 MÁV and 3 HÉV lines) will facilitate going to and returning from work for the population of the Budapest agglomeration. Development that includes also rail terminals, will enable a

modern, comfortable, regular and environmentally friendly rail transport, and the goal is that this type of transport exceeds the car traffic that causes traffic jams and extensive environmental pollution. The possibility of using railway and permanent routes of the urban infrastructure without changing the means of transport should also be taken into account when developing suburban railways. Construction of the third and fourth track may become necessary on ten lines leading to Budapest in order to ensure smooth transportation of passengers, separated from transport of goods. The possibility of connecting local and nonlocal public transport systems should also be considered for larger provincial cities. This can be achieved by establishing intermodal centers or by extending the tram lines towards the nearby places (trams act as suburban trains). Planning and implementation of a defined development must give higher priority to horizontal objectives of environment protection and equal opportunities. As a result of these activities, new underground lines, which significantly facilitate moving through the city, will be completed and modernization of suburban rail services could begin. Modernization of passenger trains is part of the modernization of suburban rail traffic. Public transport infrastructure and quality of services will also improve significantly in provincial cities, causing perhaps fewer people to choose private transport, which will eventually reduce roads congestion and environmental pollution and improve energy efficiency, traffic safety and population density.

3.4. Aspects of project selection, connection between the planned large projects and objectives of traffic strategy

Priorities contribute to the following objectives of the UTDS White Book: promoting optimization of modal separation of passenger transport in order to prevent an aggravation of modal separation of urban and intercity transport by means of developing rail infrastructure and maintaining the share of public transport above the EU27 average; improving the efficiency of modal separation of public transport by means of ensuring „multimodality“; contribution to the development of urban and suburban public transport infrastructure.

Strategic directions set by UTDS are no real novelty, although earlier concepts did contain different characteristics. Implementation of previous plans may, therefore, in many cases be continued or may require minor modifications to make the plan fit into the new concept. The priority of earlier concepts was development of urban rail transport, but due to lack of the required funds there has occurred only a partial development, primarily owing to the investments in maintenance. In some cases, maintenance of the existing condition could not be achieved due to lack of funds. Projects partially reflect previous situation with lack of funds because there is a large proportion of works on the reconstruction of urban rail transport, but the development that includes other countries' technologies has also been integrated into the existing system. Renewal of the fleet also causes significant problems. Earlier individual purchases make fleet management more difficult. Developing of a tram line in the capital and in three provincial cities should bring environmentally acceptable means of transport, adjusted to the needs of passengers. Development of tram lines focuses on passengers who are already using this method of transport and who can be retained only if they are provided with more comfort and shorter time of travel. In that way passengers can feel the change in the trend which is currently deteriorating.

Among the development of urban railways, at the time of preparation of the strategic plan, the construction of line 4 in Budapest was the most prepared one. Positive effects of underground line 4 on transport in Budapest will be further increased due to further development (extension of lines). As for the suburban rail development in Budapest, there is not much new construction in relation to the length of the network, but as a consequence of the development it will be possible to introduce a new, intelligent structure of timetables and passenger comfort on the respective lines will increase.

The design of suburban railways and drafting of a new above-ground rail concept are running simultaneously and it is possible to harmonize them. With regard to preparedness, reconstruction of Esztergom suburban line is probably coming next. High level of motorization and lack of road capacities result in regular and permanent bottlenecks. However, shortening the time of a currently long journey is necessary to increase the demand for railway transport that has a significant added value in terms of saving passengers' time. The concept of interoperability and connecting of networks is reflected on the regional north-south railways, where the number of passengers is calculated on the basis of estimates of the parameters of a transport system that can be implemented in an interoperable way. Flexible network system providing direct access represents a significant advantage compared to the old system where there was no connection between the lines. Total travel time becomes shorter, not necessarily due to speed increase, but because of the need to combine different forms of transportation. Tram lines (in Szeged and trolleybus) in cities other than Budapest, meet the objectives of urban transport development strategy, which aims to give priority to urban public transport instead of travelling by private car. Aspects to be considered when choosing a project include a high level of project preparedness as well as huge dedication of cities. Table shows only public funding (EU + domestic funding). However, these sources can be replaced by the private ones, taking into account the rules of competition.

Table 2: Funding the priority axes of the strategic plan of traffic development in Hungary

Priority axis	Source	Method for calculation of co-financing	EU funding (a)	Domestic financing (b)	Indicative breakdown of domestic financing		Total funding (e)=(a)+(b)	Portion of co-financing (f)=(a)/(e)	Indicative data	
					State (c)	Private sector (d)			Other fin. instruments	EIB loans
Improving international road access to the country and regional centers	CF	Public expenditure	1.182.619.139	208.697.495	208.697.495	0	1.391.316.634	85,00%		n.a.
Improving international rail and river access to the country and regional centers	CF	Public expenditure	1.721.106.773	303.742.725	303.724.725	0	2.024.831.498	85,00%		
Improving regional accessibility	ERDF	Public expenditure	1.526.986.617	269.468.227	269.468.227	0	1.796.454.844	85,00%		
Connecting the modes of transport and improving intermodality and transport infrastructure of economic centers	ERDF	Public expenditure	152.074.457	26.836.669	26.836.669	0	178.911.126	85,00%	n.a.	
Improving urban and suburban public transport	CF	Public expenditure	1.558.804.069	275.083.071	275.083.071	0	1.833.887.140	85,00%		n.a.
Technical assistance	CF	Public expenditure	81.838.094	14.442.017	14.442.017	0	96.280.111	85,00%		
Total			6.223.429.149	1.098.252.204	1.098.252.204	0	7.321.681.353	85,00%	n.a.	n.a.

Source: TRANSPORT OPERATIONAL PROGRAMME, Uniform Transport Development Strategy (UTDS)

4. CONCLUSION

Urban public transport in the world is a phenomenon that has over the past fifty years played a significant role in scientific and expert debates. Analysis of expert discussions and publications reveals conflict of opinion on how to actualize, despite increased construction and growing number of cars over the past few years, urban public transport in order to be able to compete with private transport.

In addition to cost-effectiveness and the effect of construction and development of urban public transport in the context of which scientific discussions on issues are generally led, there can also be found abundant literature that examines the choice between bus and/or rail transport as a significant investment policy in shaping the cities, the real estate market and as objects of great sociological significance. Beside all the above, the issues are additionally interesting in the context of EU accession and additional funding opportunities arising from strategic operational plans and transportation plans, which generally rely on EU cohesion funds.

In the past few years the Croatian market of urban transport has been in the accelerated process of restructuring and adjustment to the markets of developed Western countries, and some of the main features of structural changes are an increase in the number of cars, pollution, noise and old age of the population that has a much more pronounced preference to urban rail public transport. Development of the Croatian economy depends, among other things, on further development of urban centers, with the aim of enriching the production and strengthening the competition, which is impossible to do without strategic consideration about traffic priorities and use of EU funds in this context. Undoubtedly, well-documented development examples of other countries, especially those that joined the EU before us, can be useful also in determining the Croatian policy of urban public transport.

REFERENCES

- Andrews, Richard B.: Mechanics of the Urban Economic Base: Special Problems of Base Identification Land Economics, Vol. 30, No. 3 (Aug., 1954), pp. 260-269
- Barrett, Paul Public Policy and Private Choice: Mass Transit and the Automobile in Chicago between the Wars The Business History Review, Vol. 49, No. 4 (Winter, 1975), pp. 473-497
- Bourne, L. S. A Descriptive Typology of Urban Land Use Structure and Change Land Economics, Vol. 50, No. 3 (Aug., 1974), pp. 271-280
- De Borger, Bruno, and Sandra Wouters. 1998. Transport Externalities and Optimal Pricing and Supply Decisions in Urban Transportation: A Simulation Analysis for Belgium Regional Science and Urban Economics 28:163-197.
- Delucchi, Mark. 2004. The Annualized Social Cost of Motor-Vehicle Use in the U.S., 1990-1991: Summary of Theory, Data, Methods, and Results. Davis, CA: University of California-Davis Institute of Transportation Studies
- Hensher, David A. 1997. Establishing a Fare Elasticity Regime for Urban Passenger Transport: Non-Concession Commuters. In Transportation Research Part A: Policy and Practice. Sydney: Institute of Transport Studies.

- Holzer, Harry, John Quigley, and Steven Raphael. 2001. Public Transit and the Spatial Distribution of Minority Employment: Evidence from a Natural Experiment. Berkeley Program on Housing and Urban Policy.
- Hoover, Edgar M. Motor Metropolis: Some Observations on Urban Transportation in America *The Journal of Industrial Economics*, Vol. 13, No. 3 (Jun., 1965), pp. 177-192
- Kandžija, V.; Cvečić I. (2011): *Ekonomika i politika Europske Unije*, Ekonomski fakultet – Rijeka
- Kain, J.F., and Z. Liu. 1999. Secrets of Success: Assessing the Large Increases in Transit Ridership Achieved by Houston and San Diego Transit Providers. *Transportation Research Part A: Policy and Practice* 33(7):601–24.
- Lamare, Judith L. Intergovernmental Finance, Productivity, and the Local Match Question: The Case of California's Transit Subsidy Policy *Public Administration Review*, Vol. 41, No. 4 (Jul. - Aug., 1981), pp. 463-470
- Lewis, David, and Fred L. Williams. 1999. *Policy and Planning as Public Choice: Mass Transit in the United States*. Brookfield, Vermont: Aldershot, Hants, England.
- O'Sullivan, A. (1999) *Urban Economics*, 4th edition, McGraw-Hill, Boston
- Perl, Anthony; John Pucher Transit in Trouble? The Policy Challenge Posed by Canada's Changing Urban Mobility *Canadian Public Policy / Analyse de Politiques*, Vol. 21, No. 3 (Sep., 1995), pp. 261-283
- Schmitz, A. and Brett, D. L.: *Real Estate Market Analysis: A Case Study Approach* Urban Land Institute, 2004.
- URBACT II; 2007: The Urban Development Network Programme, An Exchange and learning programme for cities contributing to the European Commission Initiative "Regions for Economic Change", European Regional Development Fund Urban audit; 2008.: Baza podataka (Database), available at: <http://www.urbanaudit.org> (August 2, 2011)
- Van Dender, Kurt, and Stef Proost. 2003. *Optimal Urban Transport Pricing with Congestion and Economies of Density and Costly Public Funds*. Leuven, Netherlands: Center for Economic Studies, Energy, Transport, and Environment, Katholieke Universiteit.
- Vickrey, William S.: Pricing in Urban and Suburban Transport *The American Economic Review*, Vol. 53, No. 2, Papers and Proceedings of the Seventy-Fifth Annual Meeting of the American Economic Association (May, 1963), pp. 452-465.

Heri Bezić

University of Rijeka, Faculty of Economics, Rijeka, Croatia

Tomislav Galović

University of Rijeka, Faculty of Economics, Rijeka, Croatia

REVEALED COMPARATIVE ADVANTAGES OF THE PHARMACEUTICAL INDUSTRY IN A GROUP OF SELECTED COUNTRIES³

ABSTRACT

The paper is based on the results of 23 pharmaceutical world industries in the period between 2006 and 2010 (SITC Classification 241). What is more, the secondary research mostly covers a group of European countries, but also other competitive countries. The basic objective of the research is to measure comparative advantages and to objectively estimate export competitiveness of the manufacturing branch of medical and pharmaceutical products of the selected countries. The methodology in the paper is based on the application of indicators of foreign trade openness of comparative advantages, export competitiveness as well as complete analysis of the structure of the processing industry. For the purpose of the analysis of revealed competitive advantages of the pharmaceutical industry in the selected countries, the following quantitative methods were used: The Revealed Comparative Advantage Index (RCA), as a method for identifying comparative advantages in the export of goods in individual countries, followed by the Export Competitiveness Index (XC), as a method for measuring export competitiveness of the pharmaceutical industry, and the Relative Trade Advantage Index (RTA) which combines the RCA and RMA Index. The main research results include facts in the measuring of identified competitive advantage, estimation of the position of the pharmaceutical industry of the selected countries, especially on external market, and recommendations and proposals for reaching a higher level of export competitiveness.

Keywords: *export competitiveness, RCA Index, net RCA exports, RTA Index, pharmaceutical industry*

JEL classification: *F01, F23, L65*

1. INTRODUCTION

³ The paper was written in the framework of the scientific project „Innovativeness, Transfer of Technology and Competitiveness of Croatian Export“, No. 081-0811403-1414. Its implementation is co-financed by the Ministry of Science, Education and Sports of the Republic of Croatia.

The pharmaceutical industry represents a capital intensive industry whose competitiveness is mostly based on technology, which is a characteristic for segments of the high-technology industry. Although the pharmaceutical industry is based on production innovation and high level of R&D activity like other high-technology industries, there are certain evident particularities.

Generally speaking, the pharmaceutical industry is under the influence of two main factors: large pharmaceutical companies and state legislation. State legislation covers safety, effectiveness, and price of the pharmaceutical products, but it also devotes attention to importance of R&D and innovative policy. The world's supply of the pharmaceutical industry is characterised by a small number of industrial economies on a high-technology and product innovation level (Karn, 1997). World demand for pharmaceutical products mostly records a growing trend. The demand can be determined by income level as well as price movements, distribution, age of the population, health care system, etc.

One of the main threats to competitiveness of pharmaceutical companies, among other things, is reflected in the inability to maximise benefits from knowledge and innovation. In other words, the so-called „technological spillovers“. Namely, if pharmaceutical companies produce innovation accepted by competitive companies without any costs, they can face with the loss of their competitiveness.

Products of the pharmaceutical industry are continuously placed on the market with the objective to sustain and prolong human life. Taking into consideration that health is a basic human need, pharmaceutical products have a significant social impact in relation to other industries. Pharmaceutical products are chemical and biological substances used in therapies and prevention of illnesses. The pharmaceutical industry may be viewed from the aspect of consumers. Namely, the pharmaceutical industry comprises a group of companies which sell and distribute medicaments as final products. From the manufacturers' point of view, the pharmaceutical industry is defined in a narrower sense which implies manufacturing and processing activities; Reekie (1975:1). Multinational corporations and foreign direct investments are a driving force behind the world pharmaceutical manufacturing and trade.

Competitiveness is defined as a country's ability to produce and distribute products in a more efficient manner in relation to the competition. The value of realised exports, is an acceptable manner of measuring competitiveness in the high-technology sector (Seyoum, 2004). In the framework of the defined problem matter of the research, the basic scientific hypothesis is set: by conducting a structural analysis of indicators of comparative advantages and export competitiveness, it is possible to estimate the current state of export competitiveness of the manufacturing branch of medical and pharmaceutical products in the selected countries.

Accordingly, the basic objective of the research is to measure competitive advantages, to objectively estimate export competitiveness of the manufacturing branch of medical and pharmaceutical products in the selected countries and, in accordance with the results, to propose measures and activities for improvement of export competitiveness

of a branch of the pharmaceutical industry. The paper consists of four systematically associated parts. After the introduction, the second part of the paper presents theoretical aspects significant for measuring of comparative advantages and competitiveness of firms in the industry. Methodological framework of the research is presented in the third part. The fourth part of the paper includes analytical framework and results of comparative advantages and export competitiveness based on empirical analysis of foreign trade activities and comparative advantages of the pharmaceutical industry. The paper is concluded with proposals, recommendations, and conclusion.

2. RECENT RESEARCH

Definitions of competitiveness by the OECD and DTI (Department of Trade and Industry) point out the significance of technological factors in the creation of competitiveness. DTI (DTI, 1994) defines competitiveness of firms as a possibility for manufacturing of adequate goods and services, at the right time, at the right price. Definition by the OECD (OECD, 1992), from the micro aspect, includes competitiveness which refers to firms' ability to compete, to maximise profit and realise growth based on costs and prices by using technology, improvement of quality, and maximisation of the effect of its products. Many scientists explore the relationship between competitiveness and technological possibilities. Scientists like Fagerberg (2001), Kaldor (1971), Porter (2001), Lall (2001), and Wignaraj (2003), and institutions like the OECD challenged in an argumented manner the opinions of other scientists who tried to define competitiveness only from the aspect of price-based factors with emphasis on non-price factors such as technology. The discussion led to revision of traditional theories in the framework of the problem of competitiveness. There are two aspects which clarify the term „competitiveness“ in more detail. General macroeconomic aspect presents international competitiveness in the framework of price-based factors. On the other hand, the microeconomic aspect tries to define competitiveness on the firm level with the factors which are not price-based and emphasis is placed on analysis of the rivalry between firms.

The macroeconomic aspect is accompanied by internal and external balance of economies where special attention was devoted to effects of price-based factors on the competition. The microeconomic aspect analysed internal company dynamics which makes companies strong or weak in relation to influences (Wignaraja, 2003). The microeconomic aspect refers to presentation of competitiveness on the firm level. Perspective as such includes rivalry among firms and their strategies. In the past few years, the microeconomic aspect implies new dimensions: the impact of technology and innovation. Lall (2001) criticises the neoclassical theory whose hypotheses are based on the thesis that technology is available to all firms which are able to use technology on technically „high“ levels. However, this is a long learning process which starts by import of technology followed by innovation.

Most experts are partly or completely familiar with two theoretical frameworks from trade based on comparative advantages: Ricardo's theory and Heckscher-Ohlin (H-O) theory. Ricardo's theory covers comparative advantages achieved on the basis of different technologies, while the H-O theory uses as an example the equal level of

technology in all countries. The H-O theory at the same time points out the significance of comparative advantages in relation to different levels of costs derived from unequal prices of the manufacturing factors in the analysed countries. Postulates of traditional trade theories are based on the principle of relative prices of comparative advantages, i.e. inequalities in prices which are under the influence of supply and demand factors.

According to the H-O theory, comparative advantage of an economy is defined by the relative scarcity factor. However, irregularities in measuring of comparative advantages and verifying of the Heckscher-Ohlin theory were discovered by empirical analysis because of the inability to observe relative prices under the influence of autarky (Balassa, 1989:42). Bearing in mind these insights, Balassa (Balassa, 1965) suggested avoiding full inclusion of all the components which affect comparative advantages of different economies. Instead, it is pointed out in Balassa's analysis that „revealed“ comparative advantage is in accordance with the theoretical postulates, except for one exception, which is the inability to analyse relative prices. Deriving conclusions from the analysed data, Balassa called the results of his research revealed comparative advantage, i.e. RCA (Revealed Comparative Advantage). RCA is, at the same time, an accepted method in the analysis of trade in the observed countries. Furthermore, Balassa created an index (known as Balassa's Revealed Comparative Advantage Index) whose main objective is measuring comparative advantages of countries. It should be pointed out that Balassa's index is reflected in the identification of revealed comparative advantages instead of revealing „hidden“ elements of economic advantages of an economy.

However, the initial version of Balassa's Revealed Comparative Advantage Index was modified and revised, so that, presently, there are different indices for measuring comparative advantages. In some research, the RCA is measured on the global level (Vollrath, 1991), while in other studies, the RCA is measured on the regional level. There are also cases in which Balassa's Revealed Comparative Advantage Index was used as a measure for bilateral trade (Dimelis and Gatsios, 1995). Taking into consideration the relevant literature, a few research were dedicated to separate measuring of revealed comparative advantages and export performance of manufacturing of medical and pharmaceutical products as a branch. Most of the consulted sources cover the problem matter on the basis of an example of processing industry and its main subsectors. For example, the pharmaceutical industry is often analysed through the chemical sector (SITC 5). The argument in favour thereof can be found in the scientific paper by Richardson and Zhang (2001) who analysed export performance as well as revealed comparative advantages of the main sectors of the American processing industry with 38 partner countries in the period between 1980 and 1995. The authors point out revealed comparative advantages of the American chemical industry for the Asian market, while there is an evident lack of revealed comparative advantages for the EU market.

Utkulu and Seymen (2004) applied different variations of the Balassa's RCA Index to examine revealed comparative advantages of Turkey in comparison with its external trade partner, the EU-15. It is a detailed analysis of 89 manufacturing groups based on SITC Rev 3. Classification in the period between 1990 and 2003. Authors Utkulu and Seymen (2004) point out lack of revealed comparative advantages in the

pharmaceutical, but also the chemical industry of Turkey. Generally, the authors point out one of the factors which affects comparative advantages and comprises forms of state interventions such as tariffs, quotas, or subsidies. Additionally, Burange and Chada (2008) analysed revealed comparative advantages of products in 21 sections of Indian exports in the period between 1996 and 2005. They concluded that Indian chemical industry was marked by revealed comparative advantages, but also dynamics of the trend of the RCA coefficient.

Additionally, Sebbagala (2008) analysed revealed comparative advantages of Uganda. The analysis covered nine main categories (SITC) which are subject to analysis of the RCA Index in the period between 2000 and 2005. In accordance with Sebbagala's (2008) insights, the chemical industry of Uganda recorded lack of revealed comparative advantages. It should be pointed out that the pharmaceutical industry of Uganda, as a field of the chemical industry, was characterised by revealed comparative advantages in 2000, while in 2005, there was lack of comparative advantages. Acharya (2008) conducted an extensive analysis of revealed comparative advantages for countries like Canada, the USA, EU-27, China, Japan, Mexico, for 96 selected products in the HS-2 Classification in the period between 1996 and 1997 and 2006-2007. Archarya (2008) points out the dominant position of the USA and the EU-27 regarding redundancy of revealed comparative advantages. The author also points out high export share of the pharmaceutical products in the framework of high-technology industry of the USA and the EU-27. What is more, revealed comparative advantages of the pharmaceutical industry of the EU-27 were verified in the European Competitiveness Report (2012) in which there is an evident growing trend in the period from 2007 to 2010. Along with the 10 industrial sectors, Madariaga (2009) compared coefficients of revealed comparative advantages of the selected fields of industry in France and Germany in the period between 1996 and 2007 in his research. He points out a high level of export specialisation of the analysed countries in which there are evident revealed comparative advantages. What is more, by segregating the main sectors to smaller fields, Madariaga (2009) provides a clear overview of the state of comparative advantages of the pharmaceutical industries of France and Germany. Conclusions of the analysis of the pharmaceutical firms indicate the third rank of the French pharmaceutical industry in the context of existence of revealed comparative advantages. The case of German pharmaceutical industry points to a lower rank (the 9th place) on the scale of areas with the most revealed comparative advantages.

3. METHODOLOGY

The subject of analysis is the branch of medical and pharmaceutical products (except branch 542)⁴, field of medical and pharmaceutical products, chemicals and similar products⁵. Manufacturing of electric machines and devices was selected as a reference

⁴ Branch 542 represents medicines which, among other things, include veterinarian drugs.

⁵ According to the Standard International Trade Classification (SITC Rev.3), branch 541 called „Medical and Pharmaceutical Products“ comprises 6 classes. The classes include: provitamins and vitamins, natural or obtained by synthesis, derivatives primarily used as vitamins and inter-mixtures of the above which are not classified within the branch 542 (541.1), antibiotics which do not belong to branch 542 (541.3), herbal alkaloids, natural or obtained by synthesis, and their salts, ethers, esters and other derivatives which do not

pattern of the high-technology sector. One of the frequently used indices is the RCA Index. Balassa proposes that values of export performance be used for discovering comparative advantages of a certain economy with the exception of factors of manufacturing costs (Balassa, 1965:93).

The Revealed Comparative Advantage Index (RCA) was calculated according to the following formula (Balassa, 1978:203):

$$RCA_0 = [(X_{ij} / X_{nj}) / (X_{it} / X_{nt})]$$

wherein:

X_{ij} – exports of product “i” of the country “j”,

X_{it} – world exports of product “i”,

X_{nj} – total exports of country “j”,

X_{nt} – total world exports.

The RCA Index measures comparative advantage in the exports of goods «i» of the country «j». If the value is greater than 1, the analysed country has revealed comparative advantages in the exports of particular goods. Inversely, if the value is less than one, then there is evident lack of comparative advantages in exports of the specific goods. The RCA Index is used to present the state of economy along with the expansion of certain products which have market potential. Also, an insight in the perspective and potential of foreign trade is gained. Countries with similar RCA profiles have highly intensive bilateral trade except for inclusion of intra-industry trade.

Amir uses the Export Competitiveness Index – XC to identify success, or lack thereof, in manufacturing in the stage of facing competitive growing markets (Amir, 2000:123). The Export Competitiveness Index indicates export effectiveness of products or a group of products. The growth of the obtained values from the index in the analysed period indicates export performance of products in competitive growing world markets. The Export Competitiveness Index is calculated according to the following formula:

$$(XC_0) = (X_{ij} / X_{it})_t / (X_{ij} / X_{it})_{t-1}$$

wherein:

X_{ij} – exports of product “i” of country “j”,

X_{it} – world exports of product “i”,

t – analysed period,

$t-1$ – preceding period.

Export competitiveness of the product «i» of the country «j» may be explained as the ratio of the shares on the world market of the country «j» with the product «i» in the analysed period (t) with the ratio of shares in the preceding period. If the Export Competitiveness Index is greater than 1, there is growing export competitiveness. Inversely, the value which amounts less than 1 implies negative export competitiveness

belong to branch 542 (541.4), hormones, natural or obtained by synthesis; derivatives used as hormones, steroids used as hormones which do not belong to branch 542 (541.5), glycosides, glands, and other organs and extracts, antisera, vaccines and similar products (541.6), and pharmaceutical products and other medicines (541.9).

trend. The XC Index may also be interpreted as the ratio of the export growth rate of the product «i» of the country «j» and growth rate of the product «i» on world markets.

According to the World Bank (2011.), the Export Specialisation Index is a relatively modified Balassa's Revealed Comparative Advantage Index. The RCA Index compares the share of a sector in a country's exports with exports in which the denominator is measured in the context of specific markets. The ES Index provides an insight in revealed manufacturing specialisation of exports in individual sectors of a country and is calculated as a share of exports of products in total exports of a country in relation to the share of import of products in total import of the country.

$$ES = (x_i^A / X^A) / (m_i^K / M^K)$$

wherein:

x_i^A – exports of product “i” of the country “A”
 X^A – total exports of the country “A”
 m_i^K – import of product “i” of the country “K”;
 M^K – total import of product of the country “K”.

If the value is greater than 1, the analysed country had revealed comparative advantages in exports of specific goods, and is at the same time a country specialised in exports. Inversely, if the value is less than 1, there is evident lack of comparative advantages in the exports of specific goods. Edwards, Mlangeni and van Seventer use the ratio of exports and total trade to measure trade performance of the country which implies the possibility for exports and import within certain product categories (Edwards et al., 2000:75).

The indicator is contained in the following formula:

$$\text{Net exports } RCA_{ij} = (X_{ij} - M_{ij}) / (X_{ij} + M_{ij})$$

wherein:

X_{ij} – exports of product “i” of the country “j”
 M_{ij} – import of product “i” of the country “j”

This ratio presents the results in the intervals from -1 to +1. The values indicate lack of comparative advantage if the value is between 0 and -1. When the value is ranked between 0 and +1, there is evident comparative advantage. However, the value that equals 0 implies equality of import and exports of products. Therefore, the index represents the level of specialisation of the country in exports of a specific product.

The results obtained by the RCA measuring are especially useful when they are used in combination with other indicators (such as Net Exports RCA_{ij}) in order to overcome the limitations obtained by the Revealed Comparative Advantage Index.

The problem with similar RCA indices is that analysis of the example of trade may be unreliable because of state interventions. It is considered that government measures such as import ban, export subsidies, and other government protectionist measures may influence reliability of RCA measuring.

Vollrath (1991) recommends increased use of the RC Index because supply and demand are balanced in the index. However, Vollrath's three indices have disadvantages. Vollrath admits that the RXA Index (of Relative Export Advantage), which neutralises deviated effects, is more frequently used in practice.

Relative Trade Advantage (RTA) is calculated as the difference between relative export comparative advantage, which is equivalent to the original Balassa's index (Vollrath, 1991:270) and relative import comparative advantage. Vollrath's RXA differs from the Balassa's Index by prevention of double calculation.

$$RTA = RXA - RMA$$

wherein $RXA = RCA = (X_{ij}/X_{it}) / (X_{nj}/X_{nt})$, and

$$RMA = (M_{ij}/M_{it}) / (M_{nj}/M_{nt})$$

wherein M represents import.

$$RTA = RXA - RMA = (X_{ij}/X_{it}) / (X_{nj}/X_{nt}) - (M_{ij}/M_{it}) / (M_{nj}/M_{nt})$$

In the relative trade advantage, the original Balassa's Revealed Comparative Advantage Index and its counterpart, the Revealed (Import) Comparative Advantage Index are taken into consideration.

In the example of the processing industry, the following index will be used:
 $RCA-2$ (Relative Trade Advantage) = $RXA_i - RMA_i$

wherein:

$$RXA_i = (X_i/X) / (X_{iw}/X_w)$$

$$RMA_i = (M_i/M) / (M_{iw}/M_w)$$

RXA_i : Relative Export Comparative Advantage for product „i“

RMA_i : Relative Import Comparative Advantage for product „i“

X: Total exports of the country

X_w : Sectoral (or world) total exports

M: Total import of the country

M_w : Sectoral (or world) total import

The Relative Trade Advantage Index (RTA) is calculated as difference between relative comparative advantages (RXA_i) and relative revealed (import) comparative advantages (RMA_i). The RXA_i Index, in fact, represents Balassa's Revealed Comparative Advantage Index (RCA_0) which was analysed in the previous part of the methodology of the paper. The RMA_i Index is analysed as an additional dimension, i.e. a variable which presents the real image of comparative advantages of the Croatian processing industry. The RMA_i Index is characterised by almost identical calculation manner, except that the point of analysis is import, and not export activity, as is the case in the RXA_i Index. The RTA ($RCA-2$) results may be higher or lower than the

value 0. Positive values indicate revealed comparative advantages of the analysed trend, while negative values point to lack of comparative advantages.

The applied model of this research is based on the combination of indicators which measure export competitiveness of the Croatian processing industry. Balassa's Revealed Comparative Advantage Index is a starting point in measuring of export competitiveness. Statistics are presented as the key element in calculation of export competitiveness through exact defining of comparative advantages.

The Revealed Comparative Advantage Index has an important role in measuring of comparative advantages in the analysed area. The index served as an inevitable segment of other indicators in the framework of the analysis of comparative advantages conducted by Amir and Mlagenio. A relevant link between Balassa, Amir, and Mlagenio's indices is common use of export competitiveness parameters, like export of products on national and global level.

Because of these characteristics, it would be realistic to select the sector of high technology as the subject of analysis of export competitiveness and comparative advantages.

4. RESULTS

The analysis starts with identification of comparative advantages and export competitiveness based on the example of 23 European and other countries in the period from 2006 to 2010. The main reason for selection of the analysed countries is partly their mutual comparability, but also extensiveness, with the objective to conduct a precise analysis of revealed comparative advantages.

The variables of the RCA_0 formula did not change much in terms of methodology in relation to the initially set up model. The variable of total world exports remained unchanged, while the variable total export of the country «j» comprises total exports of the branch of medical and pharmaceutical products of the analysed countries. Table 1 below presents revealed comparative advantage indices of medical and pharmaceutical (except branch 542) products of the selected countries.

Table 1: Revealed Comparative Advantage Index (RCA) in the Period from 2006 to 2010

RCA_i*	2006	2007	2008	2009	2010
Austria	2,08	2,15	2,32	2,17	1,95
Belgium	2,47	2,69	2,83	3,49	3,71
Brazil	0,26	0,27	0,27	0,25	0,24
Bulgaria	0,50	0,44	0,41	0,41	0,41
China	0,65	0,62	0,68	0,61	0,63
Croatia	0,94	0,27	0,36	0,27	0,31
Finland	0,28	0,23	0,25	0,26	0,32
France	1,29	1,15	1,11	1,19	1,42
Germany	1,64	1,65	2,02	1,69	1,84
India	0,85	0,88	0,73	0,79	0,78
Ireland	4,29	5,03	6,52	6,26	7,32
Italy	0,91	0,76	0,76	0,78	0,78
Japan	0,28	0,24	0,23	0,22	0,21
South Korea	0,16	0,17	0,18	0,18	0,16
Latvia	0,56	0,64	0,62	0,76	0,62
Lithuania	0,12	0,14	0,17	0,20	0,15
Romania	0,05	0,04	0,03	0,06	0,05
Russia	0,03	0,03	0,02	0,02	0,02
Slovenia	0,51	0,58	0,78	0,50	0,45
Sweden	0,75	0,92	1,20	1,06	1,06
United Kingdom	1,21	1,38	1,38	1,41	1,57
USA	1,86	1,93	1,90	1,81	1,67
EU	1,43	1,43	1,49	1,46	1,59

Note: *RCA_i = RCA Index of medical and pharmaceutical products
Source: Analysis of the authors

The results of the Revealed Comparative Advantage Index obtained by using the data in Table 1 present comparative advantages of exports of medical and pharmaceutical products which are especially revealed in the European Union, Austria, Belgium, France, Germany, Ireland, Sweden, the United Kingdom and the USA. If the pharmaceutical industry trend in the analysed countries with revealed comparative advantages is taken into consideration, it can be concluded that there is an evident growing trend which resists the impacts of the global economic crisis.

Unlike the above-mentioned countries, the Republic of Croatia is characterised by lack of comparative advantages. The BRIC group should be especially pointed out; its indices indicate lack of comparative advantages in the field of medical and pharmaceutical products. The main reason might be their export orientation towards exports of energy sources (for example, Russia), and agricultural products (for example, Brazil). In the summary of the results of the RCA Index, the significance of

the USA should be pointed out as well as of developed EU Member States which take the leading positions in the context of revealed comparative advantages. Table 2 contains analysis of export competitiveness of the branch of medical and pharmaceutical products of the selected countries in the period from 2007 to 2010.

Table 2: Export Competitiveness of Medical and Pharmaceutical Products (Except Branch 542) in the Period from 2007 to 2010

MED. AND PHARM. PRODUCTS/XC*	2006	2007	2008	2009	2010
Austria	-	1,06	1,03	0,91	0,82
Belgium	-	1,10	0,99	1,24	0,97
Brazil	-	1,04	1,06	0,95	1,01
Bulgaria	-	0,93	0,96	0,94	1,04
China	-	1,04	1,11	0,96	1,12
Croatia	-	0,29	1,31	0,71	1,06
Finland	-	0,83	1,00	0,88	1,08
France	-	0,87	0,92	1,08	1,05
Germany	-	1,03	1,16	0,83	1,01
India	-	1,10	0,93	1,18	1,07
Ireland	-	1,13	1,15	1,14	0,97
Italy	-	0,86	0,94	0,99	0,90
Japan	-	0,82	0,92	0,90	1,03
South Korea	-	1,01	1,05	1,10	0,97
Latvia	-	1,34	1,02	1,19	0,83
Lithuania	-	1,19	1,47	1,02	0,81
Romania	-	0,84	0,85	2,10	0,83
Russia	-	0,94	0,85	0,81	0,99
Slovenia	-	1,27	1,30	0,63	0,84
Sweden	-	1,22	1,22	0,81	1,00
United Kingdom	-	0,96	0,90	1,00	1,05
USA	-	1,00	0,95	1,00	0,91
EU	-	1,01	0,99	0,98	1,00

Note: *XC= Export Competitiveness Index of medical and pharmaceutical products

Source: Analysis of the authors

Generally, there is an evident modest growing trend of export activity in the branch of medical and pharmaceutical products of the analysed countries. Taking into consideration the export activity trend in 2009 and 2010, revealed export competitiveness of the 12 analysed countries should be pointed out. The argument is reflected in disproportionate, but positive dynamics between exports of the selected countries and world production of medical and pharmaceutical products. The pharmaceutical industry takes the place of one of growing industries which, in most cases, more readily resist effects of the global economic crisis. However, there is an evident downward trend for insufficiently strong pharmaceutical industries of the

analysed countries. It should be added that this situation is present in most of the selected European countries. This is indicated by the values of the XC Index which are under the allowed limit of value 1. Consequently, sensitive nature of manufacturing medical and pharmaceutical products was verified in most of the selected European countries (as well as Russia, USA, South Korea) which is stimulated by the decline in export competitiveness. Although some of the analysed countries indicate insufficient export competitiveness, the pharmaceutical industry in most of the analysed countries did not record poor results. The reason may be found in the possible stagnation, or growth of demand i.e. successful neutralisation of the effects of the global economic crisis. The answer to the question what is the real level of net exports of medical and pharmaceutical products RCA of the countries is found in Table 3. Values of import and exports of the branch in the period from 2006 to 2010 are taken into account.

Table 3: Values of Net Exports of Medical and Pharmaceutical Products RCA (Except Branch 542) in the Period from 2006 to 2010

MED. AND PHARM. PRODUCTS/ NET EXPORTS RCA	2006	2007	2008	2009	2010
Austria	-0,09	0,03	0,10	-0,03	0,00
Belgium	0,16	0,17	0,17	0,14	0,11
Brazil	-0,69	-0,69	-0,70	-0,71	-0,77
Bulgaria	-0,09	-0,15	-0,21	-0,26	-0,24
China	0,71	0,69	0,67	0,62	0,60
Croatia	-0,30	-0,69	-0,64	-0,71	-0,67
Finland	-0,22	-0,27	-0,33	-0,29	-0,32
France	-0,09	-0,09	-0,10	-0,11	-0,13
Germany	0,04	0,03	0,13	0,06	0,06
India	-0,22	-0,15	-0,18	-0,08	-0,14
Ireland	0,57	0,64	0,67	0,70	0,70
Italy	-0,40	-0,43	-0,41	-0,39	-0,39
Japan	-0,40	-0,39	-0,46	-0,54	-0,57
South Korea	-0,44	-0,43	-0,39	-0,31	-0,34
Latvia	-0,43	-0,38	-0,37	-0,31	-0,25
Lithuania	-0,61	-0,60	-0,48	-0,37	-0,40
Romania	-0,92	-0,92	-0,93	-0,88	-0,89
Russia	-0,87	-0,87	-0,90	-0,91	-0,93
Slovenia	-0,23	-0,15	-0,01	-0,20	-0,23
Sweden	0,02	0,12	0,26	0,14	0,14
United Kingdom	-0,03	-0,06	-0,04	-0,04	-0,03
USA	0,06	0,081	0,06	0,17	0,13
EU	-0,02	-0,01	0,01	0,00	0,00

Source: Analysis of the authors

By comparing Table 1 and Table 3, there is an evident similarity i.e. complementarity of the obtained results. Manufacturing of medical and pharmaceutical products in most countries is facing lack of comparative advantages. The exception are European countries like Austria, Belgium, Germany, Ireland, Sweden, the USA, China and the EU, which at the same time confirm their position of export competitive countries with revealed comparative advantages. The proof is found in the trends of net exports of the RCA which are above the limit of value 0.

When the import variable is included, the situation in manufacturing of medical and pharmaceutical products in the selected countries is relatively acceptable: positive values of indicators imply higher dynamics of export growth in relation to import dynamics in the analysed period. However, some of the values of net exports of RCA manufacturing of medical and pharmaceutical products of other countries are significantly lower than 0. The reason is lower exports and stronger decline in relation to import. In conclusion, the negative trend of net exports of RCA implies insufficient export orientation and revealed inclination to import. In order to calculate the Relative Trade Advantage Index, the Revealed Comparative Advantage Index (RCA) below is presented like the Relative Export Advantage Index (RXA_i). Relative Trade Advantage Index (RCA-2) can be calculated in the manner that the values of Relative Import Advantage (RMA_i) are subtracted from the obtained values of Relative Export (RXA_i). The final results are presented in Table 4.

Table 4: Relative Trade Advantage of Medical and Pharmaceutical Products (Except Branch 542) in the Period from 2006 to 2010

Products/RCA-2	2006	2007	2008	2009	2010
Austria	-0,40	0,15	0,38	-0,20	0,04
Belgium	0,65	0,74	0,72	0,56	0,56
Brazil	-1,81	-1,64	-1,52	-1,63	-1,84
Bulgaria	0,11	0,07	0,00	-0,11	-0,15
China	0,51	0,48	0,50	0,43	0,45
Croatia	0,08	-0,45	-0,43	-0,60	-0,63
Finland	-0,21	-0,21	-0,29	-0,27	-0,32
France	-0,13	-0,05	-0,11	-0,19	-0,22
Germany	-0,18	-0,25	0,05	-0,21	-0,13
India	-0,06	0,10	0,05	0,15	0,06
Ireland	2,56	3,46	4,57	4,17	4,79
Italy	-1,11	-1,12	-1,10	-1,08	-0,93
Japan	-0,45	-0,39	-0,45	-0,62	-0,67
South Korea	-0,28	-0,27	-0,23	-0,23	-0,22
Latvia	-0,19	-0,12	-0,26	-0,46	-0,26
Lithuania	-0,26	-0,26	-0,23	-0,22	-0,18
Romania	-0,80	-0,56	-0,64	-0,81	-0,78
Russia	-0,86	-0,67	-0,74	-0,83	-1,01
Slovenia	-0,27	-0,15	0,00	-0,29	-0,27
Sweden	-0,07	0,14	0,41	0,15	0,20
United Kingdom	0,24	0,29	0,23	0,22	0,33
USA	0,98	1,00	0,85	0,92	0,83
EU	-0,00	0,01	0,05	-0,06	0,01

Note: *RCA-2 = Relative Trade Advantage Index

Source: Analysis of the authors

From the overview of the calculated relative trade advantages, it can be established that, in their framework of the analysed indeks, there are no recorded significant deviations in relation to the previously calculated results. Manufacturing activity of medical and pharmaceutical products in as much as 14 analysed countries was marked by negative trend of the index caused by a great negative difference between the results of RMA_i and RXA_i index. This situation undoubtedly indicates lack of comparative advantages, especially in the past few years of the analysed period. The greatest deficit is especially revealed in Brazil and Russia, whose import significantly exceeds export activity of manufacturing of medical and pharmaceutical products. Alternatively, significance of exports of medical and pharmaceutical products should be pointed out, because it is proven to be more dominant in terms of exports with revealed comparative advantages in relation to other countries. It is followed by the USA, Belgium, China, and the United Kingdom. Republic of Croatia is an interesting

example which recorded an unsatisfactory position in the context of revealed comparative advantages.

5. CONCLUSION OF THE ANALYSIS AND PROPOSAL OF ACTIVITIES FOR IMPROVEMENT OF EXPORT COMPETITIVENESS OF FIRMS OPERATING IN THE PHARMACEUTICAL INDUSTRY

Aggregation of the results of the calculated indices leads to a series of interesting insights related to comparative advantages and export competitiveness of manufacturing of medical and pharmaceutical products. First and foremost, the global economic crisis influenced most of the analysed countries. Namely, in the period between 2009 and 2010, most pharmaceutical industries could not readily respond to the negative impact of the global economic crisis. The argument in favour of this statement is visible in the framework of the calculated trend in the used indicators. Alternatively, there is an evident enviable position of developed countries such as Ireland, Sweden, China, the USA, Belgium, the United Kingdom, and Austria, which is reflected in the display of resistance and readiness in facing economic challenges. Most of the above-mentioned countries are characterised by above-average share of R&D activity and innovation, which enables faster adjustment to new conditions on the market. In the case of the Republic of Croatia, the results of manufacturing of medical and pharmaceutical products do not indicate redundancy of revealed comparative advantages and export competitiveness. There is also the fact that some Croatian companies represent renowned pharmaceutical companies. However, the basic components for manufacturing of medical and pharmaceutical products are mostly imported. This results in increased import activity which dominates over export activity. The consequence is lack of comparative advantages and export competitiveness of Croatian medical and pharmaceutical products.

Countries representing the BRIC group, like Brazil, Russia, India, should be pointed out. They indicate insufficiently revealed comparative advantages and lower export competitiveness. The potential cause lies in their export orientation in other sectors. Almost identical situation is characteristic for Japan, South Korea, and Finland. In spite of their high intensity of R&D research and innovation in GDP, there is evident lack of comparative advantages. Of course, what is true for economy, need not be true for the industrial sector. Lack of comparative advantages and export competitiveness in manufacturing also indicates export orientation to other products, or potential market loss. It would be interesting to point out industrialised countries like Germany and France which are marked by revealed comparative advantages. However, their import activity of medical and pharmaceutical products should be reduced in order to reach a higher level of relative trade advantage.

Generally, the conclusion is derived that most highly developed countries have preconditions for improvement of export competitiveness and development of revealed comparative advantages, while transition countries have smaller possibilities for reaching this scenario. However, one should not ignore the previously mentioned exceptions of highly industrialised countries like Brazil, Russia, etc. Consequently, in

order to improve export competitiveness and comparative advantages of firms, the branch of medical and pharmaceutical products should invest in:

- Revision and conversion of the export expansion programme,
- Establishing of stronger partnerships with large clients,
- Raising firms' awareness on growing markets and expansion to growing markets,
- More detailed identification of activities of the growing competition, especially from Asian countries,
- Openness to „joint venture“ i.e. common investments in order to supply new technology,
- R&D activities and innovation activities, and
- Continuous engagement and training of researchers and R&D staff in firms.

Application of the results of this research may contribute to improvement of competitiveness in the pharmaceutical industry, but this implies undertaking measures within firms. Therefore, in order to overcome the problems of export competitiveness, a comprehensive approach is necessary on the level of macro-environment and on the level of micro-environment. In other words, firms should ensure all the necessary preconditions for adjustment to competitive environment. Adoption of the above-mentioned measures would provide firms a greater possibility to take and keep a competitive position on the market. Adequate transfer of knowledge and technology may, of course, result in growth of export activity of the firms. Opening room for investments also plays a significant role in the stimulation of export expansion of the firms. For example, directing capital from multinational companies of developed countries into transition countries would significantly contribute to improvement of comparative advantages.

REFERENCES

- Amir, M. (2000). *Trade Liberalization and Malaysian Export Competitiveness: Prospects, Problems and Policy Implications*, 1-36., <http://econ.tu.ac.th/iccg/papers/amir.doc> (Retrieved on January 9, 2012)
- Acharya C.R. (2008). *Analysing International Trade Patterns: Comparative Advantage for the World's Major Economies*, *Journal of Comparative International Management*, Vol. 11, No.2, p. 33-53
- Balassa, B. (1965). *Trade Liberalisation and 'Revealed' Comparative Advantage*. *The Manchester School*, 33 (2), 99-123.
- Balassa, B. (1978). *Export and Economic Growth: Further Evidence*. *Journal of Development Economics*, 5, 181-189.
- Balassa, B. (1989). *Comparative Advantage, Trade Policy and Economic Development*. New York: Harvester Wheatsheaf
- Burange L. G. and Chaddha S. J. (2008). *India's Revealed Comparative Advantage in Merchandise Trade*, *Journal of the Gokhale Institute of Politics and Economics*. - Pune, Vol. 50. p. 332-363
- Department of Trade and Industry (1994). *Competitiveness. White Paper*. Cm 2867, HMSO, London
- Dimelis, S., & Gatsios, K. (1995). *Trade with Central and Eastern Europe: The Case of Greece*. *Centre for Economic Policy Research*, CEPR Discussion Paper, No 1005
- Edwards, L., Fagerberg, J. (2001). *Benchmarking: A New and Useful Tool for Policy Learning*. Working Papers on Innovation Studies 20010621, Centre for Technology, Innovation and Culture, University of Oslo

- European Competitiveness Report (2012). http://ec.europa.eu/enterprise/policies/industrial-competitiveness/competitiveness-analysis/european-competitiveness-report/files/ecr2012_full_en.pdf (Retrieved on January 27, 2013)
- Karn, Prasit Ch. (1997). *Patterns and Determinants of Australia's International Trade in Pharmaceuticals*, Ph.D. Thesis.
- Kaldor, N. (1971). *Conflicts in National Economic Objectives*. *Economic Journal*, 81 (321), 1-16.
- Lall, S., (2001) *Competitiveness Technology and Skills*, Edwar Elgar, UK Organization for Economic, Co-Operation and Development (1992) *Technology and the Economy: The Key Relationships*, Organization for Economic, Co-Operation and Development, Paris, <http://www.oecd.org/dataoecd/33/62/2095942.pdf> (Accessed 9-1-2011)
- Madariaga N. (2009). *French and German Export Specialization: Similarity or Divergence?*, *TRÉSOR-ECONOMICS*, No. 68, Treasury and Economic Policy General Directorate, p. 1-8
- Mlangeni, T., Van Seventer, D, (2000). *Revealed Comparative Advantage in SADC Economies*. *Southern African Update*, Vol. 5
- OECD (1992). *Technology and the Economy: The Key Relationships*, Organization for Economic Co-Operation and Development, Paris. <http://oecd.org/dataoecd/33/62/2095942.pdf> (Retrieved on April 9, 2011)
- Porter, M. E. (2001). *Strategy and the Internet*. *Harvard Business Review*, 62-78.
- Reekie, W. D. (1975). *The Economics of the Pharmaceutical Industry*, London: Macmillan.
- Richardson D., Zhang C., (2001). *Revealing Comparative Advantage: Chaotic or Coherent Patterns Across Time and Sector and U.S. Trading Partner?*, Topics in Empirical International Economics: A Festschrift in Honor of Robert E. Lipsey, University of Chicago Press, p. 195 -232.
- Sebagala R. (2008). *Revealed Comparative Advantage and Competitiveness of Ugandas Exports with the Rest of the World*. Ndejje University and Uganda Christian University
- Seyoum, B. (2004). *The Role of Factor Conditions in High-Technology Exports: An Empirical Examination*. *The Journal of High Technology Management Research*, 15 (1), 145 162.
- Utkulu, U., Seymen, D. (2004). *Revealed Comparative Advantage and Competitiveness: Evidence for Turkey*. In: European Trade Study Group 6th Annual conference. Nottingham, UK.
- Vollrath, T.L. (1991). *A Theoretical Evaluation of Alternative Trade Intensity Measures of Revealed Comparative Advantage*, *Weltwirtschaftliches Archiv*, 130, pp. 265-79.
- UNCTAD. <http://www.unctad.org> (Retrieved on May 22, 2011)
- Wignaraja, G. (2003). *Competitiveness Analysis and Strategy*. In Wignaraja, G. (Ed.), *Competitiveness Strategy in Developing Countries*, New York: Routledge, 15-60

Alen Host

University of Rijeka, Faculty of Economics, Rijeka, Croatia

Vinko Zaninović

University of Rijeka, Faculty of Economics, Rijeka, Croatia

Tina Mirkov

University of Rijeka, Faculty of Economics, Rijeka, Croatia

REAL CONVERGENCE AND PERSPECTIVE OF INTEGRATION – THE ANALYSIS OF CROATIAN INTRA-INDUSTRY TRADE

ABSTRACT

Classical theory finds impulse for international exchange in different relative prices of production, i.e. relative abundance of different factors of production. Intra-industry trade concept means trade between similar products of different countries (economic integration). Applying classical concept in practice would mean that the trade between states at similar stage of development will decline through time. However, the fact is that developed countries (this especially applies to the EU) exchange more despite the fact that their relative costs of production, i.e. relative wealth of the factors of production are more similar.

Statistically it is just possible to substantiate the fact that the most developed countries in the world exchange between more than half of total world trade (OECD, 2010). This fact has led to the development of alternative theories, opposite to classical theories of international trade. Thereby, it took into account entirely new assumptions. These assumptions reflect the actual conditions in which international trade takes place, such as economy of scale, product differentiation, monopolistic (oligopolistic) competition, multinational companies etc.

Croatia is a small open economy that will join the EU on July 1st, 2013. Nominal Copenhagen criteria are fulfilled, but the real question is where Croatia stands when real convergence is concerned (if we take into account that intra-industry trade could be a significant indicator of real convergence of national economy), i.e. the extent which Croatia trade/exchange is inter-industry and intra-industry. The increase in the share of bilateral intra-industry trade would mean that Croatia managed to differentiate production, and that is able to compete in the EU market by selling similar products. In other words, it leads to a smooth adjustment hypothesis, according to which the adjustment costs of particular country or sector, when entering the economic integration will be low if there is a relatively high level of intra-industry trade.

Aim of this paper is to analyze intra-industry trade of Croatia between year 2002 and 2012 and section of 10 European countries with biggest share of bilateral trade flows: eight from the EU (Italy, Germany, Slovenia, France, Great Britain, Austria, Hungary and Netherlands) and two countries from CEFTA 2006 (Bosnia & Herzegovina and Serbia).

Key words: intra-industry trade, international trade, economic integration, Croatia, EU

JEL classification: F14, F15

1. INTRODUCTION

Croatia will join the EU on the 1st July, 2013. Croatian National Bank suggests that Croatia will seek to join the EMU as soon as possible. However, the announcement of joining the European integration does not follow the debate on the real convergence of the Croatian economy to the EU. Meeting the Copenhagen criteria (which Croatia had met), or Maastricht Treaty (which is the next goal), does not bring real convergence itself. Croatia will maximize its benefits to the EU and EMU only if its economy achieves real convergence with the EU economy. In order to do so, Croatia has at its disposal national macroeconomic policies, as well as EU funds.

In general, the literature identifies three types of convergence. First, convergence is defined as the synchronicity of business cycles. For example, monetary policy guided from one center brings benefits to everyone, provided that all the countries are in the economic crisis or in the GDP growth zone. The second definition refers to the similar structure of the economy, where the usual criterion is proportion of agriculture in relation to the processing sector. The third definition is based on a similar level of productivity, GDP/pc or employment level. If we apply any of these criteria, Croatia does not satisfy or partially satisfies the convergence criteria.

On the other hand, the OCA theory identifies the following criteria: labor mobility (Mundell), production diversification (Kenen), openness (McKinnon), fiscal transfers and homogeneous preferences.

One of the indirect methods of measuring the level of real convergence is the Grubel-Lloyd (GL) index. Countries with a similar structure of the economy have a greater level of intra-industry trade. These facts impose the following hypothesis: using the GL index of intra-industry trade and marginal intra-industry trade is possible to identify sectors in which the adjustment costs will be the smallest and the largest. This is the basis for a possible intervention of the state (Croatia) or by structural or cohesion funds of the EU with the aim of reducing the total social costs of accession to the EU. Besides, in this way, it will be possible to indirectly determine the level of real convergence Croatia to the EU.

Parallel with the process of negotiations and joining the EU lasts the greatest economic crisis since the time of Great Depression. It was initially developed in the U.S., but its full force shows in the EU, particularly in the periphery countries. This crisis fully exposed the need for differentiating the nominal (Maastricht) and real convergence. This is particularly important from the point of joining the monetary union and satisfying the criteria of OCA.

2. THEORETICAL BACKGROUND

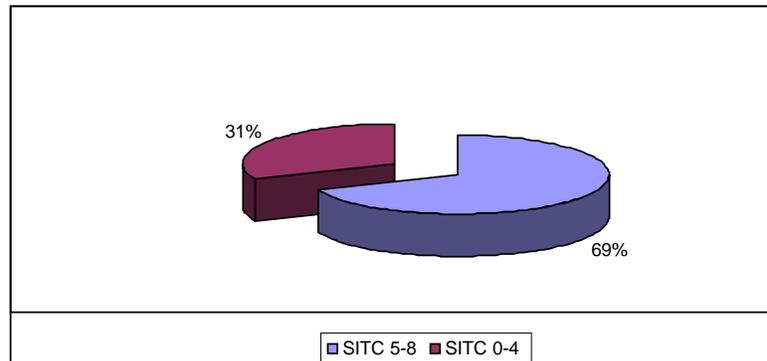
Traditional theories of international trade such as the Ricardian and Heckscher-Ohlin theory are relatively successful in finding the impulse for inter-industry trade. They find reason for it in differences in the relative abundance of production factors. In addition, they are based on the assumption of constant returns of scale and perfect competition. Formation of economic integration in Europe was followed by reflection on the need for specialization of each country in different sectors where they have pronounced factor advantages.

Contrary to the thinking of the creators of modern economic integration, about the increasing specialization of the Member States, statistical data showed a different trend. This is noted in the Benelux countries (Verdoorn, 1960), and in six founder states EEC (Dreze (1961)). The form of trade with similar products is called intra-industry trade. Existence of intra-industry trade (IIT) is contrary to classical theory of international trade. The classical theory does not provide an answer to why there is this type of trade. However, intra-industry trade starts from the premise that even in the absence of comparative advantage, economies of scale becomes impulse for specialization within the industry and allows the existence of intra-industry trade.

Studies of intra-industry trade have its origins in Verdoorn (1960) and Balassa (1960) research, in which they analyzed the existence of this type of trade among European countries. Grubel and Lloyd (1975) conducted empirical studies on the importance of this form of trade and lay the foundation for the measurement of intra-industry trade. The development of the theory of intra-industry trade is induced during the 1980s and later under the new trade theory, which is based on imperfect (monopolistic) competition.

The research was continued by Greenaway and Milner (1986) and Greenaway and Hine (1991). Their research, as well as research by the OECD (1994) confirmed the increase in the share of intra-industry trade between developed countries.

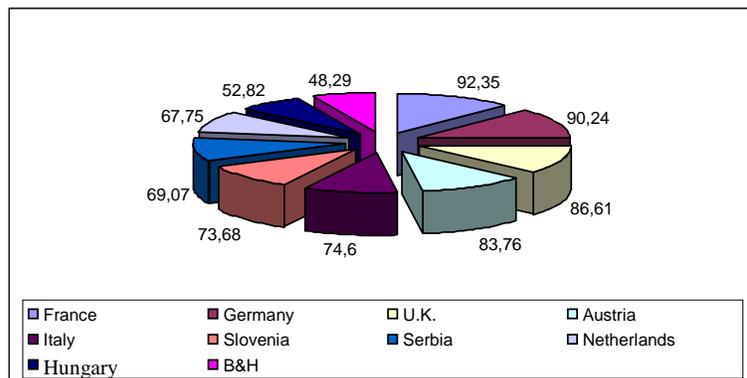
Figure 1 Share in total trade with selected countries, according to SITC sections for the period from 2002 to 2012



Source: Production by the internal data of CBS

According to data from Figure 1 it is evident that intra-industry trade for SITC 5-8 prevails in total trade with selected countries, with 69%, while the rest of the trade, with 31%, belongs to SITC sections 0-4. A more detailed elaboration of intra-industry trade for SITC 5-8 is showed in Figure 2.

Figure 2 Trade shares of Croatia with selected countries in SITC sections 5-8



Source: Production by the internal data of CSO

Figure 2 presents a more detailed elaboration of trade with selected countries by SITC sections 5-8. For example, the highest incidence of trade with SITC sections 5-8 products is between Croatia and France (92.35%), followed by Germany (with 90.24%) and the United

Kingdom (with 86.61%). Almost in all trade with selected countries, the share of trade with SITC sections 5-8 occupy more than 50% of the total trade. The only exception is Bosnia and Herzegovina with which Croatia achieves 51.71% of the exchange for the sections SITC 0-4.

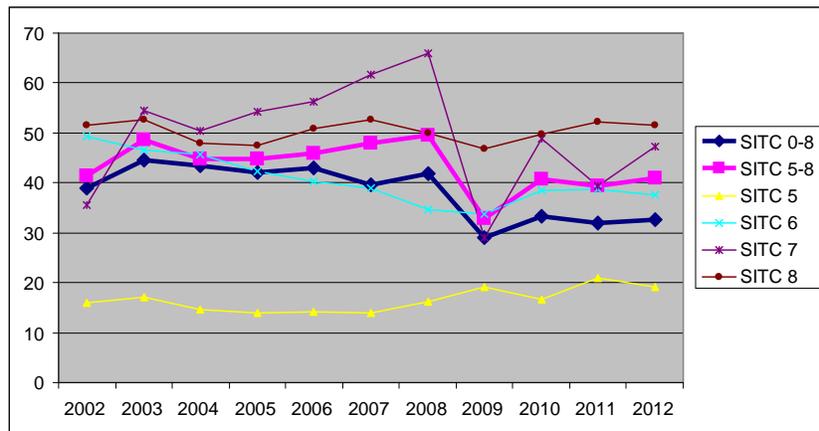
3. ANALYSIS OF INTRA-INDUSTRY TRADE OF CROATIA WITH SELECTED COUNTRIES

In the next subchapters there is detailed analysis of intra-industry trade of Croatia with selected trade partners.

3.1. Intra-industry trade of Croatia and Italy

Italy is the most important Croatian trade partner with a share in total trade of 29.21%. Figure 3 shows intra-industry trade by SITC sections.

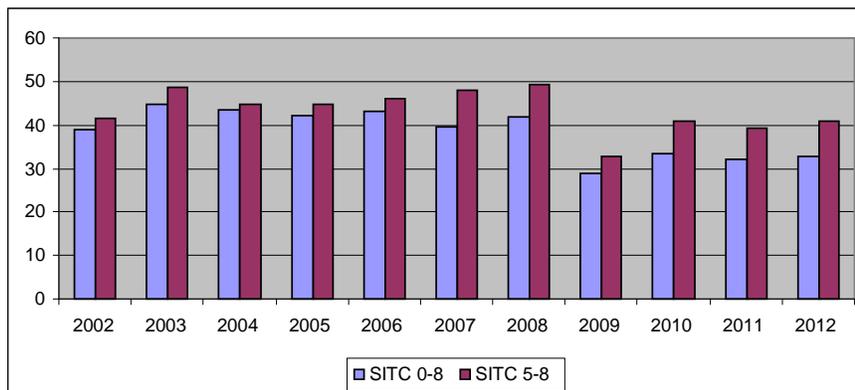
Figure 3 Intra-industry trade between Croatia and Italy from 2002 to 2012 year by SITC sections



Source: Production by the internal data of CSO

According to data from the Figure 4 the highest value of intra-industry trade was reached in 2003, when the value of the GL index was 44.64% for sections 0-8 and in 2008 for a section of 5-8 with values of GL index 49.41%. In contrast, a sudden drop of intra-industry trade was recorded in 2009 when the value is 29% for sections 0-8 and 32.86% for a section of 5-8. Detailed movement of Croatian and Italy intra-industry trade for sections 0-8 and 5-8 are showed in Figure 4.

Figure 4 Intra-industry trade between Croatia and Italy in the period from 2002 to 2012 for SITC section 0-8 and SITC 0-5



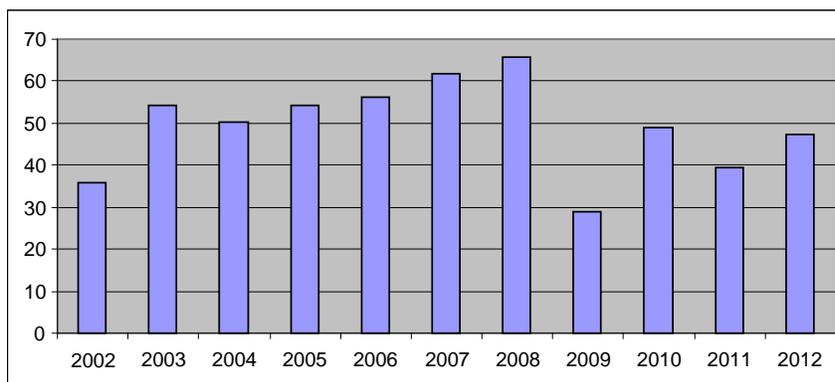
Source: Production by the internal data of CSO

Figure 4 shows Croatian and Italian intra-industry trade in the period from 2002 to 2012. Intra-industry trade in sections 5-8 trade in 2008 amounted to 49.41%. The biggest drop was recorded in 2009 and it was also the lowest level recorded in trade for sections 0-8 and 0-5 in the period from 2002 to 2012. Intra-industry trade in the sections 5-8 participated with 74.60% of total trade for sections 0-8.

The largest share of intra-industry trade occupies section SITC 7 with 27.72%, followed by the petroleum products with 6.35% (SITC 3) and natural gas with 5.92% (SITC 3). Trade trend from 2002 to 2012 for the sections 7 is showed in Figure 5.

Figure 5 shows different trends throughout the years: the highest recorded level of trade in this section (65.86%) was in 2008, followed by a sudden drop of 56% (to less than 30%); generally, there is positive trend from 2002 to 2012 (growth by 32%). The largest share of the trade in section 7 accounted for ships and boats (SITC group 793, 11.78%). Other most common products of this section are equipment for heating and cooling (1.42%), and other machinery and equipment specialized for particular industries (1.15%).

Figure 5 Representation of SITC 7 in intra-industry trade between Croatia and Italy in the period from 2002 to 2012



Source: Production by the internal data of CSO

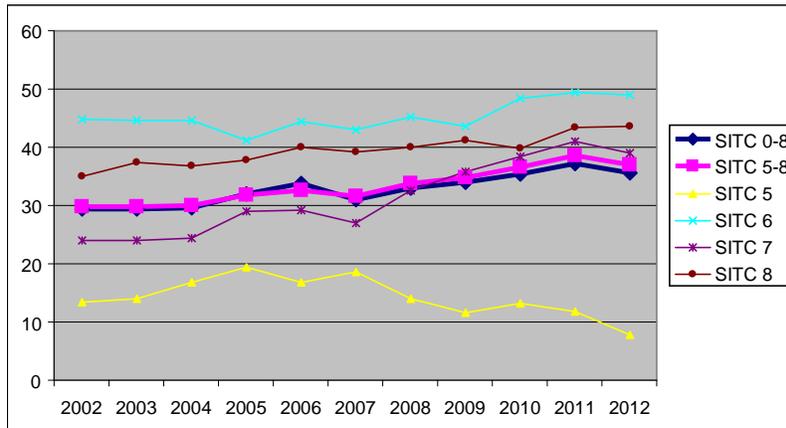
Other sections have the following values: section 5 with 9.08%, where the hydrocarbons are the most common products in the trade (1.49%), section 6 with 20.68% which is the most trade aluminum (2%) and section 8 with 17.10% of which 3.62% belong to parts for clothing textiles.

3.2. Intra-industry trade between Croatia and Germany

Germany is traditionally one of the most important trade partners of Croatia and is ranked second after Italy. Trade with Germany amounted to 21.43% of the total Croatian trade. Figure 6 shows intra-industry trade between Croatia and German.

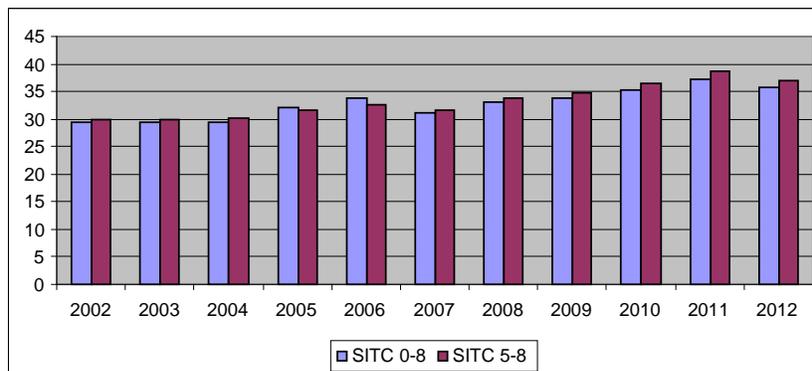
According to Figure 6 trade between Croatia and Germany is characterized by a high proportion of trade in sections 5-8 since there is almost identical value of GL index for sections 5-8 and sections 0-8, while very low trade share in sections SITC 0-4 is recorded. The exchange is fully inter-industry because the value of the GL index is less than 50 for the entire period. Further, Figure 7 shows detailed analysis of trends intra-industry trade section for sections 0-8 and sections 0-5.

Figure 6 Intra-industry trade between Croatia and Germany from 2002 to 2012 by SITC sections



Source: Production by the internal data of CSO

Figure 7 Intra-industry trade between Croatia and Germany in the period from 2002 to 2012 for SITC 0-8 and SITC 0-5

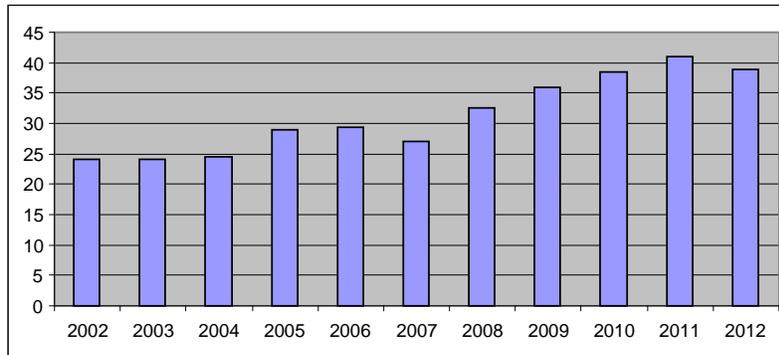


Source: Production by the internal data of CSO

According to Figure 7 it is evident that trade with products in sections 5-8 records constant increase when comparing 2012 with 2002 and trade for SITC 5-8 increased by 23%. Intra-industry trade sections 5-8 accounted for 90.23% total trade of sections 0-8. The section 7 with 41.84% of the exchange makes the largest share of inter-industry trade, while cars and

other motor vehicles occupy the largest share in total trade with 8.15%. Trade trend in the section 7 from 2002 to 2012 is showed in Figure 8.

Figure 8 Representation of intra-industry trade in SITC section 7 products between the Croatia and Germany in the period from 2002 to 2012



Source: Production by the internal data of CSO

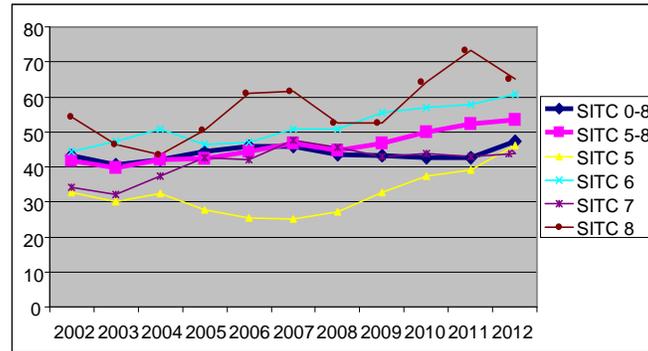
According to data in Figure 8 there is an increase in trade in the 2012 compared to 2002 for about 60%. The largest share in trade have cars (8.16%), other motor vehicles (3.26%), miscellaneous machinery (2%), electrical appliances (1.79%), telecommunications equipment (1.55%), ships and boats (1.40%) and non-electrical machinery and tools.

Representation of other sections has the following values: section 5 with 12.29%, where the trade in medicinal and pharmaceutical products made 2.35% of trade and are most frequent products in exchange; section 6 with 18.90%, where the most common products are of base metal (2.05%); and section 8 with 17.20% (products for furniture-beds, mattresses, i.e. division 82).

3.3. Intra-industry trade between Croatia and Slovenia

Slovenia, with the share of 11.43% in total trade is the third most important trading Croatian partner. Figure 9 shows intra-industry trade between Croatia and Slovenia.

Figure 9 Intra-industry trade between Croatia and Slovenia from 2002 to 2012 by SITC sections



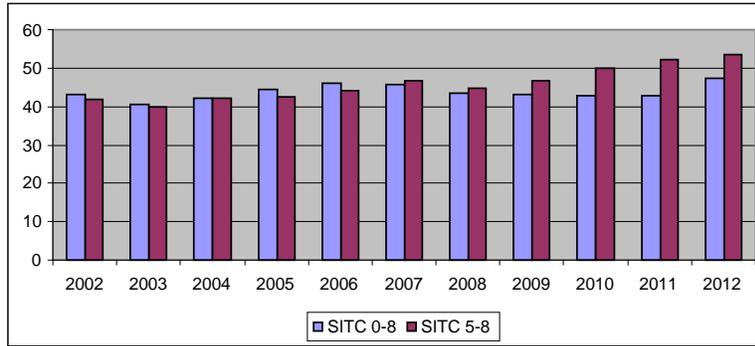
Source: Production by the internal data of CSO

The highest value of intra-industry trade was reached in the 2012, when for the sections 0-8 GL index value was 47.43%, while for the sections 5-8 was 53.36%. In contrast, the lowest values of GL index reached were reached in the 2003 when the Index of sections 0-8 was 40.49%, while in the sections 5-8 was 39.8%. Trade trends in sections 0-8 and 5-8 are detailed analyzed in the Figure 10.

The figure 10 shows that trade between Croatia and Slovenia for sections 5-8 records constant slight increase and when comparing 2012 with 2002, there is an increase by about 28%. Intra-industry trade in sections 5-8 presents 73.68% of total trade for sections 0-8.

The largest share of intra-industry trade is in a section 6 with 25.78% and electricity with 5.64% (SITC 3) occupies the largest share in total trade. Other most common products in trade are medications with 4.26%, furniture products with 4.08%, and parts for a specific section of motor vehicles with 3.53%.

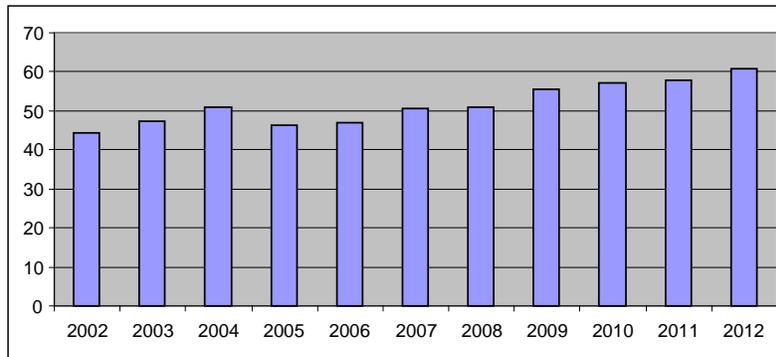
Figure 10 Intra-industry trade between Croatia and Slovenia in the period from 2002 to 2012 for SITC sections 0-8 and 0-5



Source: Production by the internal data of CSO

Trade trends from 2002 to 2012 for SITC 6 are showed in Figure 11.

Figure 11 Intra-industry trade in SITC 6 section between the Croatia and Slovenia in the period from 2002 to 2012



Source: Production by the internal data of CSO

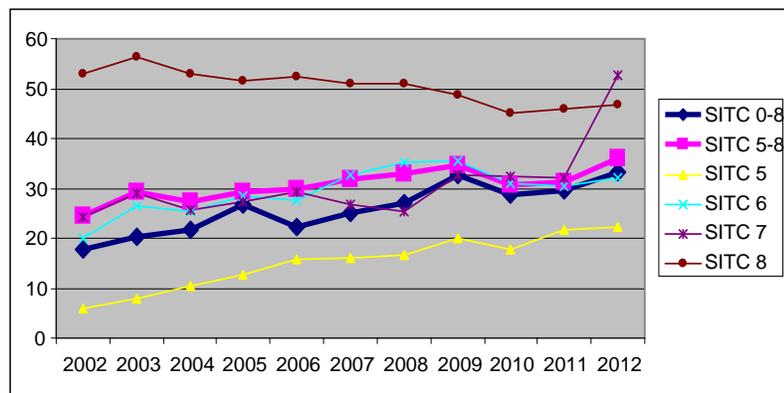
Figure 11 shows positive trend in the period from 2002 to 2012. There is a constant growth throughout that period, except in 2005. The trade level in the 2012 in relation to 2002 increased by about 37%. The largest share of the trade in section makes trade with base metals (2.64%) and remaining most common traded products are cardboard and paper (2.37%).

Other section have the following values: section 5 with 15.58% and the most common are medications (4.26%), section 7 with 18.82% where the most common trade includes some parts for motor vehicles (3.53%) and section 8 with 13.47% of which (4.08%) goes on products for furniture.

3.4. Intra-industry trade between Croatia and Bosnia and Herzegovina

Bosnia and Herzegovina is very important for Croatia's foreign trade. Croatia in trade with Bosnia and Herzegovina achieves a constant surplus and in total trade participates with a share of 10.42%. Figure 12 shows intra-industry trade between Croatia and Bosnia and Herzegovina to the SITC sections.

Figure 12 Intra-industry trade between Croatia and Bosnia and Herzegovina in period from 2002 to 2012 by SITC sections

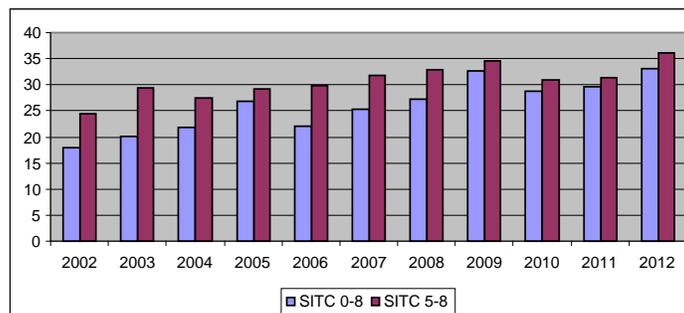


Source: Production by the internal data of CSO

In the period from 2002 to 2012 growth of GL index is recorded for sections 0-8 and 5-8, and the highest values are recorded in 2012. GL index value for sections 0-8 is 33.18%, while for the section 5-8 is 36.04. Tendency of sections 0-8 and 5-8 are analyzed in detail by Figure 13.

Figure 13 shows different movement trends in total trade sections 0-8 while for the sections 5-8 is recorded an upward trend with slight fluctuations. There was a trade increase in sections 5-8 in 2012 when compared to 2002 by about 47%. In the 2010 trade has decreased, but in the 2011 is moving again with an upward trend. Intra-industry trade in sections 5-8 participate with 48.29% of total trade for sections 0-8.

Figure 13 Intra-industry trade between Croatia and Bosnia and Herzegovina in the period from 2002 to 2012 for SITC sections 0-8 and 0-5



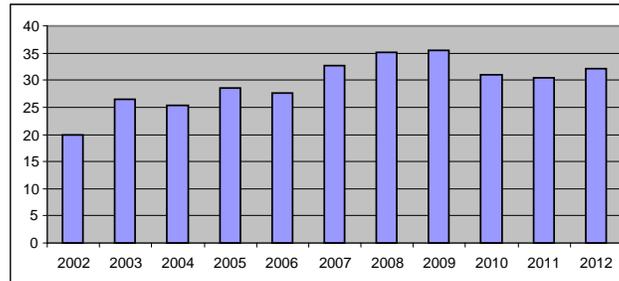
Source: Production by the internal data of CSO

The largest share in total intra-industry trade (sections 0-8) takes trade of products in SITC 3 with 25.20%, while in the sections 5-8, the largest share accounts for the trade in section 6 with 24.07%. If section-by-section trade is analyzed then petroleum products trade (petroleum oils) with 19.86% (section 3) occupies the largest share in total trade, followed by the trade of aluminium products (section 6, 6.11%), electricity (section 3, 3.14%) and manufactured tobacco (section 2, 3.07%). Trade trends from 2002 to 2012 for section 6 are showed in Figure 14.

Figure 14 shows great oscillations in trade between Croatia and Bosnia & Herzegovina in the period from 2002 to 2012. The trade in section 6 peaked (35.43%) in 2009, followed by decline and in 2012 was again recorded a slight increase in the trade. When comparing 2012 and 2002 the trade increased by about 61%.

The largest share in the trade in section 6 goes to aluminium (6.11%). Among other most represented products is calx, cement and other building materials produced (2.81%), iron and steel bars (1.97%) and building material made of clay (1.73%).

Figure 14 Intra-industry trade in SITC 6 section between the Croatia and Bosnia-Herzegovina in the period from 2002 to 2012



Source: Production by the internal data of CSO

Other sections have following values: section 5 with 8.34% and where the most common products are various fertilizers (1.47%), section 7 with 8.24% where is the most traded equipment goes for the distribution of electricity (1.02%) and section 8 with 7.62%, where the most prevalent trade products for furniture (2.02%).

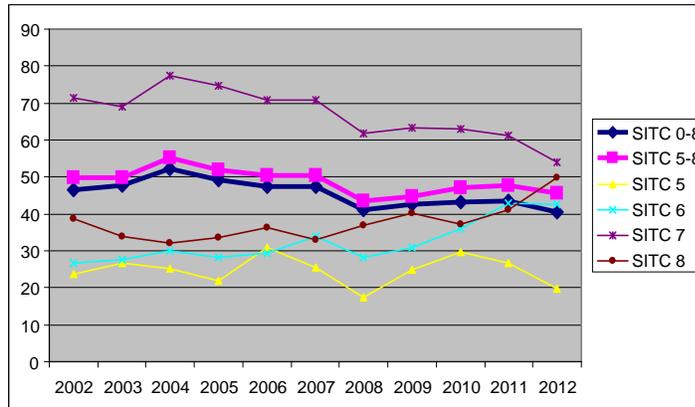
3.5. Intra-industry trade between Croatia and Austria

Austria is the fifth most important trading partner of Croatia. Share in total trade with Austria amounts to 9.5%. Figure 15 shows intra-industry trade between Croatia and Austria.

The highest value of intra-industry trade in the observed period was reached in 2004 when the GL index value was 42.09% for the sections 0-8, while the GL index value for the sections 5-8 was 55.24%. In contrast, the lowest values of GL index were reached in 2008.

The highest value of inter-industry trade is recorded in 2004 when the sections 0-8 GL index value was 42.09%, while the section of 5-8 was 55.24%. In contrast, the lowest value of the GL index was reached in 2008 when the GL index for the SITC sections 0-8 was 41.2%, while for the section 5-8 was 43.5%.

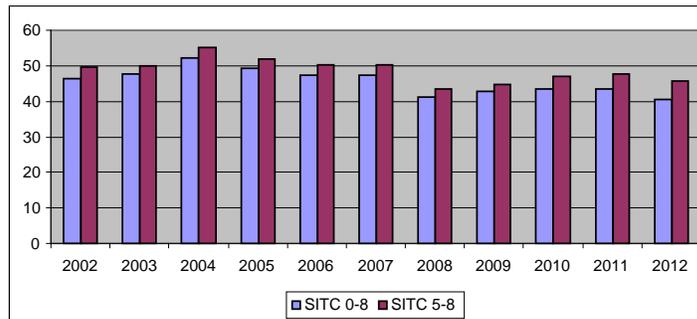
Figure 15 Intra-industry trade between Croatia and Austria from 2002 to 2012 by SITC sections



Source: Production by the internal data of CSO

Trade tendencies of the SITC sections 0-8 and 5-8 are analyzed in detail in Figure 16.

Figure 16 Intra-industry trade between Croatia and Austria in the period from 2002 to 2012 for the SITC 0-8 and SITC 0-5

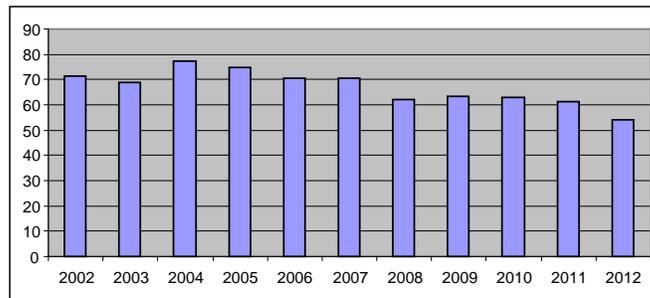


Source: Production by the internal data of CSO

From Figure 16 it is evident that the trade of the SITC 5-8 records constant drop from 2002 to 2012, with the exception of growth in 2004 when it recorded the highest value of trade with 55.24%. When comparing 2012 to 2002, there is an intra-industry trade decrease by approximately 9%. Intra-industry trade of SITC sections 5-8 accounted for 83.76% of total trade for SITC 0-8. The largest share of intra-industry trade goes to section 7 with 39.04%,

and electrical machinery and apparatus are the most common traded products with 8.74% of total trade. Trade trend in period from 2002 to 2012 for the SITC 7 section is recorded in Figure 17.

Figure 17 Intra-industry trade in SITC 7 section between the Croatia and Austria in the period from 2002 to 2012



Source: Production by the internal data of CSO

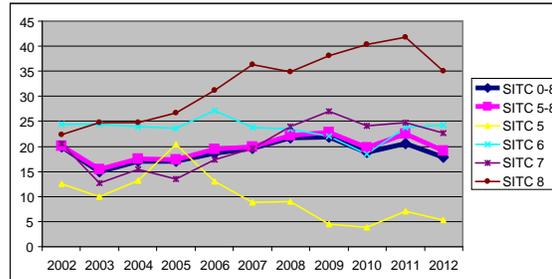
Although most of the trade between Croatia and Austria is recorded in section 7, according to data from Figure 17 there is a drop in the trade in 2012 compared to 2002 for about 32%. The largest share of trade in this section includes electrical machinery and apparatus (8.74%), electrical apparatus for switching and circuit protection (7.10%) and thermionic, cold and photo-cathode valves (4.62%).

Other sections have the following values: section 5 with 9.78%, where the most common products in the trade are medical and pharmaceutical products (1.61%), section 6 with 23.16% where the most abundant is trade in metal construction (1.80%) and section 8 with 11.77% with the shoes as the most frequent traded product (2.94%).

3.6. Intra-industry trade between Croatia and France

France is sixth most important trading partner with the Croatia, with the share of 5.27% of total trade. Figure 18 shows intra-industry trade between Croatia and France.

Figure 18 Intra-industry trade between Croatia and France in period from 2002 to 2012 by SITC sections

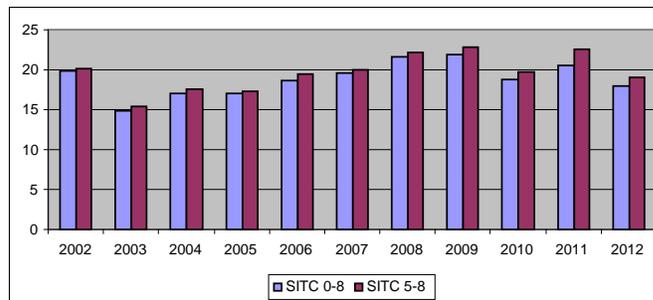


Source: Production by the internal data of CSO

In 2012, GL index values for sections 0-8 and 5-8 assumed lower values than those from 2002. In 2003, GL index values was lowest in sections 0-8 with the index value being 14.9%, while for the sections 5-8 it was 15.36%. In contrast, the highest values of intra-industry trade in the researched period were reached in 2009 when, for the sections 0-8, GL index value was 21.89% while for the sections 5-8 was 22.88%. Developments of intra-industry trade in the sections 0-8 and 5-8 are shown in Figure 19.

Figure 19 shows different trends in trade between Croatia and France. It is evident that trade decreased in 2012 compared to 2002, and the value of SITC 5-8 is about 6%. Intra-industry trade in sections 5-8 is accounted for 92.35% of total trade in sections 0-8.

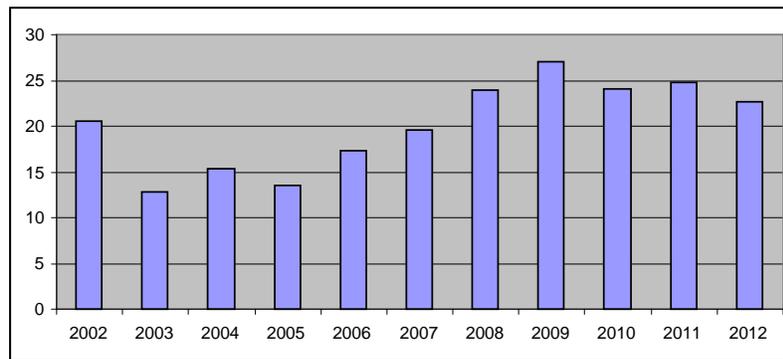
Figure 19 Intra-industry trade between Croatia and France in the period from 2002 to 2012 for SITC 0-8 and 0-5



Source: Production by the internal data of CSO

The largest share of intra-industry trade takes section 7 with 53.62%, and ships and boats with 6% occupy the largest share of total trade. Figure 20 presents trade trends from 2002 to 2012 for section 7.

Figure 20 Representation of intra-industry trade in SITC section 7 between the Croatia and France



Source: Production by the internal data of CSO

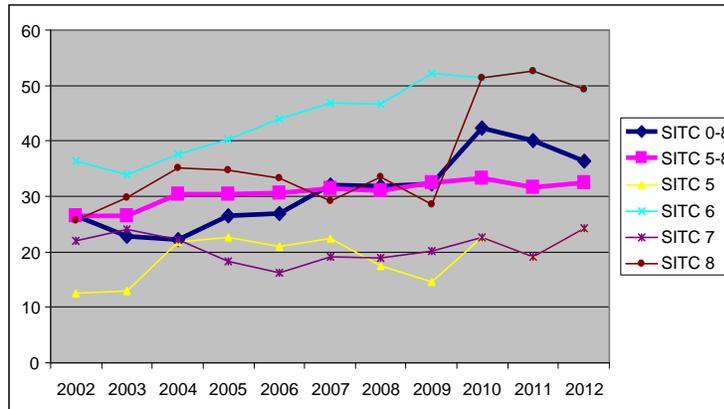
Figure 20 shows oscillations through the researched period. The only constant growth was recorded from 2005 to 2009. The overall growth in intra-industry trade was only 10% in the selected period. In 2012, ship and boats trade (section 7) accounted for 6% and was followed by motor vehicle trade (4.03%).

Other sections recorded the following values: section 5 with 16.20% where the drugs were the most common traded products (3.93%), section 6 with 12.32%, where the most traded were pneumatic tires (1.37%) and section 8 with 10.19% with furniture as the most frequent product (2.89%).

3.7. Intra-industry trade between Croatia and Hungary

In the overall trade of Croatia, Hungary participates with 4.45%. Figure 21 shows intra-industry trade between Croatia and Hungary.

Figure 21 Intra-industry trade between Croatia and Hungary in the period from 2002 to 2012 by SITC sections

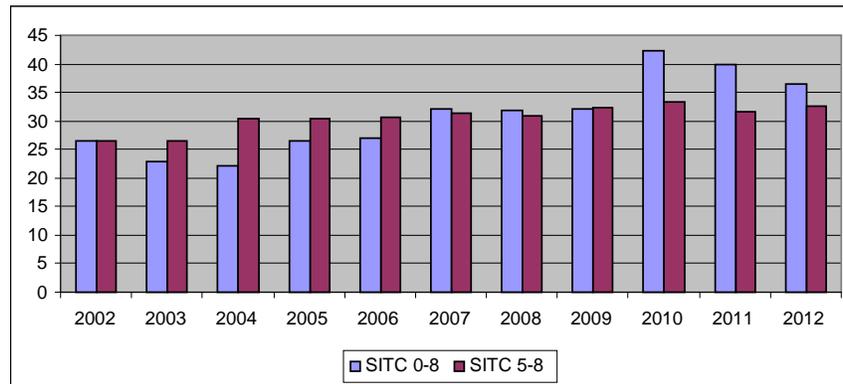


Source: Production by the internal data of CSO

The highest values of intra-industry trade in the selected period were recorded in 2010. For sections 0-8 when the GL index was 42.37%, while for the sections 5-8 index was 33.32%. In contrast, the lowest levels of GL index for the section 0-8 were recorded in 2004 (22.13%). Section 5-8 had the lowest level of the index in 2002 (26.55%) and since then records slight but constant increase. Trade trends in sections 0-8 and 5-8 are analyzed in Figure 22.

According to the Figure 22 there is a slight increase in trade between Croatia and Hungary in sections 0-8. Trade of sections 5-8 also recorded constant increase, although lower than in sections 0-8. Intra-industry trade reached its maximum in sections 5-8 in 2010 with the 33.32%. Intra-industry trade in sections 5-8 section accounted for 52.82% of total trade in sections 0-8 but despite this, the most common section in the trade was section 3 with 23.58%.

Figure 22 Intra-industry trade between Croatia and Hungary in the period from 2002 to 2012 for SITC sections 0-8 and 0-5



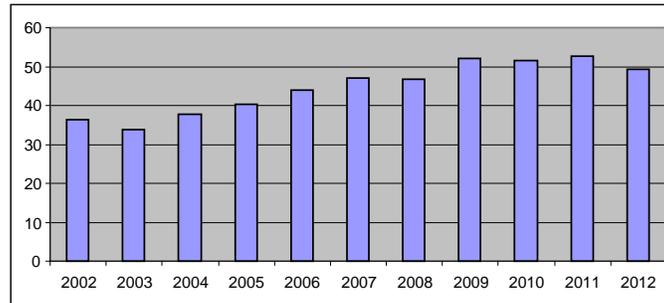
Source: Production by the internal data of CSO

In the sections 5-8 the largest share of intra-industry trade takes section 6 with 21.64%, and the trade of certain section of petroleum products (petroleum oils) with 17.19% (section 3) occupies the largest share in total trade. The second most common traded products are sugar, molasses and honey (4.87% SITC 0). Tendency of trade in the period from 2002 to 2012 for SITC 6 is showed in Figure 23.

In Figure 23 is visible almost constant increase of trade between the Croatia and Hungary for SITC 6, and its highest value trade was reached in 2011 with a share of 52.64%, followed by a slow decline. In 2012 the trade level in regard to 2002 increased by about 35%. The largest share of the trade section 6 made products of paper and paperboard (3.75%).

Other sections have following values: section with 11.09%, where the most common products are plates, sheets, film foil, etc. (1.12%), section 7 with 15.03% where the most trade devices were telecommunications and recording (1.47%) and section 8 with 5.06% of which plastic products occupy 1.47%.

Figure 23 Representation of SITC 6 in intra-industry trade between the Croatia and Hungary in the period from 2002 to 2012



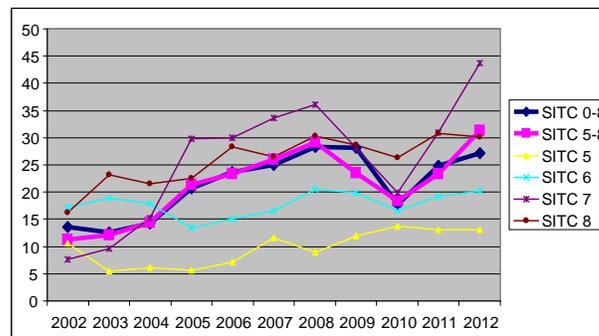
Source: Production by the internal data of CSO

3.8. Intra-industry trade between Croatia and United Kingdom

United Kingdom participates in the overall trade of Croatian with 2.89%. Figure 24 shows intra-industry trade by SITC sections.

Figure 24 indicates a substantial growth of intra-industry trade. The lowest level of GL index was in 2002 where GL index of the SITC section 0-8 was 13.53%, while in the sections 5-8 was 11.27%. The highest value in the considered period was reached in 2008 for the SITC sections 0-8 when the value of the GL index was 28.34%, while the section of 5-8 achieved the highest index value in 2012 (31,31%).

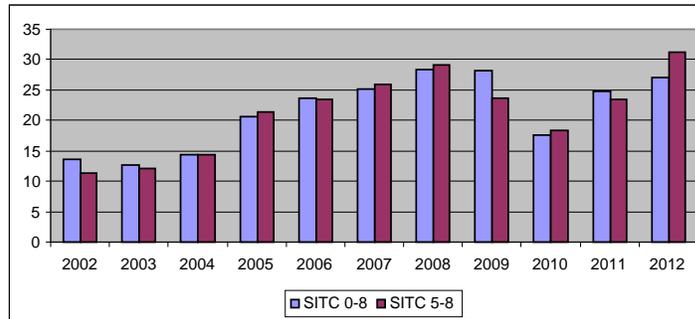
Figure 24 Intra-industry trade between Croatia and United Kingdom in the period from 2002 to 2012 by SITC sections



Source: Production by the internal data of CSO

Tendency of the SITC sections 0-8 and 5-8 were analyzed in Figure 25

Figure 25 Intra-industry trade between Croatia and United Kingdom in the period from 2002 to 2012 for SITC 0-8 and SITC 0-5

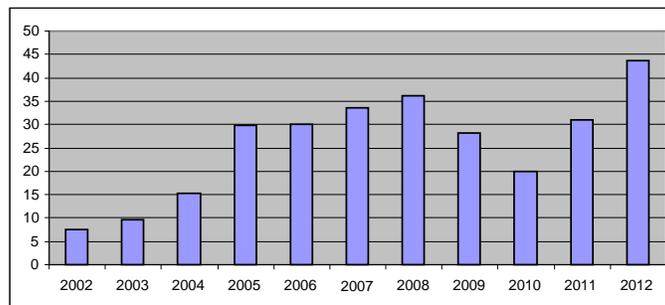


Source: Production by the internal data of CSO

According to the figure 25 it is visible an increase in trade between Croatia and United Kingdom, in the period for 2002 to 2012.

In 2012 the trade in sections 0-8 was increased by nearly 100%, while the trade for section 5-8 even increased by about 177% compared to 2002. Intra-industry in sections 5-8 section participates was 86.61% of total trade SITC 0-8. The largest by sections share of intra-industry trade was section 7 with 44.71%, and ships and boats took 11% of total trade. Trade tendencies in period from 2002 to 2012 for SITC 7 are showed in Figure 26

Figure 26 Presentation of the SITC 7 section in intra-industry trade between Croatia and United Kingdom in the period from 2002 to 2012



Source: Production by the internal data of CSO

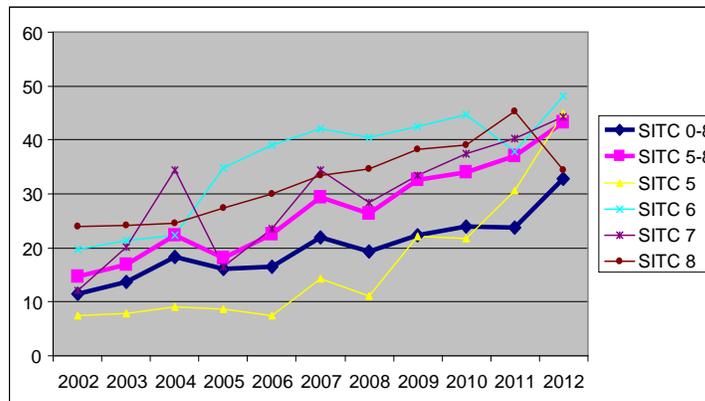
Figure 26 shows different movement trends in 2009 and 2010 in which there was a decrease in the trade. However 2011 and 2012 shows a significant increase in the trade. When comparing 2012 with 2002 there is an increase in intra-industry trade by almost 600%. Largest share of the trade in section 7 was in ships and boats (11%). Among the other most represented traded products are cars and other motor vehicles intended for the transport of persons (7.57%), construction equipment (4.09%), equipment for the distribution of electricity (3.52%) and automatic data processing machines (section , 17%). It is also significant trade for certain sections of petroleum products with a share of 5.60% (section 3).

Other sections have the following values: section 5 with 20.41% where medications are the most common products in the trade (9.78%), section 6 (10.64%), where the most common trade is aluminium (1.85%) and section 8 (10.84%) with products for furniture (2.72%).

3.9. Intra-industry trade between Croatia and Netherlands

Netherlands participate with 2.73% in the overall trade of Croatia. Figure 27 shows intra-industry trade between Croatia and Netherlands.

Figure 27 Intra-industry trade of Croatia and Netherlands in the period from 2002 to 2012 by SITC sections



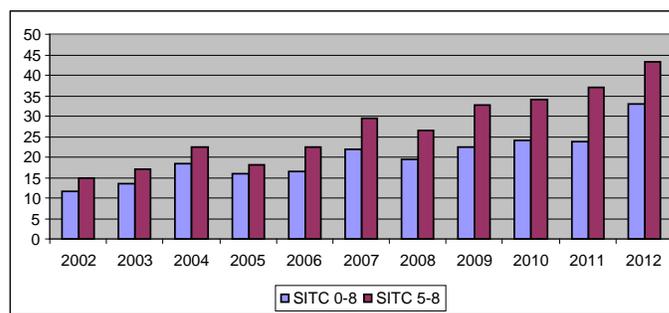
Source: Production by the internal data of CSO

According to the figure 27 it is visible substantial growth of intra-industry trade. The lowest level of GL index was in 2002 when the GL index for sections 0-8 was 11.57%, while in the sections 5-8 was 14.77%. From 2002 until 2012 there has been a constant increase in intra-industry trade and the highest values were realized in 2012. For sections 0-8 GL index

value was 32.87%, while for the section 5-8 index was 43.31%. Trade tendencies of the sections 0-8 and 5-8 are analyzed in Figure 28.

Figure 28 shows constant growth of intra-industry trade. It tripled, when we compare 2012 to 2002. Intra-industry trade in sections 5-8 participated with 67.75% of total trade in sections 0-8.

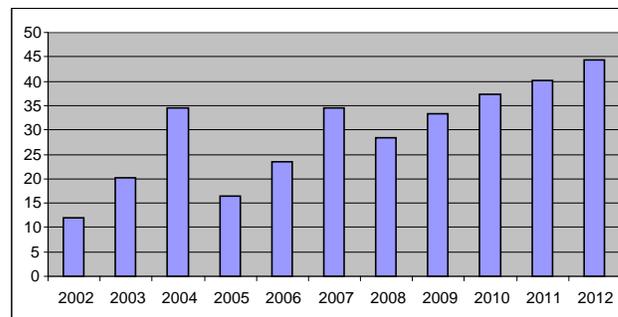
Figure 28 Intra-industry trade between Croatia and Netherlands in the period from 2002 to 2012 for SITC 0-8 and SITC 0-5



Source: Production by the internal data of CSO

With the largest share of intra-industry trade makes section 7 with 24.40%, from which 7.64% is trade in medications and which occupy the largest share of total trade. Trade tendencies in the researched period in section 7 are showed in Figure 29.

Figure 29 Intra-industry trade in SITC section 7 between Croatia and Netherlands in the period from 2002 to 2012



Source: Production by the internal data of CSO

Figure 29 presents different trends of movement through the years, and since 2008 is recorded constant trade growth. When comparing levels of intra-industry trade between

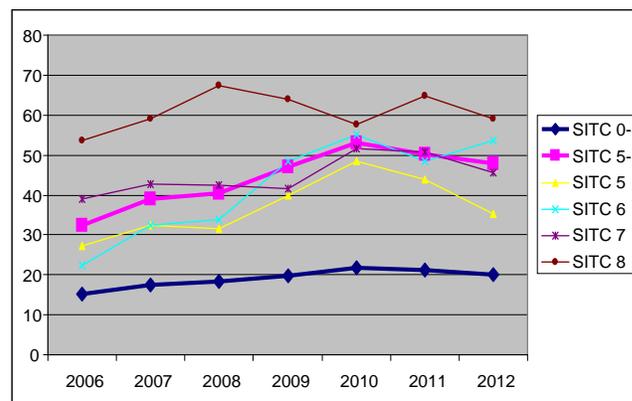
2012 and 2002, there is an increase by about 193%. The largest shares in the trade of section 7 occupy ships and boats (3.72%).

Other sections have the following values: section 5 with 21.61% where medications are the most common traded products (7.64%), section 6 with 11.24% where the major trade is in base metal products (1.89%) and section 8 (10.48%) with footwear (1.74%).

3.10. Intra-industry trade between Croatia and Serbia

Serbia participates with 2.64% in the overall Croatian trade. Figure 30 shows intra-industry trade between Croatia and Serbia.

Figure 30 Intra-industry trade between Croatia and Serbia in the period from 2002 to 2012 by SITC sections

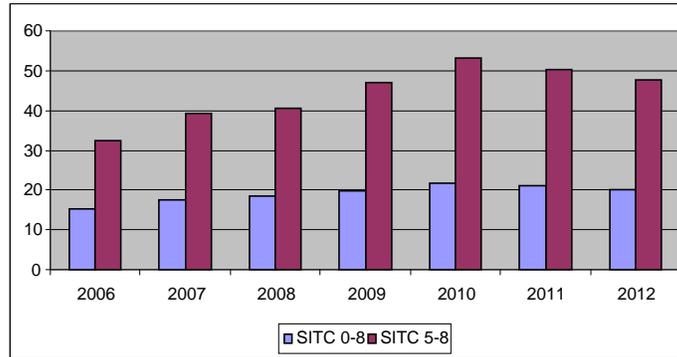


Source: Production by the internal data of CSO

In the observed period there is a slight increase in the trade in sections 0-8 with levels of GL index value varying from 15.21% to 20.13% in 2012. Sections 5-8 also recorded increase, however, the maximum value of the index was in 2010 with (21.79%), since then records a slight decline. Figure 31 shows intra-industry trade between Croatia and Serbia.

From Figure 31 it is evident that the trade with products in section 5-8 is highly represented in the total trade of SITC 0-8. Also, there was an increase in trade in 2012 when compared to 2006 by about 47%. Since 2010, the trade in sections 5-8 is in slight decline. Intra-industry trade of this section participates with 69.07% of total trade in sections 0-8.

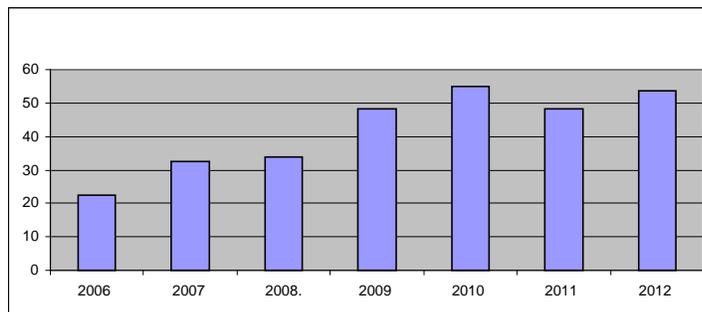
Figure 31 Intra-industry trade between Croatia and Serbia in the period from 2002 to 2012 for SITC 0-8 and 0-5



Source: Production by the internal data of CSO

The largest share of intra-industry trade takes section section 6 with 26.39%, a specific section of petroleum products occupy the largest share of 4.33% in total trade (section 3). Other most common groups of products in total trade are paper and cardboard (3.55% SITC 6), various fertilizers (3.04% section 5). Trade tendency in the period from 2002 to 2012 for section 6 is showed in Figure 32

Figure 32 in intra-industry trade for SITC section 6 between the Croatia and Serbia in the period from 2002 to 2012



Source: Production by the internal data of CSO

Figure 32 shows trade growth in the period from 2002 to 2012. When comparing 2012 and 2002 the intra-industry trade was doubled. The largest share of the trade was in section 6 were trade in paper and cardboard took 3.55%. Among the other most represented products

were glass goods (2.6%), flat-rolled products of iron (2.36%) and articles of base metal (1.62%).

Other sections have the following values: section 5 with 15.59% and the most common product is various fertilizers (3.04%), section 7 with 16.66% where the most common trade products is electrical machinery (1.85%) and section 8 (10.42%), with most prevalent trade products in furniture (2.35%).

4. CONCLUSION

Considering that Croatia is relatively less developed country when compared with EU-27 average or when comparing it to its most important trade partners (there are many indications for that, e.g. BDP/pc level), statistical analysis of intra-industry trade gives realistic picture of how far is Croatia from real convergence to at least EU average.

In short term EU accession will only cause widening of the real convergence gap because of problems with adaptation to Single market and increased competition for companies. Trends from 2006 indicate that this problem could be serious given the fact that Croatia will exit CEFTA 2006 agreement and as effect, current account balance is likely to deteriorate. That will put more pressure on macroeconomic policy holders and limit their maneuvering space. Because of the already limited/if any autonomy in monetary policy and with fiscal policy under surveillance from EU, the pressure will be on the producers and companies that are already burdened by the long lasting recession in Croatia as well as their trade partners in EU and Third countries.

In long term, positive trends in the real convergence measured by intra-industry trade can be expected, not only because economic theory predicts it, but because of past experience of the other newly accessioned EU member countries.

REFERENCES

Croatian Statistical Office, 2013, Internal Data

Balassa

Drèze, J. (1961) *Les exportations intra-C.E.E. en 1958 et la position Belge*.
Recherches Économiques de Louvain, vol. 27, pp. 717-738.

Greenaway, D. and Hine R. C., 1991. *Intra-Industry Specialization, Trade Expansion and Adjustment in the European Economic Space*, *Journal of Common Market Studies*, Wiley Blackwell, vol. 29(6), pages 603-622,

Greenaway, D. and Milner, C. (1986), *The Economics of Intra-Industry Trade*, Oxford: Basil Blackwell

Grubel, H. G. and Lloyd, P. 1975. *Intra-Industry Trade: The Theory and Measurement of International Trade in Differentiated Products*. London: MacMillan

Helpman, E. and Krugman, P. (1987), *Market Structure and Foreign Trade: Increasing Returns, Imperfect Competition, and the International Economy*. Boston: MIT Press.
OECD, *Trends in international trade*, OECD Economic Outlook, No. 56, Paris

Verdoorn, P.J. (1960) *The Intra-Block Trade of Benelux*. In: Robinson, E.A.G. (ed.) *Economic Consequences of the Size of Nations*. Macmillan, London.

PART VIII

TRADE
LIBERALIZATION
AND REGIONAL
COOPERATION

Irena Kikerkova

Ss. Cyril and Methodius University, Faculty of Economics, Skopje, Macedonia

TRADE LIBERALIZATION UNDER CEFTA 2006 – THE CHALLENGE OF ELIMINATION OF NONTRADE BARIERS

ABSTRACT

The creation of CEFTA-2006 enabled liberalization of trade in goods by elimination of tariff and nontariff barriers within the Western Balkan region. Yet, five years since the enforcement of the multilateral free trade agreement, full liberalization of trade in goods has not been implemented due to the existence of a range of various nontrade barriers. Among the first who arose awareness of this problem were the economic chambers of CEFTA-2006 member-states, who pointed out that all of them had problems with long and non-transparent administrative procedures and insufficient customs and transportation infrastructure. The lack of adequate infrastructure is considered to be the basic obstacle that hinders and interrupts the normal flow of goods. The problem of nonexistence of mutual recognition of national technical and quality standards, as well as of sanitary and phytosanitary standards and procedures is considered to be another major problem within the free trade area. Even more surprising is the fact that most economic operators from the Western Balkans are not even aware of the existence of administrative or any other nontrade barriers. Due to the long experience of doing trade within the region they have already got used to various impediments and treat them as a normal way of doing business. This article is going to analyze the up-to-date effects of the elimination of qualitative and quantitative barriers upon the volume of trade exchange of goods of the Republic of Macedonia with CEFTA-2006 trading partners. It is also going to make an overview of the results and recommendations of the realized monitoring under the OECD Framework of technical, sanitary and phytosanitary and administrative barriers to trade within the region.

Keywords: CEFTA-2006; trade liberalization, trade facilitation, nontrade barriers, OECD monitoring tool

JEL classification: F15

1. INTRODUCTION

After six years of signification of CEFTA-2006, its positive effects upon the trade exchange of goods among the Western Balkan countries are evident. However, it has manifested limitations that could not be neglected and has not enabled the exploitation of the full trading potential of the region.

The Agreement enabled elimination of tariff and non-tariff-barriers to trade, and in most of the disputes that arose after its signification, it also prevented the attempts of installing additional trade barriers. The positive impact of the Agreement by elimination of tariff and non-tariff barriers was registered especially right after its signification in the period from 2006 until 2008. The whole region registered an increased volume of trade exchange of goods. At that time the total Macedonian trade within the region almost doubled, and similar tendencies were experienced in most of CEFTA-2006 member-states.

Table 1: Trade exchange of goods of the Republic of Macedonia within CEFTA-2006 for the period 2006-2010 (in million USD)

Year	Export	Import	Total trade exchange within CEFTA
2006	787.51	400.19	1,817.70
2007	991.72	613.70	1,605.42
2008	1,408.95	761.68	2,107.63
2009	1,000.42	600.36	1,600.78
2010	1,018.32	628.11	1,646.43

Source: According to the Ministry of Economy of the Republic of Macedonia and the USAID (2008), *Report on Foreign Trade of Macedonia 2008*, Ministry of Economy of the Republic of Macedonia and the USAID, Skopje, 2008, p. 67 and www.mchamber.mk

*Note: Data for 2006 are given for comparison purposes. The implementation of the Agreement between Macedonia, on the one hand, and Albania, Kosovo, Moldova and Monte Negro, on the other, began on the 26th of July 2007; with Croatia on the 22nd of August 2007; with Serbia on the 24th of September, 2007 and with Bosnia and Herzegovina on the 22nd November 2007. Data consider the whole year period of time (Statistical Office of the Republic of Macedonia, 2008).

The beginning of the crisis put an end to the expanding growth of the trade exchange within the region. Facing serious problems in their balances of payments and increasing instability of the macroeconomic parameters, the greatest traders in the region - Croatia and Serbia – tried to find a way to impose various restrictions and additional barriers to the import of goods, which affected CEFTA-2006 trading partners as well. The rest of the member-states having significantly smaller economic capacity did not have such a strong negative impact upon the total decrement of CEFTA-2006 trade exchange of goods. In the case of Macedonia, the crises restricted the participation of CEFTA-2006 trade exchange of goods to only 20% of the total Macedonian trade exchange by the end of 2009, which especially affected exports from Macedonia to the region, as it decreased by 37.2% in comparison with the export realized in 2008 (www.statistics.gov.mk). Data presented in Table 2 show that in 2010 the situation slightly improved and there was slight recovery of trade flows of goods among member-states. The situation was stable during 2010 and 2011, and the Macedonian surplus amounted about 430 million American dollars. In 2011 the total trade exchange of goods of Macedonia with CEFTA-2006 trading partners reached 2,028 million American dollars and the country realized increment of the trade exchange of goods with all CEFTA member-states, with exception of Moldova. Total Macedonian export to CEFTA countries amounted 1,229.31 million, while total import from the region amounted 799.29 million USD. The total increment of the Macedonian export within the region reached about 28% of the export realized in 2010 (www.mchamber.mk).

Table 2: Trade exchange of goods of the Republic of Macedonia with CEFTA-2006 member - states in million USD *

Year	Serbia		Croatia		B&H		Albania		Moldova		Montenegro	
	X	M	X	M	X	M	X	M	X	M	X	M
2001	266.94	189.41	58.49	46.49	6.04*	8.46*	9.77*	0.56*	-	-	-	-
2002	245.21	189.41	59.08	55.36	19.20	14.30	13.86	1.13	-	-	-	-
2003	273.80	215.73	66.10	63.67	20.83	11.75	15.34	3.93	-	-	-	-
2004	347.60	243.72	80.16	65.78	33.22	16.31	23.59	6.35	0.04*	0.32*	-	-
2005	459.54	264.20	81.05	75.23	50.46	23.58	27.52	9.07	0.06	0.27	-	-
2006	557.85	282.85	124.23	78.96	64.70	26.53	40.56	11.72	0.17	0.13	-	-
2007 ¹	639.42	448.40	163.87	109.74	88.02	34.52	72.69	19.52	0.04	0.18	27.69	1.34
2008	934.72	532.02	228.96	137.71	104.84	52.60	106.77	35.66	0.03	3.36	38.57	1.21
2009	337.59	397.05	152.72	118.34	86.64	46.53	83.95	24.10	0.09	2.93	24.88	1.18
2010	271.82	418.39	123.62	113.28	84.94	49.12	72.38	22.89	0.35	0.92	27.43	1.43
2012	295.27	481.82	98.49	120.78	84.54	70.99	75.64	35.03	0.55	0.73	31.38	2.75

Source: The Ministry of Economy of the Republic of Macedonia and the USAID, (2008): Report on Foreign Trade of Macedonia 2008, the Ministry of Economy of the Republic of Macedonia and the USAID, Skopje, pp. 68-78 and www.statistics.gov.mk

*Note: As the free trade agreements with Bosnia and Herzegovina (B&H) and with Albania were enforced in 2002, data on 2001 are given only for comparison purposes.

**Note: Until 2008 data on trade exchange of goods of Macedonia with Serbia also comprised the trade exchange with Kosovo. The total Macedonian exports to Kosovo in 2009 amounted 314.54 million USD, and the total import from Kosovo amounted 9.65 million USD. In 2010 the realized export to Kosovo reached 437.77 million American dollars, and the import from Kosovo amounted 22.05 million USD.

¹* Free trade agreements with Bosnia and Herzegovina and Albania were enforced in 2002. Therefore, data for 2001 are given for comparison purposes only. Data for 2007 are given for comparison purposes, too.

Last year the statistical evidence showed once again a serious decrement of the total trade exchange of goods of Macedonia within CEFTA-2006 which cut down to half the trade surplus realized in the period before, as exports from the country decreased by 20.5% and at the same time imports decreased by only 7.4% in comparison with 2011.

The trade pattern within CEFTA-2006 is inter-industrial and all of the countries are trading with only two or three trading partners from the region. Actually the inter-industrial trade pattern is followed by all member-states not only in the regional trade exchange of goods, but also with other trading partners, especially with those from the EU (Kikerkova, 2009:167-168). This confirms the backward economic structure of the CEFTA-2006 economies which is heavily dependent on imports of raw-materials and components, but is unable to provide high level of finalization of goods. Therefore, most of the countries from the region are capable to export mostly semi-processed goods that make them uncompetitive on foreign, but also on their domestic markets, rather vulnerable and exposed to the influence of various external shocks.

This is also true in the Macedonian case. For Macedonian exporters CEFTA-2006 is especially important for the export of agricultural goods. More than half of the total Macedonian export of agricultural goods is exported to CEFTA-2006, of which almost 1/3 consists of fresh vegetables, and the rest are confectionary products and cigarettes. Over 60% of the exported agricultural products go to Serbia and Kosovo, less to 15% go to Croatia and about 11% to Bosnia and Herzegovina. At the same time Macedonia also depends on imports of agricultural products, especially wheat and vegetable and animal oils. The import of agricultural goods from CEFTA-2006 creates around 30% of total Macedonian imports and the greatest Macedonian trade partners in the region are Serbia which provides more than 2/3, and Croatia with 17.8% of the total amount of this kind of imports. Actually the significant decrement of the trade surplus with CEFTA-2006 countries is partly due to the increased import of food from the region, especially of wheat, corn and dairy products (Kikerkova, 2009:165).

The most important non-agricultural export items for Macedonian exporters within CEFTA-2006 are: mineral fuels and iron and steel which create more than 1/4 each of the total Macedonian exports to the region, followed by much smaller participation of iron and steel products, pharmaceuticals and some electrical machinery and equipment. At the same time Macedonian imports from the region are mostly steel and iron; mineral fuels; electrical machines and equipment; plastics and paper and paper board. The most important trade partners from the region both for exporting and importing of non-agricultural products are Serbia and Croatia (Kikerkova, 2009:165).

Having on mind the weak capacity of the economies in the region and their inability to keep strategic positions simultaneously on regional and on other important foreign markets (such as the EU) we still believe that the economic and trading potential within the region is used far below the optimal level. One of the important facts that we have to face is that true liberalization in trade depends not only on elimination of tariffs and various non-tariff measures and instruments, but also on elimination of various non-trade barriers that exist and function in the region.

2. THE ISSUE OF NON-TRADE BARRIERS WITHIN CEFTA-2006

Following the process of trade liberalization among CEFTA-2006 member-states, all parties agree that the Agreement provided significant trade liberalization by elimination of tariffs on all non-agricultural products and substantial tariff liberalization on agricultural goods. Countries in the region did not register the usage of quotas and similar impediments to trade as common within their national trade regimes even before signing the Agreement. During the last six years they have also not manifested any extremes in subsidizing domestic production, with a few exclusions in the case of several agricultural products. However, all these problems the member-states managed to sort out in a short period of time, and the general conclusion was that there was no actual attempt of increasing or implementing additional tariff or non-tariff barriers to trade.

Though, all involved parties express their disappointment on the fact that their trade is still more oriented towards the EU, than within the region. They found out that trade flows within CEFTA-2006 suffer from the existence of non-trade barriers (NTBs), of which some have already been evidenced, such as the non-existence of accredited national laboratories and certification bodies. Unfortunately, there is a whole range of NTBs that are hidden and difficult to recognize, though have a strong negative impact on the speed of the trade exchange flows, which creates additional costs to exporters and hinders the process of trade liberalization within the region. Last year the economic chambers of CEFTA-2006 countries stated that these barriers were very difficult to identify, as the trading companies treated them "...as a usual way of doing business within the region...", and they even did not bother to report on their existence (www.mchamber.mk). Having this fact on mind, last year CEFTA-2006 decided to introduce a system of regular identification of NTBs, helped by a monitoring tool provided by the OECD. According to the OECD methodology supporting the monitoring tool, NTBs were divided in three groups: technical barriers to trade (TBT); sanitary and phytosanitary measures (SPS) and administrative barriers to trade. For each group of NTBs were defined several indicators that should be measured and evaluated during the monitoring process, where the lowest mark in the evaluation process would be 1, and the highest 5 (OECD&CEFTA, 2012:7). The detection of NTBs was realized by following the trade flows in intermediary goods of 12 selected sectors among CEFTA member-states. The selected sectors were: food products and beverages; fabricated metal products, except machinery and equipment; other non-metal mineral products; agriculture; pulp, paper and paper products; chemicals, chemical products and man-made fiber, electrical machinery and apparatus; rubber and plastic products; wood and products of wood and cork; machinery and equipment; coal, refined petroleum products and nuclear fuels. Most of the priority sectors pointed three most frequently traded products with CEFTA-trading partners. This means that the monitoring was effectuated upon 193 products in total (OECD&CEFTA, 2012:14). In the monitoring process analyzers were supposed to register those barriers that should be eliminated on bilateral basis, on the one hand, and those that should be eliminated on regional level, on the other. At the same time one should have on mind that all these barriers also exist in the trade between each CEFTA-member and the EU. As CEFTA-members are part of the EU-integration process, they have to transpose the *acquis* and comply with EU regulation. This process should help elimination of NTBs. However,

each CEFTA-country has its own pace in getting closer to the EU, which is causing unsynchronized adoption of the acquis and creates additional impediments to trade within the region. The indicators for each group of NTBs are given in Table 3.

Table 3: NTB indicators selected for monitoring within CEFTA-2006

1.	Technical barriers to trade (TBT)
1.1.	Institutional framework for standardization and co-operation
1.2.	Transposition of European technical regulations in priority sectors
1.3.	Transposition of European standards in priority sectors
1.4.	Institutional framework for accreditation and co-operation
1.5.	Conformity assessment infrastructure and procedures
1.6.	Information and notification mechanisms
2.	Sanitary and phytosanitary measures (SPS)
2.1.	Institutional framework for SPS measures
2.2.	SPS agencies internal and external co-operation
2.3.	Framework legislation on SPS
2.4.	Transposition of European SPS measures
2.5.	Information and notification mechanisms
3.	Administrative barriers to trade
3.1.	Establishment and functioning of a national customs website
3.2.	Establishment and functioning of enquiry points
3.3.	Involvement of the trade community
3.4.	Advance rulings
3.5.	Appeal procedures
3.6.	Fees and charges
3.7.	Formalities: documents and automation
3.8.	Customs procedures and processes
3.9.	Domestic and cross-border/international agency co-ordination and co-operation

Source: OECD&CEFTA (2012): "Draft-Assessment Framework to monitor elimination on non-tariff barriers in CEFTA", *CEFTA Issues Paper No. 4*, www.investmentcompact.org & www.cefta2006.com, p. 7

Each specific set of NTB-policy indicators was analyzed separately and the basic findings of the monitoring are going to be presented in the paper.

2.1. Findings on technical barriers to trade within CEFTA -2006

The indicators that the OECD monitoring measured in the case of TBT addressed the framework of standardization and accreditation, the existence of infrastructure and conformity assessment procedures, the level of transposition of EU regulation and technical standards and information and notification procedures (see Table 3).

The evidence pointed out that almost all CEFTA-2006 member-states strived to adopt European standards and technical regulations, as they were trying to achieve compliance with EU regulation in this area. However, all of them found themselves in a different stage of transposition and compliance with established EU standards and

regulation, which created additional barriers to trade within the region. With the help of the conformity assessment systems of the countries in the region with the EU system provided through Multilateral or Bilateral Agreements of the European Cooperation for Accreditation, some of them recorded significant improvement. However, only few of them had satisfactory physical capacity and competence for conformity assessment in all 12 priority sectors that were selected for the monitoring. Also, National Standards Bodies of the CEFTA-countries showed insufficient capacity for active participation in the European standardization activities. All of the member-states did not possess systematic notification systems on new technical regulations, mandatory conformity standards and draft national standards (OECD&CEFTA, 2012:15-36).

The monitoring report on TBT within CEFTA-2006 pointed out that in this area the biggest improvement was recorded in Croatia, followed by Macedonia, Serbia and Albania, which were above the CEFTA - average. Montenegro was found to be close to the region's average, while the rest of the member-states were far below it. In order to overcome this kind of barriers to trade, the monitoring group recommended that all member-states should focus their efforts on adoption of the European standards and at the same time they should remove all conflicting national standards. It is also recommended that they should define few priority sectors important from the view point of the intra-CEFTA trade volume, and here they should be trained how to negotiate with the EU on Agreements on Conformity Assessment and Acceptance of Industrial Products. By these Agreements the TBT issue should be solved with mutual recognition on regional level (OECD&CEFTA, 2012:39).

2.2. The issue of sanitary and phytosanitary measures within CEFTA-2006

At the end of 2011 the national economic chambers on their mutual meetings clearly pointed out that the problem of mutual recognition of national quality certificates, as well as the non-existence of accredited national laboratories for certification of quality, created serious barriers to trade within the region and substantially slowed down the trade of agricultural products and food. The problem was considered to be even greater, as all of the member-states were not WTO members and they were obliged to follow WTO recommendations only by accepting and following the recommendations in the signed CEFTA-2006 Agreement. They suggested that the lack of the necessary capacity and institutions in this area could disable the full implementation of the CEFTA-2006 Agreement. Therefore, they recommended bilateral recognition of national certificates issued by national institutions, such as the *Protocol on Mutual Recognition of Certificates Issued by Accredited Bodies and Facilitation of the Bilateral Trade in Goods* between Serbia and Bosnia and Herzegovina, or signification of bilateral agreements between national ministries responsible for this area, as in the case of the signed *Agreement on Phytosanitary Cooperation* between Serbia and Macedonia (www.mchamber.mk). The economic chambers especially emphasized the meaning of the OECD monitoring tool in this area, as they all agreed that there were not only unresolved issues of mutual recognition of sanitary and phytosanitary measures, but also that there were a lot of subtle and hidden measures that created significant problems and additional impediments to free trade in the region.

Having these recommendations on mind, the OECD monitoring tool made a measurement of SBS by following up 5 criteria: the institutional framework for SPS measures; the level of internal and external co-operation of the existing SPS agencies; the framework legislation on SPS; the transposition of European SPS measures and information and notification mechanisms (see Table 3).

The monitoring confirmed the existence of SPS agencies in all CEFTA member-states. However, most of them suffered from lack of adequate equipment for field inspection, lack of trained personal, lack of financial means mostly because of state budget restrictions, and had restricted electronic communication access. It was also found out that some of the countries in the region did not have any strategic plans in the area, and some of them although had such strategies they were not updated according to the current circumstances in the region. This was found to be also true for the legislation in this area, as most of the laws that should regulate it had already been outdated. When drafting new regulations, companies and operators from national states were rarely consulted and their opinion made no difference (OECD&CEFTA, 2012:46-48).

The framework of SPS legislation was measured regarding the WTO SPS Agreement and the EU legislation. By evaluating the implementation of WTO rules, the monitoring confirmed that the region had not defined its common interest as basis for creating a unified position in negotiations within different international organizations and bodies, and delegates were present on their meetings only in order to acquire information on the novelties, but not to discuss their own regional interest. The best implementation of the existing WTO regulation was evidenced in Croatia and Macedonia, while Serbia was also slightly over the CEFTA average. All other member-states were far below the average (OECD&CEFTA, 2012:50).

When it comes to EU regulation, in this field the situation is a bit different as all member-state are making efforts to transpose and implement EU requirements. However, as their capacity for implementation differs, the transposition of EU rules and regulation differs among the countries in the region and creates additional barriers to trade.

The OECD monitoring focused on the trade in food products and beverages and agricultural products in the region, and therewith it followed 36 products affected by the existence of NTBs. The OECD report evaluated Croatia and Macedonia as leaders in the region in transposition and application of EU rules and measures for food products and beverages, but it also found out that for these products almost 42% of the national legislation was not harmonized (OECD&CEFTA, 2012:53).

In the case of SPS measures on agricultural products, the following was evidenced:

Table 4: Transposition of EU SPS measures on agricultural products

CEFTA member-states	Not transposed sector measures	Measures in state of draft	Measures in place more than 50%	Enforced sector legislation aligned with the aquis	Full implemented sector legislation
Albania	26%	5%	47.4%	10%	
B&H	32%	63%		5%	
Croatia	26%		50%	68.5%	
Macedonia	26%			21%	
Moldova				16%	
Montenegro	42%	16%	16%		5%
Serbia	32%	16%	16%	10%	
Kosovo	16%	5%			

Source: OECD&CEFTA, "The Elimination of Non-Tariff Barriers in CEFTA-2006", *CEFTA Issues Paper No.4*, www.investmentcompact.org & www.cefta2006.com, p. 54

Data on transposition of EU regulation in the field of agricultural products confirms the problem of different speed of adoption of EU rules, where Croatia is leader in the region by not achieving full adoption of EU rules for only 3 of 36 products. The second best result is again in the case of Macedonia. However, here the national rules are in full compliance with the aquis for only 9 of 36 products. All of the other countries fulfilled the transposition for only 2 from the monitored 36 products, and only Kosovo has a score of 0 (as presented in Table 4).

The information and notification mechanism functions by the establishment of enquiry and notification points. As they have limited capacity and are not always properly functioning, CEFTA-2006 used workshops and regional meetings on dissemination of more complete and up-date information. However, due to the lack of financial means the number of participants to these events was restricted (www.mchamber.mk).

Having on mind all the constraints that countries in the region have to face, the basic recommendations from the OECD monitoring are that all the member-states have to strengthen their capacities and systems on regular exchange of information on SPS issues and define SPS strategies for priority sectors and products; they should work on strengthening the cooperation among their national agencies and on the capacity to include representatives from the private companies in the process of creation of the national legislation in the area; they should enable early notification of drafting new laws by the CEFTA trade portal; and of course they should continue the process of harmonization of their national rules and regulation according to WTO and EU standards (OECD&CEFTA, 2012:57-61).

2.3. The administrative barriers to trade within CEFTA-2006

Despite of the functioning of the CEFTA Agreement for full 6 years, the administrative barriers in the region have still been considerable. National customs services of all the member-states control each shipment of goods exported from whatever member-state by taking at least three samples from each traded good. The inter-border flow of goods is many times slowed down as a result of inconsistency in understanding and implementation of national customs rules by customs officers from different member-states, which substantially increases the costs. All member-states have not signed the *Convention on Transit of Goods*, yet, and therefore, customs officers are asking for different set of documentation on each border crossing. Because of the insufficiency and sometimes non-existence of real electronic communication system, it has not been possible to establish and connect the new computerized transit system among member-states, yet (www.mchamber.mk).

The OECD monitoring tool selected nine criteria of measurement of administrative barriers within CEFTA-2006, such as: establishment and functioning of a national customs website; establishment and functioning of enquiry points; greater involvement of the trade community; advance rulings; appeal procedures; fees and charges; formalities: documents and automation; customs procedures and processes and domestic and cross-border/international agency co-ordination and co-operation (see Table 3).

The monitoring stated that all of the member-states followed the commitment under the CEFTA Agreement and the WTO rules on transparency on trade related regulations and issues. They all published on their national customs website trade-related regulations and procedures in the national language, as well as in English, although, the information in English language was rather limited. They all regularly informed on the up-date of the rates of customs duties, customs procedures and necessary information on customs valuation. However, not all of the members published information on advanced rulings, on effectuated penalties and on border agencies procedures on regular terms. With exception of Croatia, Serbia and Montenegro, the member-states did not possess only one enquiry point on trade related issues and full time telephone hot-lines have not been available in any of them, yet. Also, there is not any coordination among the established enquiry points in the region (OECD&CEFTA, 2012:64-67).

The customs policy related issues and objectives are published in national official gazettes and on the national customs websites. However, trading companies are involved in the drafting process of creation of customs laws and regulation only in Macedonia and in Serbia (OECD&CEFTA, 2012:68).

All CEFTA-2006 countries have a mechanism for advanced rulings mainly concerning classification of goods under the national customs tariff and verification of the origin of goods under preferential trade regime. Nevertheless, advanced ruling under CEFTA-2006 has a much limited scope in comparison with the WTO system. The established advanced rulings are officially published and are usually available on the national websites, and all of these provisions include appeal mechanisms. Appeal procedures in

all of the member-states begin with the possibility to appeal within the administration that issued the original decision, and proceed with a possibility to submit it on a higher level that supervises the administration. The next level is appeal to an independent authority, which is though not possible only in Albania, Bosnia and Herzegovina and Moldova. All the countries allow the possibility to appeal to an independent judicial authority. Most of the member-states, however, have limited access to information on appeal procedures on internet.

Most of the member-states also neglect recommendations under the multilateral trading system on the simplification of the imposed fees and charges. They still apply non-ad valorem fees and charges, with exception of Albania, Moldova and Kosovo. The applied fees and charges are not reviewed on regular terms, however all the novelties are published in official gazette and are available under the certain customs code, but not on a specially created web-site (OECD&CEFTA, 2012:73).

CEFTA member-states have complicated documentation formalities. The complicated documentation procedures are due to the non-existence of electronic customs system, with exception of Croatia and Macedonia, which makes electronic exchange of documents impossible within the region. Only in Macedonia there is a fully established system on providing digital certificates in signatures, while Croatia and Moldova provide only digital signatures, and Serbia only digital certificates (OECD&CEFTA, 2012:75). Besides this, member-states suffer from lack of trained staff in the area and the custom services do not possess the necessary capacity and knowledge on contemporary risk management practices.

When tackling the issue of trade facilitation from the point of view of customs procedures, it covers the establishment of a single window, pre-arrival customs processing, developing separate release and customs procedures and post-clearance audit. Only Macedonia and Moldova established the electronic single window system. In Macedonia it is used for import, export, transit licenses and tariff quotas (EXIM) (www.customs.gov.mk). As automation of customs systems has not been effectuated throughout the region, pre-arrival processing is not available despite of changes introduced in national legislations. Separation of release of goods from customs clearance in most of the countries is available if a certain amount of money is placed as security deposit. They all have procedures on post-clearance audit, however it is not well integrated within the risk management system (OECD&CEFTA, 2012:76-77).

Within the region most of the member-states have bilateral agreements on joint customs control with at least one neighboring country. Actually, national legislation provides provisions in favor of cooperation between customs and other government agencies, and many regular meetings are held in order to improve cooperation in this field. They are also willingly exchanging programs through the multi beneficiary IPA programs (OECD&CEFTA, 2012:79).

The OECD monitoring report found out that Croatia, Macedonia and Serbia recorded best results in elimination and harmonization of administrative barriers to trade while Montenegro was slightly above the CEFTA-average, and Albania and Moldova were

very close to reach it. Bosnia and Kosovo would have to make additional efforts to make substantial improvement in this area (OECD&CEFTA, 2012:80).

The recommendation of the OECD monitoring report on this type of barriers was to enhance transparency by regular exchange of information on customs procedures through the CEFTA Trade Facilitation Web Portal, enabling automation of documentation processing, special emphasis on full implementation of risk management and acceleration of implementation of simplified procedures (OECD&CEFTA, 2012:14).

3. CONCLUDING REMARKS

Six years since its creation it has been evident that CEFTA-2006 had provided a certain level of trade liberalization among Western Balkan countries, thus positively influencing the total trade exchange within the region. Due to the weak economic capacity of each of the member-states, they are not able to increase the volume of the trade exchange of goods out of the region and the volume of the trade exchange of goods within the region. Trying to keep their strategic positions on the EU-market, all of the countries have experienced contraction of the trade exchange of goods under this Agreement since the beginning of the economic crisis in 2008. The weak capacity of the member-states could be also confirmed by the fact that over 40% of the total intra-regional trade within CEFTA-2006 consists of agricultural products. The exploitation of the full trading potential of CEFTA-2006 is not limited by the backward economic structure, weak economic capacity and severe dependence upon the EU-trading partners, but is also due to the low political will and negotiating potentials of all of the governments of its member-states. They have not been able to articulate their essential mutual interest and there has not been defined what should be considered as regional interest, yet.

The trading potential of the region has not been used at its utmost also due to the existence of a whole range of hidden, but also of open nontrade barriers. The OECD monitoring tool defined 12 priority sectors for elimination of nontrade barriers and followed 36 intermediary goods in each of them among member-states. The OECD monitoring tool confirmed that the best way of eliminating technical barriers to trade (TBTs) should be enhancing the process of full implementation of the established EU technical standards and elimination of the conflicting national standards. In the case of sanitary and phytosanitary barriers to trade (SPS) despite of harmonization of national standards with those of the WTO and the EU, it is considered to be necessary to enhance cooperation and exchange of information among the national agencies and to follow the requirements of the private sector while creating new regulation. With regard of the administrative barriers within the region, the monitoring came to a conclusion that it is especially important to improve customs risk management on the borders and to enhance the implementation of simplified procedures among all member-states in order to avoid physical control of each shipment and full implementation of The Convention on Mutual Transit. The CEFTA-2006 Ministerial Conclusions in 2012 confirmed everything which was already stated in the OECD monitoring report. This document especially emphasized the need of:

- Further trade facilitation by improving risk management not only by the customs, but also by the involved national agencies and economic operators;
- Simplification of customs procedures, decrement of the number of documents presented on the borders and full implementation of paperless trade by full automation of procedures, and
- Acceleration of the ratification and full adoption by the Pan-Euro-Med cumulation of origin and modification of the CEFTA-Protocol on rules of origin by merging variable cumulation zones.

Another priority for CEFTA-2006 is also the establishment of good trade-dispute settlement mechanism. However, especially important issue is the need of modernization of the obsolete and completely outdated transport infrastructure on the border-crossings, but also within the region as a whole. In regard of the transport infrastructure the SEETO initiative might be of help, but it is far from sufficient having on mind the real needs of the region.

REFERENCES

- Chamber of Commerce of the Republic of Macedonia (01.04.2010): *Report on CEFTA-2006*, : The Chamber of Commerce of the Republic of Macedonia, Skopje
- Hadziski, B., Lucas, R., Martin, P. & Gunerin, S., S. (January 2010): *Enhancing Regional Trade Integration in Southeast Europe*, World Bank Working Paper No.185, the World Bank, Washington D.C.
- Kikerkova, I. (15th-17th October, 2009): “CEFTA-2006 as basis for economic reintegration of Western Balkan countries”, Third International Conference on *Regional Cooperation and Economic Integration – challenges and opportunities*, Ss. Cyril and Methodius University, Faculty of Economics, Skopje
- Kikerkova, I. (October 2011): “The importance of the Creation of CEFTA-2006 for the Western Balkans”, *Chinese Business Review*, David Publishing Company, Libertyville, Illinois, Volume 10, No. 10, pp. 844-855
- Kikerkova, I (7th-8th July, 2011): “Reintegrating Western Balkans – CEFTA-2006 and the Macedonian Experience”, International Scientific Conference on: *Western Balkans: From Stabilization to Integration*, Hans Seidel Stiftung & Institute of International Politics and Economics, Belgrade
- The Ministry of Economy of the Republic of Macedonia and the USAID (2008): *Report on Foreign Trade of Macedonia 2008*, Ministry of Economy of the Republic of Macedonia and the USAID, Skopje
- OECD&CEFTA (2012): “The Elimination of Non-Tariff Barriers in CEFTA-2006”, *CEFTA Issues Paper No.4*, www.investmentcompact.org &www.cefta2006.com
- OECD&CEFTA (2012): “Draft-Assessment Framework to monitor elimination on non-tariff barriers in CEFTA”, *CEFTA Issues Paper No. 4*, www.investmentcompact.org &www.cefta2006.com
- www.mchamber.mk (accessed on 19.10.2011): *ЦЕФТА-форум во Сараево – Што се расправаше и што се заклучи на работните групи? – ПРОТОЧНИ ГРАНИЦИ КАКО ВО ЕВРОПСКАТА УНИЈА*
- www.statistics.gov.mk
- www.customs.gov.mk

Jiří Dušek

The College of European & Regional Studies, České Budějovice, The Czech Republic

IMPACT OF WTO MEMBERSHIP AND EU MEMBERSHIP ON FOREIGN TRADE OF THE CZECH REPUBLIC

ABSTRACT

After 1989, Czechoslovakia embarked on a way of market economy. The transition from a centrally planned economy to a market economy was complicated. A closed economy has gradually become a very open economy, for which export is no longer just a way of gaining foreign currency but a necessity for its healthy development and survival. Now, in 2013, the Czech Republic is a small, open economy. As such, it depends to a great extent on foreign trade, i.e. on exports of domestic goods and services. Export of goods and services accounts for 70-80% of Czech GDP in the long term, while the vast majority of trade is with other EU members – 84%. Foreign trade thus accounts for a major part of the Czech Republic's GDP; the basis of Czech exports are vehicles and machines, industrial consumer goods and chemicals.

The main objective of this work will acquire and carry out analyses of indicators characterizing the impacts of memberships in the WTO and the European Union on economy of the Czech Republic. Based on the acquired data, the follow-up objective will establish trends in the development of individual indicators and identify the various trends in the foreign trade, as well as formulate recommendations for its further development and optimization. This objective will be supplemented by an analysis of the current situation in foreign trade from a territorial point of view.

Keywords: *Czech Republic, European Union, foreign direct investment, foreign trade, World Trade Organization*

JEL classification: *F10*

1. INTRODUCTION

The creation of International Trade Organization (ITO) was proposed at Bretton Wood conference in 1944. Its purpose was to define rules for mutual trade among countries. Members of the United Nations Conference agreed on the creation of ITO as of March 1948 in Havana, but the creation was ultimately blocked by US Senate. Some historians believe that the decision not to approve the creation of ITO was a consequence of fear of the American business community which believed that the ITO

could serve as a tool of protectionism, rather than a tool for liberalization of the world trade.

The agreement which came out of the unsuccessful attempt to create the ITO was called General Agreement on Tariffs and Trade (GATT). Seven rounds of negotiations took place within the framework of GATT. It was in the eighth round – known as the Uruguay Round negotiations (1986-1995) – that the World Trade Organization was created. Principles and agreements defined under the GATT were taken over by the WTO, which was given the authority to further extend them. As opposed to GATT, the WTO is based on institutional structure (Dušek, 2008). The creation of WTO enabled an institutionalization of a multilateral trade system. Membership in the WTO and the operation of the WTO are based on the “members-driven organization” principle. This means that any activities of the organization are based on initiatives of member states, the WTO secretariat does not have the right to submit any proposals or recommendations to members regarding activities, negotiations, changes to agreements or trade rules (Kubišta et al., 2009). As of 2012, there were 157 member states in the WTO and 26 observer states.

Czechoslovakia was a founding member of GATT and has never left the organization, even though up until 1989 it was not actively involved in its activities because of its centrally planned economy. After the division of Czechoslovakia into the Czech Republic and the Slovak Republic in 1993, both countries became members of GATT. The Czech Republic is thus a founding member of WTO too. WTO agreements and treaties represent basic legal framework for trade policies, even after the accession into the EU (CzechTrade, 2011).

After 1st May 2004 (accession of the Czech Republic into EU), the position of the Czech Republic in WTO has changed. It remains a member state, but in accordance with principles of EU common trade policy, it stopped negotiating and acting independently. There have also been major changes in relation of the Czech Republic to its business partners – see Table 1. From the point of view of WTO, EU is a customs union and as such is represented in the WTO by European Commission representatives. Common EU standpoints towards the WTO are formulated in Brussels and/or in coordination meetings in Geneva. Negotiation mandate for the European Commission is approved by the General Affairs and External Relations Council (GAERC). Before the Lisbon Treaty came into effect, specific questions were dealt with by Council 133, as well as the COREPER and GAERC councils.

Table 1: Non-preferential trade relations between EU and the Czech Republic and its business partners (Černohlávková, Plchová et al., 2004)

Business partner	Trade relationship with EU	Trade relationship with the Czech Republic	Changes for the Czech Republic after joining the EU
USA, Canada, Japan, Australia, New Zealand, Hong Kong, Singapore, South Korea	Treaty-less state based on a clause of most-favoured-nation treatment	Non-preferential trade agreements for the Czech Republic based on GSP	Shift to trading according to most-favoured nation clause → loss of advantages from GSP for the Czech Republic
ACP countries and other developing countries (except the Mediterranean)	Provision of advantages according to GSP	Provision of advantages according to GSP	No change in conditions
Countries with transition and/or state run economies (except CEFTA and the Baltic states)	Non-preferential trade relations according to most-favoured nation clause	Non-preferential trade relations according to most-favoured nation clause	No change in conditions

The coming of Lisbon Treaty into effect (1st December 2009) has also influenced the position of common trade policy within the EU. The common trade policy was extended by the area of direct foreign investments and has newly become a part of the European Union External Action which, according to the Lisbon Treaty, is created by the Foreign Affairs Council (FAC). At the same time, in connection with the coming of the Lisbon Treaty into effect, the 133 Committee was renamed to Trade Policy Committee.

The European Union supports a system of World Trade Organization (WTO) rules, which guarantee a certain level of legal safeguards and transparency in the area of international trade. The WTO defines rules under which its members can defend against unfair practices such as dumping (sale below cost), which exporters use to fight competition. The WTO also provides guidelines for solving disputes between two or more business partners. Also, EU trade policy is closely connected to EU development policy. Within the framework of a general system of preferences (GSP), the EU enabled a duty-free or highly preferential access to market to most imports from developing countries and emerging countries. The 49 poorest countries in the world enjoy even more advantages. All their exports – with the exception of weapons – can enjoy duty-free access to EU markets according to a programme launched in 2001. However, the EU does not have any special trade agreements with major trade partners from the ranks of developed countries, such as the United States or Japan. In these cases, trade relations are governed by WTO mechanisms (European Union, 2012).

Figure 1: Members and observers of the WTO (Wikipedia, 2012)



2. MATERIAL & METHODS

The main objective of this work will acquire and carry out analyses of indicators characterizing the impacts of memberships in the WTO and the European Union on economy of the Czech Republic. Based on the acquired data, the follow-up objective will establish trends in the development of individual indicators and identify the various trends in the foreign trade, as well as formulate recommendations for its further development and optimization. This objective will be supplemented by an analysis of the current situation in foreign trade from a territorial point of view.

The methodology of this contribution is in compliance with methods usually used in scientific research; it is based on the use of the latest theoretical knowledge gained from specialised literature, specialised research and studies, newspapers and materials published by individual participants in regional development. Also, the methodology is based on looking for and assessment of mutual relationships which contribute to the clarification of the problems solved and to a deduction and formulation of adequate conclusions which can be derived from such an analysis. The analysis of impact of WTO membership and EU membership on foreign trade of the Czech Republic carried out in the contribution is based on statistical data of Ministry of Industry and Trade of the Czech Republic, the Czech Statistical Office and the Czech Trade agency. The main methods used in the article are analysis, description and comparison.

3. RESULTS AND DISCUSSION - IMPACT OF WTO MEMBERSHIP AND EU MEMBERSHIP ON FOREIGN TRADE OF THE CZECH REPUBLIC

After 1989, Czechoslovakia embarked on a way of market economy. The transition from a centrally planned economy to a market economy was complicated. A closed economy has gradually become a very open economy, for which export is no longer just a way of gaining foreign currency but a necessity for its healthy development and survival. The territorial structure of exports has also changed. Exports from Czechoslovakia were mainly going to so-called Comecon countries (Council for Mutual Economic Assistance). Because of a difficult transformation from a centrally planned economy to a market economy, the Czech Republic experienced economic difficulties at the beginning of 1990s. These difficulties manifested themselves in weakened purchasing power, unemployment and stagnation of economic growth.

Now, in 2013, the Czech Republic is a small, open economy. As such, it depends to a great extent on foreign trade, i.e. on exports of domestic goods and services and imports of foreign goods and services. Export of goods and services accounts for 70-80% of Czech GDP in the long term, while the vast majority of trade is with other EU members – 84%. Foreign trade thus accounts for a major part of the Czech Republic's GDP; the basis of Czech exports are vehicles and machines, industrial consumer goods and chemicals.

During the 1990s, the Czech Republic and its foreign trade were influenced by many aspects and it is not possible to assess impact of individual factors or changes. Based on statistical data, it is not possible to quantify concrete financial impact of Czech Republic's membership in the World Trade Organization for several reasons:

- Czechoslovakia / the Czech Republic is a founding member not only of GATT, but also of WTO. Thanks to the long-term adherence to GATT principles in the area of trade management, accession to the WTO did not bring any substantial changes in the area of Czech foreign trade which could be precisely statistically quantified. This fact is demonstrated on data in tables 2-3,
- After 1989 (so-called Velvet Revolution), Czechoslovakia underwent an economic transformation from a centrally planned economy to a market economy; there has been a major refocus of the economy from “eastern” to “western” markets,
- There is no relevant statistical data available for the period before 1944 (before GATT) and 1995 (before WTO).

If we analyse Table 2 – Czech Republic foreign trade, we can find the biggest year-on-year increases in foreign trade in the years 1993, 1995, 2000 and 2004. In terms of size of the increases, the year 1995 is the second biggest. This could lead to the assumption that accession to the WTO had a major influence on the Czech economy, but the reality is different.

1. In 1993, The Czech and Slovak federal republics were divided into 2 states – The Czech Republic and the Slovak Republic. Mutual domestic trade suddenly became foreign trade (change in exports +69.9% and in imports +45.2%).
2. In 1995, the WTO was founded but, also, Law No. 58/1995 Coll. on Insuring and Financing of Exports with a State Subsidy comes into force in the Czech Republic. This law brought more stable conditions to the functioning of EGAP (= Export

Guarantee and Insurance Corporation) and also was an impulse for the creation of another state-supported pro-export institution – The Czech Export Bank (it also started in 1995). The +23.4% change in exports can thus be attributed not only to the accession to the WTO, but also to the pro-export measures taken by the state. On the other hand, the +33.6% increase in imports can also be attributed not only to accession to the WTO, but also to strong domestic demand, which could not be covered by the inflexible supply of Czech companies, growth in real wages, the strengthening of financially strong foreign companies (e.g. also thanks to privatization of state assets, the economic slowdown in the majority of EU countries, the increase in oil and gas prices and further strengthening of the Czech currency).

3. Around the year 2000, apart from a growing economy, growing exports (+23.4%) and imports (+27.6%) were to a great extent due to measures taken by the government, which in 1998 passed resolution No. 298/1998 on the Provision of Investment Incentives in the Czech Republic, on the basis of which incentives started to be provided in the processing industry, and which later led to Law on Investment Incentives (No. 72/2000 Coll.), in force from 1st May 2000. It was the beginning of active support of foreign and domestic investments in advanced industrial technologies and of catching up in the level of investments with neighbouring transforming economies (for more see Štrach, 2009). The significance of these provisions is visible from Graph 1 where, after resolution No. 298/1998 was passed, there is a year-on-year increase in foreign direct investments by 184% in 1999. On the other hand, accession to the WTO or the EU did not have any direct influence on the flow of investments into the Czech Republic.
4. The last major change in Czech foreign trade was the entry of the Czech Republic into the EU on 1st May 2004. The development of foreign trade between May 2004 and April 2005, i.e. in the period of 12 months after accession of the Czech Republic to the EU can be characterized by a significant year-on-year improvement in trade balance to black numbers and by a fast growth in foreign trade, especially exports of goods. Exports of goods increased in the given period by 23.8% and imports by 17.5%. Also, the dynamism of turnover in foreign trade was biggest in the period of first six months after accession to the EU (the increase in exports exceeded 30% and imports increased by almost 26%), where apart from positive changes on the supply side, there was also the positive effect of growing foreign demand and expectation of further global economic growth. Also a factor was the elimination of remaining customs barriers in trade with the EU, with an impact on implementation of postponed transactions. For the first time in history, the Czech Republic ceased to be a net importer and became a state with a favourable balance of payments. However, a year-on-year improvement in trade balance was not apparent in all areas and to a large extent was connected to a major increase in trade surplus in machines and vehicles. This development shows that direct impact of the Czech Republic joining the EU (change in customs rules, streamlining of administrative work on borders) was not crucial in terms of improvement in trade balance. The defining factor remained the positive effects from the influx of foreign direct investments. More significant was probably the indirect impact of the Czech Republic's entry into the EU, which was that the Czech Republic joined the ranks of advanced market economies. It may be this fact – apart from the main requirement for cutting costs – which contributed to a

significant shift of production from Western Europe to the Czech Republic, which significantly contributed to an improvement in trade balance (e.g. Bosch) (Czech National Bank, 2012a).

**Table 2: Foreign trade of the Czech Republic
(Czech Statistical Office, 2012a, own calculations)**

Year	Turnover	Exports	Imports	Balance	Year-on-year change in %		Coverage of imports by exports in %
					exports	imports	
in billionCZK							
1989	427,5	216,5	211,0	5,5	.	.	102,6
1990	448,0	214,1	233,9	-19,8	-1,1	10,9	91,5
1991	442,4	233,6	208,8	24,8	9,1	-10,8	111,9
1992	541,5	248,1	293,4	-45,3	6,2	40,5	84,6
1993	847,7	421,6	426,1	-4,5	69,9	45,2	98,9
1994	957,2	458,8	498,4	-39,4	8,8	17,0	92,1
1995	1 231,9	566,2	665,7	-99,5	23,4	33,6	85,0
1996	1 356,4	601,7	754,7	-153,0	6,3	13,4	79,7
1997	1 569,0	709,3	859,7	-150,4	17,9	13,9	82,5
1998	1 748,7	834,2	914,5	-80,3	17,6	6,4	91,2
1999	1 882,0	908,8	973,2	-64,4	8,9	6,4	93,4
2000	2 363,0	1 121,1	1 241,9	-120,8	23,4	27,6	90,3
2001	2 654,2	1 268,6	1 385,6	-117,0	13,2	11,6	91,6
2002	2 580,6	1 254,9	1 325,7	-70,8	-1,2	-4,3	94,7
2003	2 811,6	1 370,9	1 440,7	-69,8	9,3	8,7	95,2
2004	3 471,8	1 722,7	1 749,1	-26,4	25,7	21,4	98,5
2005	3 698,6	1 868,6	1 830,0	38,6	8,5	4,6	102,1
2006	4 249,4	2 144,6	2 104,8	39,8	14,8	15,0	101,9
2007	4 870,5	2 479,2	2 391,3	87,9	15,6	13,6	103,7
2008	4 880,2	2 473,7	2 406,5	67,2	-0,2	0,6	102,8
2009	4 127,7	2 138,6	1 989,0	149,6	-13,5	-17,3	107,5
2010	4 944,4	2 532,8	2 411,6	121,2	18,4	21,2	105,0
2011	5 566,3	2 878,7	2 687,6	191,1	13,7	11,4	107,1
2012	5 814,8	3 062,8	2 752,0	310,8	6,4	2,4	111,3

Figure 2: Inward Foreign Direct Investment in the Czech Republic (in millions of CZK) (Czech National Bank^{2012b})

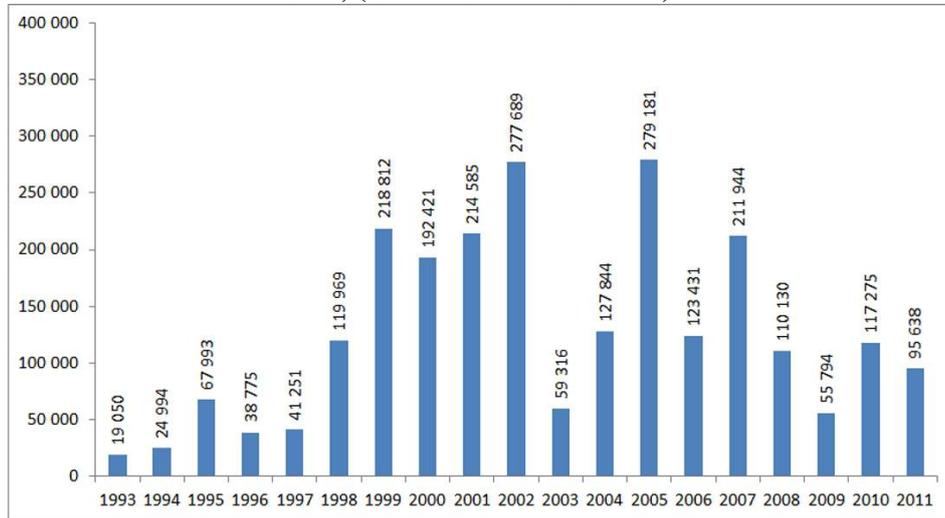


Table 3a: Foreign trade of the Czech Republic – territorial point of view (Czech Statistical Office, 2012b)

Year	Turnover	Exports	Imports	Balance	Year-on-year change in %	
					exports	imports
in millionCZK						
Czech Republic total						
1989	427 503	216 532	210 971	5 561	.	.
1990	447 999	214 060	233 939	-19 879	-1,1	10,9
1991	442 375	233 594	208 781	24 813	9,1	-10,8
1992	541 489	248 090	293 399	-45 309	6,2	40,5
1993	847 685	421 601	426 084	-4 483	69,9	45,2
1994	957 220	458 843	498 377	-39 534	8,8	17,0
1995	1 231 911	566 171	665 740	-99 569	23,4	33,6
1996	1 356 244	601 679	754 565	-152 887	6,3	13,3
1997	1 568 972	709 261	859 711	-150 450	17,9	13,9
1998	1 748 687	834 221	914 466	-80 245	17,6	6,4
1999	1 881 925	908 756	973 169	-64 413	8,9	6,4
2000	2 363 023	1 121 099	1 241 924	-120 825	23,4	27,6
2001	2 655 953	1 269 634	1 386 319	-116 685	13,2	11,6
2002	2 580 111	1 254 394	1 325 717	-71 323	-1,2	-4,4
2003	2 811 653	1 370 930	1 440 723	-69 793	9,3	8,7
2004	3 471 752	1 722 657	1 749 095	-26 438	25,7	21,4
2005	3 698 548	1 868 586	1 829 962	38 624	8,5	4,6
2006	4 249 385	2 144 573	2 104 812	39 761	14,8	15,0
2007	4 870 553	2 479 234	2 391 319	87 915	15,6	13,6
2008	4 880 225	2 473 736	2 406 489	67 246	-0,2	0,6
2009	4 127 659	2 138 623	1 989 036	149 587	-13,5	-17,3
2010	4 944 353	2 532 797	2 411 556	121 241	18,4	21,2
2011	5 566 254	2 878 691	2 687 563	191 128	13,7	11,4
2012	5 814 797	3 062 779	2 752 018	310 761	6,4	2,4

Table 3a: Foreign trade of the Czech Republic – territorial point of view (Czech Statistical Office, 2012b)

Year	Turnover	Exports	Imports	Balance	Year-on-year change in %	
					exports	imports
in millionCZK						
EU countries (EU 27)						
1989	208 130	105 192	102 938	2 254	.	.
1990	239 377	110 670	128 707	-18 037	5,2	25,0
1991	266 374	146 631	119 743	26 888	32,5	-7,0
1992	367 106	178 064	189 042	-10 978	21,4	57,9
1993	659 697	333 433	326 264	7 169	87,3	72,6
1994	760 356	373 645	386 711	-13 066	12,1	18,5
1995	988 555	471 608	516 947	-45 339	26,2	33,7
1996	1 080 348	495 942	584 406	-88 464	5,2	13,0
1997	1 246 048	588 638	657 410	-68 772	18,7	12,5
1998	1 418 001	711 080	706 921	4 159	20,8	7,5
1999	1 550 132	796 312	753 820	42 492	12,0	6,6
2000	1 898 271	965 383	932 888	32 495	21,2	23,8
2001	2 132 819	1 099 568	1 033 251	66 317	13,9	10,8
2002	2 036 080	1 074 969	961 111	113 858	-2,2	-7,0
2003	2 231 081	1 196 871	1 034 210	162 661	11,3	7,6
2004	2 764 999	1 500 796	1 264 203	236 593	25,4	22,2
2005	2 906 656	1 597 541	1 309 115	288 426	6,4	3,6
2006	3 324 346	1 837 052	1 487 294	349 758	15,0	13,6
2007	3 806 630	2 113 649	1 692 981	420 668	15,1	13,8
2008	3 719 265	2 107 915	1 611 350	496 565	-0,3	-4,8
2009	3 139 760	1 811 957	1 327 803	484 154	-14,0	-17,6
2010	3 654 222	2 126 339	1 527 883	598 456	17,4	15,1
2011	4 104 490	2 388 968	1 715 522	673 446	12,4	12,3
2012	4 237 173	2 473 592	1 763 581	710 011	3,5	2,8

4. CONCLUSION

For the Czech Republic, membership in the WTO means not only the necessary consolidation of multilateral legal and institutional order for the Czech foreign trade, but also gaining of a specific idea for promotion and defence of trade and economic interests of the Czech Republic and of Czech entities, mainly *vis-a-vis* stronger trading countries such as the USA, Japan and others. It helps the Czech Republic to better integrate into the global economy and improves its access to foreign markets. In view of the fact that the Czech Republic is one of the founding members of both the GATT and the WTO, it is not possible to exactly calculate the impact of membership in these institutions on the Czech Republic, mainly due to the non-existence of a comparison period. Further factors which significantly influence involvement of the Czech Republic in international trade include the division of Czechoslovakia into the Czech and Slovak republics in 1993, the transformation of economy, accession into the EU in 2004 and government policies, especially in the area of support of foreign direct investments, which did not play a major role in the Czech economic policies until the middle of 1990s, as a reaction to dynamic growth in adverse trade balance, which after 1996 started to cause problems in trade balance and was one reason why foreign investors in the Czech Republic started to feel ill at ease. Membership of the Czech Republic in WTO and the EU thus has mainly indirect impact (e.g. trustworthiness for foreign investors, stability of the political and legal environment...), which positively influence not only the development of foreign trade, but also of the whole Czech economy – in the last 20 years, the Czech Republic was able to transform itself from a centrally planned economy with an adverse trade balance into a market economy which successfully exports over 80% of its output abroad.

REFERENCES

- Čermohávková, E., Plchová, B., et al. (2004), *Zahraniční obchod*, Bankovní institut vysoká škola, Praha.
- Dušek, J. (2008), *Základy ekonomie*, Vysoká škola evropských a regionálních studií, České Budějovice.
- Evropská unie na světové scéně* [online]. Brusel : European Union, 2012 [cit. 2013-02-07]. Available at WWW: <http://europa.eu/abc/12lessons/lesson_11/index_cs.htm>.
- Kubišta, V., et al. (2009), *Mezinárodní ekonomické vztahy*, Vydavatelství a nakladatelství Aleš Čeněk, s.r.o., Plzeň.
- Postavení České republiky ve WTO* [online]. Praha : CzechTrade, 2011 [cit. 2013-02-07]. Available at WWW: <<http://www.businessinfo.cz/cz/clanek/pravni-prostredi-celni-problematika/zakladni-informace-k-wto-a-dda/1000487/39073/>>.
- Příliv přímých zahraničních investic podle sektorů a zemí - časová řada* [online]. Praha : Czech National Bank, 2012b [cit. 2013-02-07]. Available at WWW: <http://www.cnb.cz/miranda2/export/sites/www.cnb.cz/cs/statistika/platebni_bilance_stat/pzi/download/pzi_rada.xls>.
- Štrach, P. (2009), *Mezinárodní management*, Grada Publishing, Praha.
- Vývoj zahraničního obchodu v prvním roce po vstupu ČR do EU* [online]. Praha : Czech National Bank, 2012a [cit. 2013-02-07]. Available at WWW: <http://www.cnb.cz/cs/menova_politika/zpravy_o_inflaci/2005/2005_cervenec/boxy_a_prilohy/c_05_cervenec_b2.html>.

World Trade Organization [online]. Wikipedia, 2013, 6.2.2013 [cit. 2013-02-07]. Available at WWW:
<<http://en.wikipedia.org/wiki/WTO>>.

Zahraniční obchod - hledisko teritoriální [online]. Praha : Czech Statistical Office, 2012b [cit. 2013-02-07].
Available at WWW: <http://www.czso.cz/cz/cr_1989_ts/0602.xls>.

Zahraniční obchod [online]. Praha : Czech Statistical Office, 2012a [cit. 2013-02-07]. Available at WWW:
<http://www.czso.cz/cz/cr_1989_ts/0601.xls>.

Michele Bertoni

University of Trieste, Department of Economics, Business, Mathematics and Statistics,
Trieste, Italy

Bruno De Rosa

University of Trieste, Department of Economics, Business, Mathematics and Statistics,
Trieste, Italy

Guido Grisi

University of Trieste, Department of Economics, Business, Mathematics and Statistics,
Trieste, Italy

MANAGERIAL CONTROL AND COST ACCOUNTING SYSTEMS IN NATIONAL HEALTH CARE SERVICES: A CASE STUDY

ABSTRACT

Many governments in Europe are struggling with the need to reduce public spending, especially because of the global recession and of the recent sovereign debt crisis. The reduced growth rates (or, in some cases, even recessions) that several European countries are currently experiencing are putting a strain on public spending, and have forced some governments to introduce drastic measures for increasing financial stability. National health care services, which normally constitute an important portion of public spending, are also affected. The compounded effect of an aging population and an increase in health care costs is forcing even more governments to focus on the efficiency in the management of their national health services. However, the critical relevance of health care expenditures in maintaining the welfare of the population advises against indiscriminate and non-focused cost reductions. Instead, it is essential to identify and understand the main health care cost drivers, in order to develop rational cost reduction plans, aimed at the patient or at the medical procedure level. In order for reduction plans to be successful, in fact, it is paramount that the health care administrators know about the costs related to the different therapeutic or diagnostic treatments (see: Francesconi, 1993; Grisi, 1997; Baker, 1998; Cinquini et al., 2009; Kaplan and Porter, 2011).

In this paper we study the methods and results of cost analysis of selected medical and diagnostic treatments offered by the University Hospitals in Trieste, Italy (*Azienda Ospedaliera Universitaria Ospedali Riuniti di Trieste*). We describe the theoretical and practical implications of the determination of costs in this context, with a particular emphasis on the implementation of modern costing systems, such as Activity Based Costing (Kaplan and Cooper, 1998; De Rosa, 2000; Kaplan and Anderson, 2004). This paper represents the first step in a research project that aims to develop an international comparison of health care costs in neighbouring countries. Cross-country benchmarking and comparison, in fact, may be a precious tool for defining the most cost-efficient methods for offering therapeutic and diagnostic medical services.

Key words: national health care service, managerial control systems, cost accounting, activity based costing, ABC

JEL classification: M41

1. INTRODUCTION

This paper summarizes the preliminary results of research effort aimed to delineate and improve the theoretical and operational frameworks of a complex project devoted to enhance the application of process analysis and activity-based costing (ABC) at the *Azienda Ospedaliero-Universitaria* (AOU – University Hospital) “*Ospedali Riuniti*” (Joint Hospitals) of Trieste, Italy. The AOU arises from the integration between the pre-existent hospitals of Trieste and the Faculty of Medicine and Surgery of the University of Trieste. Its mission, among other things, mentions the following:

The Azienda Ospedaliero Universitaria, already a hospital of national importance and high specialisation, aims at the united and coordinated development of the functions of care, teaching and research, so as to improve the public health-care service, expand the quality of education, develop biomedical and technical innovation knowledge, as well as valorising equally the responsibilities and activities of the hospital and university staff.

The roots of the project go back to several years ago, when one of the authors, who had already published a book on Activity Based Costing for healthcare (Grisi, 1997), undertook a research venture with some physicians of the Radiology Department of the AOU. The aim of that study was to analyze the activities and costs related to some specific radiological examinations (Stacul et al., 2006 and 2009).

The activity of data gathering and organizational analysis that was necessary in order to compute the full cost of the radiological procedures required the involvement in the project of the AOU controller. The management of the hospital consequently foresaw an opportunity to extend the method to other AOU Departments. The original research program informally evolved, therefore, into a more composite project aimed to gradually enhance the AOU cost system, providing it with some ABC features nowadays still lacking. As a matter of fact, the hospital's current cost system is based on the traditional paradigm of organizational structure and control based upon responsibility centers. While this logic might still be considered useful for budgetary control reasons, it is not certainly as helpful in determining the accurate costs of specific healing treatments provided by the hospital, especially when these treatments differ in complexity and intensity of resource usage. Indeed, the costs data gathered within the current AOU cost system lack the granularity required in order to correctly “trace” the resource consumption to definite activities or processes performed. It is, consequently, very challenging to compute the realistic cost of a detailed cost object. Due to this, the initial research evolved in a series of distinct pilot case studies realized at different departments within the AOU. Each of them required the contribution of the

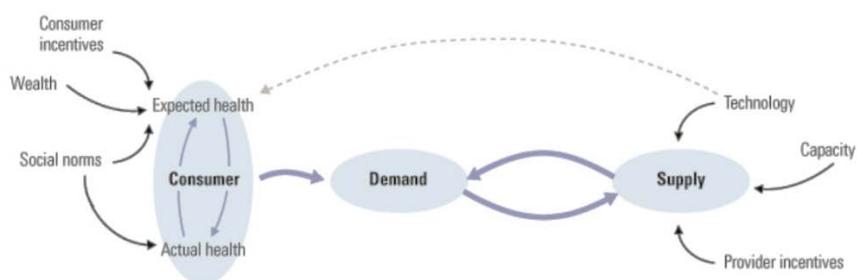
physician in charge of the organizational unit concerned and of their staff. In fact, all the studies were developed by multidisciplinary teams in which there was a jointly contribution of competences pertaining to different scientific areas. In every team there was at least an accountant.

The present stage of the research project focuses on the development of a unitary conceptual framework, based on the empirical work already done. The effort is to find a model of cost assignment that is sufficiently standardized (one single cost assignment procedure for all the hospital's departments), but still capable of reflecting the peculiarities of specialized medical treatments offered (e.g., heart surgery, dental treatments, etc.). This could lead to an update of the measurements of the information produced in previous case studies, in the light of the improvements to the model introduced. We also intend to compare the costs of specific treatments measured within AOU with those of the private sector. A further goal is to search for cooperation within the macro region for a joint research effort in the measurement of healthcare costs in bordering areas.

2. DEMAND AND SUPPLY OF HEALTHCARE

The issue of healthcare costs has become increasingly problematic over the years. Most countries have experienced a rise in the percentage of GDP devoted to national health systems (Reinhardt et al., 2004; Perotti, 2006; Pammolli and Salerno, 2006; WHO, 2000 and 2010; McKinsey Global Institute, 2008; Armeni and Ferrè, 2012; Scheggi, 2012). In order to understand the root causes of this surge in healthcare expenditures, it is useful to consider that, even if in most countries healthcare is not provided in a competitive market context, there is however a demand and supply of healthcare services, whose main causes can be summarized by the following figure:

Figure 1: Demand and supply of healthcare



Source: Drouin et al., 2008

Healthcare demand, although peculiarly subjective, is mainly driven by supply. In fact, the availability of specific medical treatments often generates its own demand. In turn, supply is influenced mainly by technology, i.e. the ability to treat. Historically, technology has transformed medicine into a discipline in which professionals deal not only with the symptoms, but also with the causes of the disease (Drouin et al., 2008).

New therapies, products, and medical services set expectations to a new level, pulling up demand. Supply is influenced by capacity: since health care is free or heavily subsidized for many patients, the mere presence of healthcare facilities affects the rate of their consumption (Drouin et al., 2008; Ehrbeck et al., 2010). Finally, supply is also affected by incentives offered by providers: funding policies set by healthcare regulators and governments can determine under- or overproduction of specific treatments or services. Demand, on the other hand, is relatively insensitive to price (being most users fully or partly subsidized), and it is mainly driven by social norms, wealth (the higher a country's GDP, the higher the demand for healthcare services), actual and expected health. The influence of the said variables on the demand and supply of healthcare tends almost invariably to generate an increase in the availability of healthcare products and services, since the system is apparently unbounded, given the probable evolution of medical technology and healthcare expectations.

It is therefore not surprising that many countries have experienced a surge in healthcare costs, and this is why cost analysis and control in the production of healthcare services has become increasingly important. There are multiple explanations for the increase in healthcare spending, in part already mentioned, and not necessarily related to a deterioration in the general health level of the population. The most plausible explanations may be found, in the developed world, in an aging population that requires additional healthcare, for a longer time, and in the evolution of technology.

Although the above factors are indubitably relevant, it is our opinion that one of the drivers that can explain a significant part of the healthcare costs is complexity, and how it is managed. In the last century, the role of medicine and of physicians has changed dramatically: approximately 100 years ago, before the discovery of penicillin, medics acted like craftsmen: they could have all the necessary knowledge in their field, and they had the ability to apply it. As a result, autonomy, in sense of independence and self-sufficiency, emerged as one of the principal values of the medical profession. The current situation is completely different: the number of medical treatments and surgical procedures has increased, and so have drugs, that have been discovered in vast numbers.

“There was a study where they looked at how many clinicians it took to take care of you if you came into a hospital, as it changed over time. And in the year 1970, it took just over two full-time equivalents of clinicians. That is to say, it took basically the nursing time and then just a little bit of time for a doctor who more or less checked in on you once a day. By the end of the 20th century, it had become more than 15 clinicians for the same typical hospital patient -- specialists, physical therapists, the nurses”¹.

The increased complexity in the medical treatments had as a side-effect the emergence of coordination issues among different specialists, because the processes have become more fragmented, involving a larger number of professionals. Therefore, organizational

¹ A. Gawande, *How do we heal medicine?*, TED Talks, 2012, video file retrieved from www.ted.com.

problems have become increasingly important for healthcare providers, and so have the costs associated with them. But there is mounting evidence that the most expensive care is not necessarily the best care: the most effective and often the most efficient healthcare treatments are those developed with a systematic approach. Having components of the highest quality does not assure the best results, and yet in today's medicine there is a great emphasis on components (the best drugs, the best technologies, the best specialists, etc.). What it lacks is a holistic approach to processes.

In our view, one of the most important supports that helps providers better organizing their activities is the availability of relevant information. Therefore, the data analyzed should be elaborated within a framework that takes into consideration the systemic reality, i.e. the information should be able to reflect the level of complexity, the interconnections, and the constraints of the system. Translating this concept into the measurement and reporting of costs, it means that the cost accounting system should provide information with a level of detail and a depth of analysis that is consistent with the complexity of the reality being measured. In this sense, ABT (Activity Based Techniques) represent an indubitable improvement over traditional measurement systems in providing valuable information for process management interventions (Activity Based Management and Business Process Reengineering).

3. ABC VERSUS TRADITIONAL COST ACCOUNTING IN HEALTHCARE

The traditional view of cost accounting is that services or products consume resources (Baker, 1998, p. 3). Conventional cost systems therefore assume a direct relationship exists between the level of product or services provided and the amounts of the resources utilized. Traditional performance measures of productivity, such as "labor productivity", defined according to this view, are therefore flawed. Traditional cost systems led to over-emphasize the distinction between "variable costs" (i.e. costs that are correlated to variation in the output performed) and "fixed costs" (i.e. costs that are not dependent on the level of goods or services produced).

By contrast, activity based costing (ABC) theory recognizes that resource usage is intimately linked with the carrying out of activities. The causal relation among these "entities" is expressed by a parameter called "resource driver". A "resource driver", therefore, explains the measure of the resource consumption triggered by a definite activity (Cooper and Kaplan, 1988; Bubbio, 1993; Kaplan and Cooper, 1998; De Rosa, 2000; Gupta and Galloway, 2003; Sandinson et al., 2003).

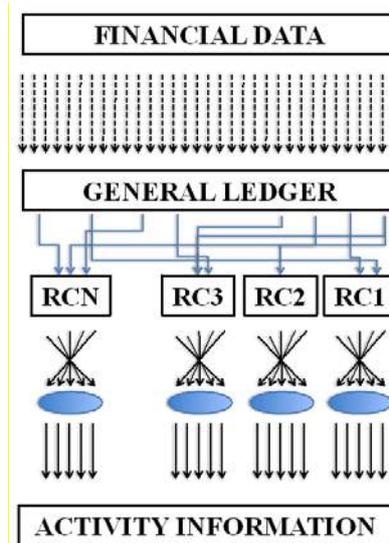
Products and services, instead, consume activities. An "activity driver" thus defines the consumption of activities caused inside the organization by the delivery of products or services. As we will specify better later, activity drivers may synthesize both volume-related or non-volume-related connections between activities and products.

The ABC framework reveals a "double productivity circuit" that must be properly managed in order to achieve a superior level of efficiency. At one side of the circuit there is what we may call a "resources productivity", which compares outputs in term of activities performed to inputs expressed by the amount of resources consumed. At

the other side of the circuit stands instead the “activities productivity”, that matches outputs obtained, articulated in term of products or services delivered, to inputs consumed, measured by the quantity of activity required to produce the outputs.

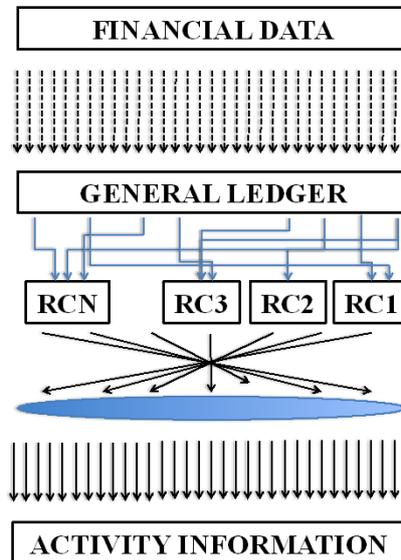
Cokins (2001) uses the analogy of an optical lens to show how ABC “serves as a translator of general ledger data to provide more focused information for improved decision support. The lens not only translates the ledger costs into a more useful and flexible format, it provides more sensory information”. ABC, therefore, is neither a replacement for the general ledger accounting, nor for responsibility accounting. Rather, it is a decoder of information provided by these systems in favor of its end users, such as managers and analysts, who apply cost data in decision making. “It translates expenses into a language that people can understand. It translates expense into elements of costs, namely the work activities, which can be more flexibly linked or assigned to business processes or cost objects based on demand-driven consumption patterns, not simplistic cost allocations” (Cokins, 2001, p. 11-12). The following figure summarizes the present stage of the project, where the ABC still operates within a specific responsibility center (Hospital Departments), providing information to final users expressed in terms of cost of activities performed in that Department.

Figure 2: Actual stage of the cost assignment process



The accuracy of information provided certainly increases, but it still lacks the completeness of information encompassing all responsibility centers. The aim of the project, basing on the case studies conducted so far, is to expand the model to its full potential, providing information common to all responsibility centers of the organization.

Figure 3: Desired stage of the cost assignment process



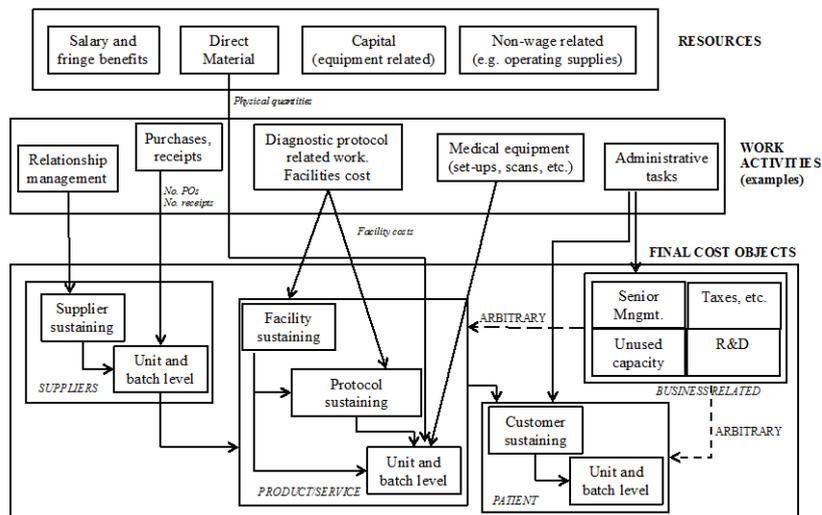
A major improvement in cost assessment provided by the ABC methodology consists in the proliferation of cost objects. While the organizational departments are necessarily linked to the product or the service they contributed to deliver, activities may be perceived as performed in order to serve numerous “entities”, such as different “customers”, “suppliers”, “channels” or, even, “type of customer order”, “type of freight-haul trip”, etc. Each of these entities may “serve as an intermediate repository to capture the diversity of the type of work output”. By means of this attribution of costs to intermediate cost objects, ABC is able to recognize the role of complexity in determining the level of resource usage. Once activity costs have been preliminary traced to intermediate cost-objects, these costs are further retraced to subsequent stages based on appropriate activity drivers. Not recognizing this pattern of input-output relationship among activities would normally produce a significant distortion on the final cost figure computed. In Health Care Organizations “cost-objects are any patient, product, service, contract, project, or other work unit for which a separate cost measurement is desired” (Baker 1998, p. 5).

Another fundamental difference between “activity-based” and “conventional” cost systems is the use of **non-unit cost drivers** for assigning resource usage to cost object. ABC system assign costs using drivers based on the “quantity” of each activity used. Since the drivers are expected to appropriately synthesize the “root causes” that induced the activity to be performed, they may occur on several levels:

1. **Unit level drivers** correlate the increase of the resource consumption with every “unit” of a “cost-object” served. The “cost-object” may be a product or service delivered (e.g. a “specific treatment”) or a customer served (e.g. “a single patient”); it can, nevertheless, also be a supplier.

2. **Batch level drivers** link, instead, the variation of the inputs to activities carried out for every “batch” of “cost-objects”. The costs incurred in performing these activities must, therefore, be assigned to individual batches, provided that they are completely “fixed”, regardless of the number of units in the batch.
3. In addition to activities and costs that are outlined by “unit” and “batch” drivers, there is a third, higher-level of activities, usually labeled “**sustaining activities**”. Their occurrence doesn’t vary in accordance with the amount of “batches” or “unit” of the selected cost-object served in a specific period of time. Indeed, the amount of sustaining activities performed “reflect policy or strategy or response to the importance” of the cost-object. In short, they are “overhead work activities whose existence can be attributed to suppliers, products, service lines, channels, or customers” (Cokins, 2001). Each of those entities will have its “sustaining” cost object. This led to existence of specific **sustaining activity drivers** that must be used in order to correctly trace costs incurred in performing these activities to the pertaining “sustaining” cost object. Among these drivers one must certainly mention:
 - a) **Product level drivers** which assume the necessity of the inputs to support the production of each different type of product.
 - b) **Facility level drivers** which are related to the facility’s manufacturing process. Users of the ABC system will need to identify the activities which generate costs and then match the activities to the level bases used to assign costs to the products.

Figure 4: Framework for cost assignment in healthcare using ABC



Moreover, among the sustaining activities, one should mention the so called “business sustaining activities”, that are the “do not directly contribute to customer value, responsiveness, and quality. That does not mean those activities can be eliminated or even reduced without doing harm to the business entity. For example, preparing

required regulatory reports certainly does not add to the value of any cost object or to the satisfaction of the customer. However, that activity does have value to the organization because it enables it to function in a legal manner” (Cokins, 2001, p. 71) Costs incurred in performing these activities are usually traced to a **“sustaining cost object group”**. Although these costs may be attributed to the main cost objects in order to determine their full cost, their allocation is always arbitrary.

The existence of numerous cost objects and the presence of multiple levels of variability conduces to the identification of intermediate stages of activities, that is, activity outputs that are inputs to successive work activities. The cost of the resource used at the intermediate level cannot easily be traced directly to final cost objects, because it is extremely difficult to perceive the causal relationship linking them. As a result, a multistage cost assignment process emerges, in which a significant amount of what may be labeled as “organizational work activity” supports the activities that are in closer proximity to products and customer services. It is, therefore, possible to explicitly detect and measure the variation and diversity of resource consumption due to different products or service line. By means of the multistage cost assignment process, the cost of these support activities is traced in proper proportions to other activities that require their work. These costs are eventually burdened into the primary activity costs. The ABC approach requires mapping every administrative and clinical activity involved in the treatment of specific medical condition (Ostinelli, 1995).

These activities are the analytical components of a processes (i.e. a “net” of activities performed in the accomplishment of a specific aim) that “starts when the patient first presented for treatment and extended through surgery, recovery and discharge” (Baker, 1998). In order to adequately perceive the major interrelations existing among different activities, a process map must consequently be drawn. In hospitals like in businesses, this requires the involvement in the project of “groups of experts”; i.e. multidisciplinary teams composed by personnel that possesses “expertise” in performing each and every step of the process. Significant improvements in the level of efficiency may arise in this step of the work, through the removal or the amendment of activities that prove to be redundant, erroneous or useless and therefore are labeled as “non value added”. In fact, ABC is not only a method of costing, but it also represents the first step toward Activity Based Management (ABM), a group of techniques for managing the organization better. ABC measures the cost and performance of activities, resources and cost-objects in order to generate more accurate and meaningful information for decision-making. By means of the data and information provided by ABC systems, managers gain a thorough understanding of their processes and cost behavior. This knowledge is easily diffusible within the organization: ABC and ABM describe activities using an “action-verb-adjective-noun” grammar convention that is highly understandable. “Such wording is powerful because managers and employee teams can better relate to these phrases, and the wording implies that the work activities can be favorably affected, changed, improved, or eliminated” (Cokins, 2001). In conclusion, the knowledge provided by the ABC system acts as a strong incentive for reengineering initiatives (i.e. non-continuous improvement projects). It also supports ABM and its quest for continuous improvement by allowing management to gain new insights into activity performance by focusing their attention on the sources of demand for activities.

Additionally, we should mention time driven activity based costing (TDABC), as an enhancement of traditional ABC systems. Its proponents advocate that it improves the original methodology by eliminating the need for time consuming, subjective interviews and survey process to define resource pools, that it reduces the processing time required to elaborate the data (thus allowing a more detailed mapping of the resource consumption patterns), that it is easier to maintain and update, and that it enables more accurate representations of over/under capacity by expressing it in units of time (Kaplan and Anderson, 2003; Keinth, 2004; Kaplan, 2005; Demeere et al., 2009; Dewi et al., 2009; Dejinega, 2011; Öker et al., 2013).

Accurate cost measurement in health care is a difficult task, mainly because of the inherent complexity of healthcare itself (Kaplan and Porter, 2011). In fact, every treatment involves the consumption of many different types of resources - personnel, equipment, space, and supplies - each with different capabilities and costs.

If one follows the care cycle, it appears clear how different resources, pertaining to different responsibility centers, are being activated every time a patient requires a treatment. This mix of clinical and administrative activities, and the variety of medical conditions presented by patients, adds complexity to the process, rendering the calculation of costs particularly difficult (Francesconi, 1993; Waters et al., 2003; Järvinen 2005; Cinquini et al., 2009; Ashford, 2011; Bahadori et al., 2012; Doyle et al., 2002 and 2004; Eriksen et al., 2011; Geri and Ronen, 2005; Kuchta and Zabek, 2011; Groves et al., 2013; Kaplan et al., 2013; Popesko, 2013).

The already complex path of care is further complicated by the highly fragmented way in which health care is delivered today (Kaplan and Porter, 2011). Care is also idiosyncratic; patients with the same condition often take different paths through the system. There is also a lack of standardization, due to the fact that medical practices allow for considerable discretion - physicians in the same organizational unit performing the same medical process often use different procedures, drugs, devices, tests, and equipment. In operational terms, healthcare could be described as a highly customized job shop (Kaplan and Porter, 2011).

4. A SUMMARY OF TWO CASE STUDIES

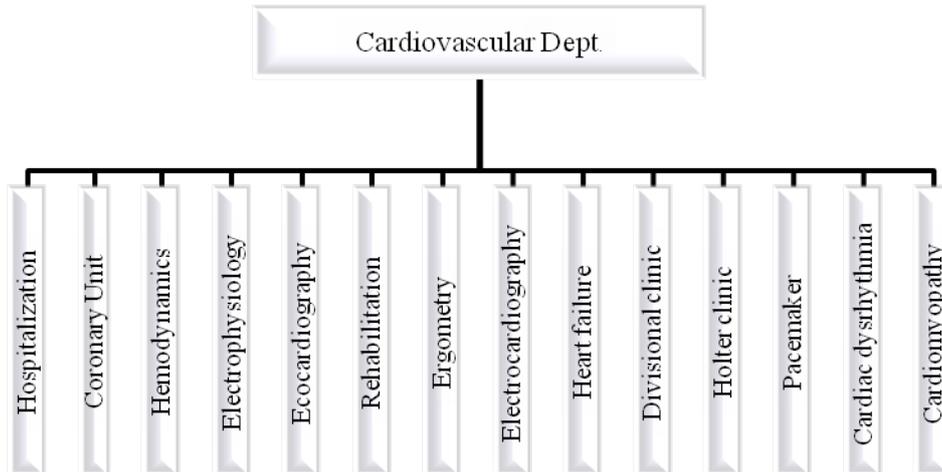
In order to describe the various steps that have to be considered in order to develop a unitary model for cost determination and analysis at whole hospital level, we present two specific case studies. One of them was conducted at the Cardiovascular Department² of the AOU (Azienda Ospedaliera Universitaria – University Hospital) of Trieste, Italy. The other regards the Dentistry and Stomatology Clinic, within the Department of Specialist Surgery of the same hospital³. One of the activities performed was an analysis of the organizational structure of the units examined. In both cases, the

² We are thankful to C. Ciccarelli, who developed her master thesis on this topic, under the supervision of G. Sinagra, A. Rebelli, and G. Grisi.

³ This study was developed by A. Avanzini, to whom we are grateful, in her master thesis under the supervision of R. Di Lenarda, A. Rebelli, and Grisi.

units presented a high level of organizational complexity; the following organizational chart shows, for example, the structure of the Cardiovascular Department:

Figure 5: Organizational chart of the Cardiovascular Department



The conventional cost system, already adopted by the hospital, although structured by responsibility centers, does not possess the required level of analysis and granularity, necessary to reflect the organizational complexity shown in the above chart. For example, the Cardiovascular Department has nine different clinics (each corresponding to an activity cost pool), while the cost system only has one single cost center for all the clinics included in the Department. Similarly, in the Dentistry and Stomatology Clinic case, the cost centers identified correspond to activity cost pools, since each has specific resources, and it is characterized by the use of different technology, physical space, and professional skills.

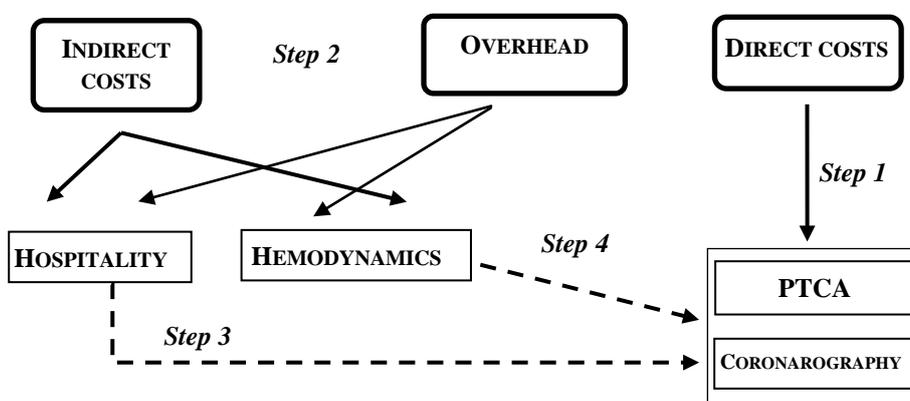
In both cases, it was necessary to select only a few medical treatments, given the high level of technical complexity encountered (number and variability of treatments performed by the organizational units), and the time and cost constraints of the studies. For example, in the case of the Cardiovascular Department, the attention of the research team focused on Clinic of Hemodynamic, which deals with diseases related to the blood circulation. This clinic performs about 1,800 treatments per year, highly differentiated by nature and complexity, classified in following three categories, in order of growing emergency: elective, urgent, and emergent. The study focused only on the costs attributable to the first category. In particular, the analysis concerned two specific treatments (coronarography and percutaneous transluminal coronary angioplasty - PTCA), that correspond to three different DRG (Diagnosis-related Group): 125, 556, and 558. In the case of the Dentistry and Stomatology Clinic, a preliminary distinction was introduced among treatments with different payment/reimbursement modality. In fact, this clinic operates partly on the market, asking the patient the full price of the medical treatment, and partly within the Italian National Health System. The ABC cost model was developed only considering the

treatments performed within the “institutional” context, i.e. those with no or partial payment from the patients. These treatments represented in 2010 approximately 61% of the total activities performed by the clinic, and were composed by 70 different items, totalling 74,983 treatments.

The next step consists in defining the flow of the activities performed within the organizational units analysed, in order to determine the cost of the objects identified. At the present stage, the analysis of the activities was confined to those performed within the chosen units, whereas, in more advanced stages of the project, it would be advisable to extend the analysis to interactions arising among different Departments.

The following figure illustrates the cost attribution process that was developed within the Clinic of Hemodynamics for the two medical treatments previously mentioned (coronarography and PTCA).

Figure 6: The logic of the cost allocation model in the Cardiovascular Department



The first step in the four-step cost allocation process developed by the research team required the determination of costs directly attributable to the two cost objects, consisting of drugs, medical and general materials, linens, laboratory analyses provided by other departments, and use of surgery room. Direct costs amounted approximately to €350 for coronarography, and were 4 times higher for PTCA⁴. In step 2, department overhead costs were traced to the activity cost pools, according to specific resource drivers. The most important overhead cost was certainly represented by personnel costs, which amounted approximately to €7 million, corresponding to 134 full time equivalent workers. The resource driver chosen in this case was a duration driver, derived by the analysis of personnel yearly average shifts. The remaining overhead costs consisted of depreciation, maintenance, cleaning, laundry, utilities, garbage disposal, security, EDP, and other indirect costs. For each category, an appropriate resource driver was identified and adopted. The cost of hospitalization (step 3) was attributed to the cost objects by means of resource drivers capable of capturing the

⁴ Considering that this is just the first stage of a more comprehensive research project, the data are still temporary and subject to verification and integration. For these reasons, the Authors were requested by the management of the University Hospital of Trieste not to fully disclose some results of the analysis. Given the fact that this paper focuses mainly on the methodology of cost analysis, we believe that this limited disclosure of data is not detrimental to the implications that can be drawn from our research.

different complexity and length of the treatments performed in favour of the hospitalized patient, and therefore the intensity of the resource consumption. The final step utilized activity drivers in order to trace the cost of the Hemodynamics cost pool to the two cost objects. In this context, the team chose to select different activity drivers in relation to the nature of the inputs. As an example, for medical personnel cost, the activity driver was linked to the standard duration of the treatment, and was so calculated:

$$\text{Cost of personnel} * \frac{\text{avg. time needed for the treatment}}{\text{total surgery room hours available}}$$

The whole process led to determine the full costs for the coronarography for normal patient approximately equal to € 1,400. The approximate proportions among the calculated costs of different treatments in the clinic are the following:

Table 1: Costs of treatments provided by the Hemodynamics clinic

Treatment	Costs for a “normal” patient	Costs for a patient with complications
Coronarography	100%	115%
PTCA with non-medicated stent	255%	280%
PTCA with medicated stent	278%	310%

The results achieved can be compared with the tariffs determined by the Italian National Health System, used for calculating standard costs and for refunding private providers of healthcare when operating under a convention with the National Health System. Table 2 reports the tariffs:

Table 2: Italian NHS tariffs for the treatments examined

Treatment	DRG No.	Old tariff	New 2013 tariff
Coronarography	125	€1,908.64	€2,142
PTCA with non-medicated stent	556	7,976.63	4,747
PTCA with medicated stent	558	7,976.63	6,434

By comparing the amounts calculated in the research, it emerges that, even considering the new, revised tariffs introduced in 2013⁵, the effective costs measured at the University Hospital of Trieste are lower than the standard costs determined by the Italian National Health System, even in the case of the “patient with complications”, i.e. needing a longer hospitalization than a “normal” patient. However, given the fact that national tariffs only loosely reflect the actual consumption of the resources, it cannot be excluded that other treatments may be instead under-priced, leading to a

⁵ The tariffs were introduced by the Decree of the Ministry of Health of 18 October 2012, published in the Official Journal of the Republic of Italy on 28 January 2013.

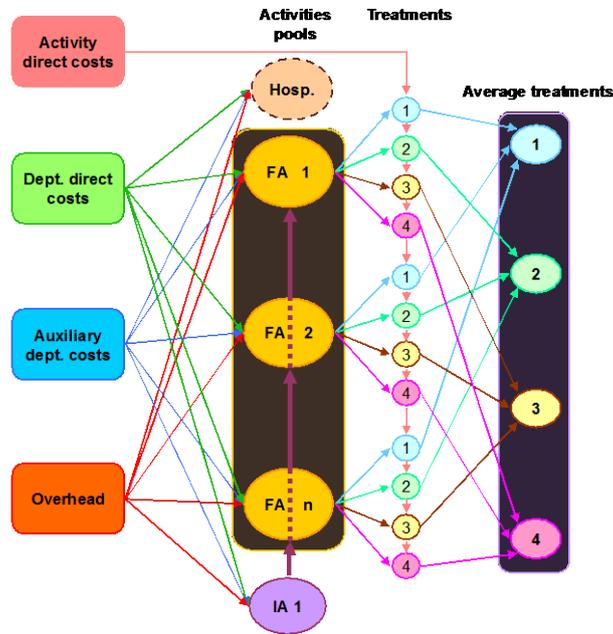
well-known effect named cross-subsidization among different “products”. Although the tariffs do not take into consideration regional variations in the costs of the treatment, it is safe to assume that they probably offer an incentive for private providers of healthcare to enter the market, especially if one considers that private hospitals can choose to focus their offer on elective treatments, leaving the more costly emergency and urgent treatment to the public providers of healthcare.

With reference to the Dentistry and Stomatology Clinic, the following cost allocation pattern was identified. While apparently very different, the cost allocation pathway is in reality rather similar to the one previously described. For this reason, we only focus our attention on specific issues raised by this case study.

One of the differences in the logic of cost attribution consisted in the fact that the indirect costs were more detailed, being divided into costs directly attributable to the structure (but not to the cost objects), and department overhead.

Another difference arose from the presence of activity pools whose costs were not attributed forward (hospitalization and surgery room). In other cases, costs were not traced immediately to the final cost objects (laboratory, sterilization, and check-in procedures). These costs were in fact traced to other activity cost pools. In particular, the costs related to the activity of sterilization carried a significant weight (€213,172 over a total of €2,756,942); therefore, the cost of the final objects was extremely sensitive to the allocation criterion chosen. Finally, the above reported graph shows that the final cost figure arises as an average of similar activities performed in different activity cost pools. In fact, even if every cost pool is characterized by specific resources, the activity they perform is often very similar. For this reason, it was necessary to calculate an average cost of each activity performed.

Figure 7: Pattern of cost assignment in the Dentistry and Stomatology Clinic



Note: FA = Final activities; IA = Intermediate activities

Another specific issue concerning this case arose in relation to the existence of unpaid work performances: in fact, dentistry medical postgraduate students pursuing their specialization, unlike the norm in other fields, do not perceive any remuneration for their work performed within the Clinic. This certainly led to an understatement of the costs, requiring an adjustment consisting in the introduction of a figurative cost for the above mentioned professional positions. Although the cost accounting system of the hospital does not take into consideration this figurative charge, this cost is not negligible, weighing almost 10% of the total cost of the Department (€260,000 over a total cost of €2,756,942⁶).

In this case study we could also observe some cross-subsidization among different treatments, where the calculated costs were greater than the national tariff in some cases, and lower in others. For example, a short visit has a tariff of €16.60, but a cost of €25.46, whereas a specialist visit has a tariff of €59.40, but a cost of just €25.55.

5. CONCLUSIONS

The enhancement of information content provided by the Activity Based Costing approach in the pilot case studies we have realized proved to be relevant. The cost

⁶ The cost of work services performed by postgraduate students was estimated multiplying the number of the dentistry students by the average cost of students specializing in other medical fields.

figures obtained resulted more accurate, realistic and reliable, mainly because ABC fully recognizes the effects of different complexity levels presented by different activities performed by the organization. In the case of healthcare, differences in complexity may be quite substantial, leading to completely different cost figures for different treatments. However, the implementation of this method is not without an additional effort, for it requires the availability of data which are not usually gathered by traditional cost systems. Moreover, the obsolescence of the information provided can be an important problem, because activities performed in a complex environment (such as healthcare providers) tend to change with a dramatic pace. For this reason, ABC cannot completely replace traditional responsibility accounting, but it offers most of its potential when used in ad-hoc applications, i.e. with the purpose of determining the costs of specific activities or treatments. A possible improvement, traditional cost systems could be modified in order to incorporate the systematic gathering of relevant data needed in order to perform this analysis.

REFERENCES

- Armeni P., Ferré, F. (2012), *La spesa sanitaria: composizione ed evoluzione, L'aziendalizzazione della sanità in Italia*, Rapporto Oasi.
- Ashford C. Chea (2011), *Activity-Based Costing System in the Service Sector: A Strategic Approach for Enhancing Managerial Decision Making and Competitiveness*, International Journal of Business and Management, 11, pp.3-10.
- Bahadori M., Babashahy S., Teymourzadeh E. and Mostafa Hakimzadeh S., (2012) *Activity based costing in health care center: A case study of Iran*, African Journal of Business Management, 6, pp. 2181-2186;
- Baker, J.J. (1998), *Activity-Based Costing and Activity-Based Management for Health Care*, Aspen Publishers, Gaithersburg, Maryland.
- Bubbio A. (1993), "L'Activity Based Costing per la gestione dei costi di struttura e delle spese generali", *Liuc Papers*, 4, pp. 1-27;
- Cinquini L. Miolo Vitali P., Pitzalis A. and Campanale C. (2009), *Process view and cost management of a new surgery technique in hospital*, Business Process Management Journal, 6, pp.895-919.
- Cokins G. (2001), *Activity-Based Cost Management, An Executive's Guide*, John Wiley & Sons, Inc.
- Cooper R., and Kaplan R. S. (1988), *Measure Costs Right: Make the Right Decisions*, Harvard Business Review, 1988.
- Dejnega O. (2011), *Method Time Driven Activity Based Costing – Literature Review*, Journal of Applied Economic Sciences, 1, pp. 7-15;
- Demeere N., Stouthuysen K., Roodhooft F. (2009), *Time-driven activity-based costing in an outpatient clinic environment: Development, relevance and managerial impact*, Health Policy;
- De Rosa B. (2000), *Attività aziendali e processi di attribuzione dei costi*, Edizioni Goliardiche, Trieste.
- Dewi D. S., di Mascio R., van Voorthuysen E.J. (2012), "Application of Time Driven Activity Based Costing to an Industrial Service Provider", *Proceedings of the Asia Pacific Industrial Engineering & Management Systems Conference*;
- Doyle G., Duffy L. and McCahey M. (2002), *An Empirical Study of Adoption/Non-adoption of Activity Based Costing in Hospitals in Ireland*, UCD Business Schools.
- Doyle G., Duffy L. and McCahey M. (2004), *Case Studies of ABC Adoption in Hospitals: A Comparison across Canada and Ireland*, UCD Business Schools.

- Drouin J. P., Hediger V., and Henke N. (2008), *Health care costs: A market-based view*, The McKinsey Quarterly.
- Ehrbeck T., Henke N., and Kibasi T. (2010), *The emerging market in health care innovation*, McKinsey Quarterly, 2010;
- Eriksen S. D., Urrutia I., Cunningham G. M. (2011), *Design of an activity based costing system for a public hospital: a case study*, Journal Managerial and Financial Accounting, 1, pp. 1-21.
- Francesconi, A. (1993), *L'Activity - Based Costing nei servizi sanitari: un'analisi critica*, Economia & Management, v. 1, p. 33-46.
- Geri N. and Ronen B. (2005), *Relevance lost: the rise and fall of activity-based costing*, Human System Management, 24, pp. 133-144.
- Grisi, G. (1997), *Introduzione alle misure di efficienza nelle aziende ospedaliere*, Edizioni Goliardiche, Trieste.
- Groves P., Kayyali B., Knott D., Van Kuiken S. (2013), *The 'big data' revolution in healthcare Accelerating value and innovation*, McKinsey&Company;
- Gupta M., Galloway K. (2003), *Activity-based costing/management and its implications for operations management*", *Tecnovation*, 23, 2003, pp.131-138;
- Järvinen J. (2005), "Rationale For Adopting Activity-Based Costing In Hospitals", *University of OULU*.
- Kaplan R. and Anderson S. R. (2004), *Time-Driven Activity-Based Costing*, Harvard Business Review.
- Kaplan R. S. (2005), *Rethinking Activity-Based Costing*, Research & Ideas, HBS.
- Kaplan R. S. and Porter M. E. (2011), *How to Solve the Cost Crisis In Health Care*, Harvard Business Review, pp. 47-64.
- Kaplan R. Witkowski M. L., Hohman J. A. (2013), *Boston Children's Hospital: Measuring Patient Costs*, Harvard Business School.
- Kaplan, R.S. and Cooper, R. (1998), *Cost & effect. Using integrated cost systems to drive profitability and performance*, Harvard Business School Press, Boston, Massachusetts.
- Keinth N Cleland (2004), *Limitations of Time-Driven Activity Based Costing, from a Contribution Based Activity™ perspective*, CIMA, 2004.
- Kuchta D., Ząbek S., "Activity-based costing for health care institutions", *8th International Conference on Enterprise Systems, Accounting and Logistics*, 2011, pp. 300-311;
- McKinsey Global Institute (2008), *Accounting for the cost of US health care: A new look at why Americans spend more*.
- Öker, Figen PhD; Özyapici, Hasan PhD, (2013), A New Costing Model in Hospital Management: Time-Driven Activity-Based Costing System, *The Health Care Manager*, 1, 2013, pp.23-36;
- Ostinelli C. (1995), *La mappatura e l'analisi dei processi gestionali: al cuore dell'activity based management*, Liuc Papers, 22, pp. 1-46.
- Pammolli F., Salerno N. C. (2011), "Le proiezioni della spesa sanitaria SSN", *Working paper*, CERM, 3, 2011.
- Perotti L. (2006), *Analisi e valutazione dei costi delle prestazioni sanitarie*, *Economia Aziendale Online*, 4, pp. 36-71;
- Popesco B. (2013), *Specifics of the Activity-Based Applications in Hospital Management*, *International Journal of Collaborative Research on Internal Medicine & Public Health*, 3, 2013, pp.179-186;
- Reinhardt U. E., Hussey P. S., and Anderson G. F. (2004), *U.S. Health Care Spending In An International Context*, *HealthAffairs*, 3, 2004, pp. 10-25;
- Sandison D., Hansen S. C., and Torok R.G. (2003), "Activity-Based Planning and Budgeting: a New Approach from CAM-I", *Cost Management*, 17, pp. 16-22;

- Scheggi M. (2012), *Il governo della spesa sanitaria*, Rigore ed Equità.
- Stacul F., Pozzi-Mucelli, F., Lubin, E., Gava, S., Cuttin-Zernich, R., Grisi, G. and Cova, M.A. (2006), *MR angiography versus intra-arterial digital subtraction angiography of the lower extremities: activity-based cost analysis*, *La radiologia medica*, 111, 73-84.
- Stacul, F., Sironi, D., Grisi, G., Belgrano, M., A. Salvi, A., and Cova, M. (2009), *64-Slice CT coronary angiography versus conventional coronaryangiography: activity-based cost analysis*, *La radiologia medica*, 114, 239-252.
- Waters H., Abdallah H., Santillán D. and Richardson P. (2003), *Application of Activity-Based Costing (ABC) in a Peruvian NGO Healthcare System*, Quality Assurance Project.
- World Health Organization (2000), *The World Health Report - Health System: Improving Performance*.
- World Health Organization (2010), *The World Health Report - Health System financing: the path to universal coverage*.

Željana Aljinović Barać

University of Split – Faculty of Economics Split, Croatia

Tina Vuko

University of Split – Faculty of Economics Split, Croatia

Tonči Vučak

University of Split – Faculty of Economics Split, Croatia

EFFECTS OF WORKING CAPITAL MANAGEMENT ON PROFITABILITY: EVIDENCE FROM CROATIA

ABSTRACT

Working capital management includes managing the relations between firm's short-term assets and liabilities in order to obtain the optimum level of both. The objective of this paper is to empirically investigate the impact of working capital management on the profitability on the sample of trading firms, because the trade industry is the most common type of activity in Croatia. The effects of different variables of working capital management including the average collection period, inventory turnover in days, average payment period and cash gap are researched. Variables of return on assets (ROA) and return on equity (ROE) are employed as measures of company's profitability. The variables of debt ratio, sales growth, size of the company and working capital to total assets ratio have also been used for controlling the working capital management policy. Our findings are not consistent with the view of the traditional working capital theory and previous research results. Obtained results show that only the number of days accounts receivable is statistically significant correlated with the return on equity while statistically significant relation between other variables examined have not been found. Finally, statistically significant difference in working capital management policy between wholesale and retail trading companies is found.

Keywords: working capital management, profitability, trade industry, Croatia

JEL classification: M40, M41

1. INTRODUCTION

Working capital management (WCM) include managing the relations between firm's short-term assets and liabilities in order to obtain the optimum level of both. It can be considered as vital issue in financial decision-making and thus it directly affects the profitability of the company. According to Eljelly (2004:48) working capital management involves planning and controlling current assets and liabilities in the manner that eliminates the risk of inability to meet short term obligations and avoid

excessive investment in these assets at the same time. Furthermore, effective working capital management shortens the time that capital is tied up in the business process and consequently reduces the costs of capital from alternative sources. Working capital management and its relation to firm's profitability has been subject of many previous researches. However, these researches are mostly conducted in developed countries and only few of them are dealing with working capital management policies in emerging markets. Thus, the purpose of this paper is to examine the impact of working capital management on the profitability in trade industry in Croatia because according to our knowledge, similar research has not been done yet. Hence, our contribution can be found in research of determinants of the working capital management on the case of bank-oriented economy with emerging capital market.

The remainder of the paper is organized as follows: Section 2 presents the theoretical background of the research and Section 3 explains the sample, variables, research design and hypotheses. Empirical results of the research are presented and analyzed in the Section 4 whereas the conclusions appear in the last Section.

2. LITERATURE REVIEW

Working capital management and its relation to firm's profitability has been the subject of the many previous researches. Shin and Soenen (1998) were among the first ones that investigated the relation of efficient management of working capital with enhanced profitability on the sample of firms listed on the US Stock Exchange during the period 1975-1994. Their results showed a strong negative relation between the amounts of the firm's working capital and its profitability. In addition, they found that reasonable reduction in the cash conversion cycle could lead to an increase in the firms' profitability. These findings were also supported by Deloof (2003), who investigated the relation between working capital management and corporate profitability on the sample of more than 1,000 large Belgian non-financial firms for the 1992-1996 period and found that managers can increase firm's profitability by reducing the average collection period and inventories turnover ratio. In addition, he concluded that less profitable firms have longer average payable period. The same findings were recorded from Anand and Malhotra (2007) research on the sample of the 339 S&P CNX 500 non-financial corporations in India for the 2001-2003 period and Nobanee and AlHajjar (2009) research on the sample of 2123 Japanese non-financial firms listed in the Tokyo Stock Exchange for the 1990-2004 period.

Specificities of working capital management and its impact on profitability in small and medium enterprises in Pakistan on the sample of 40 firms listed in Karachi Stock Exchange for the 2003-2008 period were researched by Afeef (2011). His findings suggested that indicators of working capital management had a perceptible negative impact on profitability. The sample of companies listed in Karachi Stock Exchange was also the subject of Raheman and Nasr (2007), Falope and Ajilore (2009), Nazir (2009), Raheman et al. (2010) studies, and their findings were consistent with previous ones. Similar research were also conducted by Padachi (2006), Lazaridis and Tryfonidis (2006), Mathuva (2010), Gill et. al (2010), Dong and Su (2010), Kaddumi and Ramadan (2012), etc.

In an emerging European market, Charitou et.al (2010), using a dataset of firms listed in the Cyprus Stock Exchange, showed that there is negative association between the firm's profitability and cash conversion cycle as well as with all working management components: inventory turnover, average collection period and average payable period. Moreover, they concluded that efficiency is expected to lead to the reduction in default risk and to the improvement of the firm's value. After that, Charitou et. al (2012) used a dataset of all Indonesian firms over the period 1998-2010 to examine the relations between working capital management and firm's profitability in Asian emerging market and those findings on cash conversion cycle are contrary to previous: cash conversion cycle and net trade cycle are positively associated with the firm's profitability. Results also show that firm's riskiness, as measured by the debt ratio, is negatively related to the firm's return on assets.

Binti Mohamad and Binti Mohd Saad (2010), Alam et al. (2011), Pouraghajan and Emamgholipourarchi (2012) provided empirical evidence about the impact of working capital management on profitability and even more, on market evaluation. The results of the research indicate that there is a significant relation between the working capital management and profitability of company but there is no significant relationship with the market value of the company. Additionally, they concluded that management can increase the profitability of company through reducing cash conversion cycle and total debts to total assets ratio.

The relation between liquidity and profitability was also investigated by Eljelly (2004) using a sample of Saudi Arabian companies, who added a variable size in the research. The size of the company was found to have a profound impact on its profitability. Uyar (2009) followed Eljelly's methodology and investigated relation between cash conversion cycle and the size and profitability of Turkish firms listed on the Istanbul Stock Exchange. He found significant negative linkage of cash conversion cycle with the firm size as well as with its performance and concluded that smaller firms have longer cash gap. However, Falope and Ajilore (2009) found no significant variations in the effects of working capital management between large and small firms, using a sample of 50 Nigerian listed non-financial firms for the period 1996 -2005.

Ding et. al (2010) analyzed the relation between investment in fixed capital, working capital and financing constraints. They found that firms with high working capital displayed excessive sensitivity between investment in working capital and cash flows and low sensitivity between investments in fixed capital and cash flows. In addition, they suggest that good working capital management may help firms to alleviate the effects of financing constraints on fixed investment.

One of the few that did not found the average payable period and firm size statistically significant related with profitability was Ray (2012), who conducted a research on the sample of Indian manufacturing firms for the 1996-2010 period. On the other hand, the strong negative relation was identified between the cash conversion cycle, financial debt ratio and corporate profitability.

As it can be seen from the above described empirical evidences, although the subject of working capital management has been investigated worldwide, there are inconclusive

and inconsistent results with regard to the role of working capital management on a firm's financial performance. Furthermore, no significant study was conducted on the issue regarding impact of working capital management components on corporate profitability in Croatia that can be found as contribution of our research.

3. RESEARCH DESIGN

Based on theoretical background discussed above, the aim of our research is to investigate the relations between profitability ratios and different working capital management measures of companies in trade industry, as the most common type of activity in Croatia. Additionally, trading firms have a very small investment in fixed assets but require a large sum of money to be invested in working capital (Samson et. al, 2012:63). The working hypothesis is that companies which manage working capital more efficient will obtain better financial performance measured by different profitability ratios. In addition, the difference in working capital management policy in wholesale and retail trade is investigated. In order to test the above relations, the following statistical hypotheses have been developed (alternative form):

H₁ ...Working capital management components have statistically significant impact on company's profitability.

H₂ ... Working capital management do statistically significant differ in wholesale and retail trade industry.

3.1. Sample selection and variables description

This research is conducted on the sample of 70 Croatian large joint stock and limited companies from the trade industry. The data are collected from their annual financial reports for the single period of 2010 and they are analyzed using the PASW v. 18.0. software.

Variables return on assets (ROA) and return on equity (ROE) ratios are proxy variables for company's profitability and they are set as dependent in multivariate analysis, similar to Charitou et. al (2010), Afeef (2011), Charitou et. al (2012), Pouraghajan and Emamgholipourarchi (2012), Kaddumi and Ramadan (2012), etc. ROA is calculated as operating income divided by total assets and ROE is calculated as net income divided by owner's equity.

Several factors of working capital management that could affect company's profitability are considered: average collection period, inventory turnover in days, average payment period and cash gap (cash conversion cycle). Those variables are set as independents in multivariate analysis, and they are selected based on their relevance on previous research results on this topic. Average collection period (ACP) or number of days accounts receivable is used as proxy for the collection policy, similar to Shin and Soenen (1998), Deloof (2003), Lazaridis and Tryfonidis (2006), Raheman and Nasr (2007), Charitou et. al (2010), Gill et al (2010), Afeef (2011), Kaddumi and Ramadan (2012), Ray (2012), etc. It is calculated as daily accounts receivable divided

by sales. Expected association with firm's profitability is negative, indicating that reduction in average collection period will enhance profitability. Inventory turnover in days (INVT) or number of days inventories is used as proxy for the inventory policy and it is calculated as daily inventories divided by the cost of goods sold. Shin and Soenen (1998), Deloof (2003), Lazaridis and Tryfonidis (2006), Raheman and Nasr (2007), Charitou et. al (2010), Gill et. al (2010), Afeef (2011), Kaddumi and Ramadan (2012) and Ray (2012) used this variable and found statistically significant negative correlation with firm's profitability. Average payment period (APP) or number of days accounts payable is used as proxy for the payment policy, according to Shin and Soenen (1998), Deloof (2003), Lazaridis and Tryfonidis (2006), Raheman and Nasr (2007), Charitou et. al (2010), Gill et al (2010), Afeef (2011), Kaddumi and Ramadan (2012) and Ray (2012) approach. It is calculated as daily accounts payable divided by the cost of goods sold, and expected sign of association with profitability is not uniquely determined in previous research. These three variables described above are integrated in cash gap model or cash conversion cycle (CCC) as a comprehensive measure of working capital policy, which is consistent with Deloof (2003), Lazaridis and Tryfonidis (2006), Raheman and Nasr (2007), Charitou et. al (2010), Gill et al (2010), Charitou et. al (2012) Afeef (2011), Pouraghajan and Emamgholipourarchi (2012), Kaddumi and Ramadan (2012) and Ray (2012) research. It is calculated as a sum of average collection period and inventory turnover in days less average payment period and it show time lag between the expenditure for the purchase of goods and the collection for the sale of that goods. Expected association with firm's profitability is negative, indicating that effective working capital management and shortening of cash conversion cycle enhances profitability.

The variables of debt ratio, sales growth, size of the company and working capital to total assets ratio have also been used for controlling the working capital management policy. According to Shin and Soenen (1998), Lazaridis and Tryfonidis (2006), Raheman and Nasr (2007), Charitou et. al (2010) , Gill et al (2010), Afeef (2011), Charitou et. al (2012) and Pouraghajan and Emamgholipourarchi (2012), debt ratio (DR) is proxy for leverage. Negative relation with profitability is expected, indicating that when leverage increases it will adversely affect the profitability. Variable size (LSIZE) is calculated as natural logarithm of total assets and its association with firm's profitability cannot be uniquely determined. For example, Eljelly (2004) found positive correlation between size of the company and working capital management, while Uyar (2009) concluded that smaller firms have longer cash conversion cycle and Ray (2012) did not found the firm size statistically significant related with profitability. Variable of working capital to total assets ratio (WCTA) is used in Padachi (2006), Lazaridis and Tryfonidis (2006) and Raheman and Nasr (2007) research and Shin and Soenen (1998), Deloof (2003), Raheman and Nasr (2007), Charitou et. al (2010), Afeef (2011) and Charitou et. al (2012) controlled working capital management policy for the sales growth (SG) variable. Detail description of variables used in the research is presented in the table 1.

Table 1: Definition of variables

Symbol	Variable	Explanation
ROA	Return on assets	Operating income/ Average total assets
ROE	Return on equity	Net income / Average owner's equity
INVT	Inventory turnover	Average inventories / (Cost of goods sales /365)
ACP	Average collection period	Average accounts receivable / (Sales/365)
APP	Average payable period	Average accounts payable / (Cost of goods sales/365)
CCC	Cash conversion cycle	ACP + INVT – APP
WCTA	Net working capital to total asset	(Accounts receivable – Accounts payable) /Total Assets
DR	Debt ratio	Total liabilities/Total Assets
LSIZE	Size	Ln(Total Assets)
SG	Sales growth	(Sales _t – Sales _{t-1}) / Sales _{t-1}

Source: Authors' elaboration (2013)

4. RESEARCH RESULTS AND DISCUSSION

4.1. General findings

Descriptive statistics highlight the average, minimum and maximum values of all variables used in the research and they are shown in the table below:

Table 2: Descriptive Statistics

	ACP	INVT	APP	CCC	ROA	ROE	WCTA	LSIZE	SG	DR
Mean	49.30	79.58	106.24	22.64	0.039	0.134	0.032	19.01	0.078	0.715
Median	28.06	54.51	86.21	6.39	0.033	0.050	0.036	18.73	0.011	0.739
Std. Dev.	56.31	69.02	90.17	113.43	0.079	0.509	0.251	1.11	0.458	0.225
Min.	1	12	21	-599	-0.177	-1.88	-0.654	17.65	-0.55	0.120
Max.	343	358	652	368	0.375	1.772	0.534	22.79	3.045	1.210

Source: Estimated according to data from authors' database (2013)

Data presented in the table provide insights in working capital management features of firms in trading industry in Croatia. It shows that companies in average wait 49 days to receive payment from customers, and they use average twice as many days (106) to pay their creditors. The credit period granted by companies to their customers range from 1 to 343 days while credit period granted from suppliers range from 21 to 652 days. The longer the number of days accounts receivable, the bigger the uncertainty about the collectability of an amount is, and, consequently the bigger the probability of loss. Inventories take minimum 12 days and maximum a year to be sold in trade companies

in Croatia. Average inventory turnover indicate that company in average spend 80 days from the purchasing until the sales of inventory. The lower the number of days inventories, the better the turnover and profitability. In addition, a decrease of cost related to inventories (e.g. insurance cost, write-off, storage cost, etc.) could be expected. Cash Conversion Cycle varies from -599 to 368 days. Although negative cash gap looks better than the fact that company should provide additional capital sources for a year because its capital is tied up in the business process, shortening of cash conversion cycle by aggressive collection of receivables and/or stretching the payables could also have negative implications on sustainability of business in a long run. Average return on assets ratio is 0.04 and average return on equity is 0.13 for trading firm in Croatia.

4.1. Univariate analysis

In the first part of the empirical research, univariate analysis is conducted. In order to test hypothesis about statistically significant impact of working capital management components on firm's profitability, Pearson's correlation coefficients are calculated and the correlation matrix is presented in Table 3:

Table 3: Pearson's correlation coefficients matrix

	ROA	ROE	INVT	ACP	APP	CCC	WCTA	LSIZE	SG	DR
ROA	1	0.319**	-0.025	0.044	0.020	-0.010	0.533**	-0.153	-0.081	-0.379**
ROE		1	-0.095	-0.116	-0.078	-0.054	0.147	-0.045	-0.306*	0.113
INVT			1	0.152	0.150	0.565**	0.185	-0.130	-0.029	-0.063
ACP				1	0.247*	0.392**	0.230	0.149	-0.181	-0.084
APP					1	-0.581**	0.058	0.184	0.182	0.173
CCC						1	0.180	-0.152	-0.252*	-0.218
WCTA							1	-0.146	-0.035	-0.559**
LSIZE								1	-0.008	0.163
SG									1	0.233
DR										1

Note: **.Correlation (2-tailed) is significant at the 0.01 level, *at the 0.005 level respectively.
Source: Estimated according to data from authors' database (2013)

As it can be seen from the presented results, Pearson's coefficient values indicate very weak positive or negative association between profitability measures ROA and ROE and working capital management proxies that are not statistically significant. However, according to Deloof (2003:578), a shortcoming of Pearson correlation is that it does not allow to identify causes from consequences. Therefore, a multivariate analysis is also applied.

To test second hypothesis about statistically significant difference of working capital management proxy of the cash conversion cycle in wholesale and retail trade industry, firms from the sample are divided in two groups, those doing business predominantly in wholesale and retail trade industry. This hypothesis is based on the fact that firms in wholesale sector usually sell goods to other corporate clients - business entities, while

the main group of consumers of goods of companies in retail sector are natural persons. Consequently, wholesale sector is characterized with bills on large amounts and invoices due date in the future paid by wire transfers, and retail sector characterizes great number of small amount bills paid on collection of goods, usually exchanging. First, each group statistics is calculated and it shows that average cash gap in wholesale industry is 50,76 days (N=31) and average cash gap in retail trade industry is 0,28 days (N=39) and it confirms the above described assumption. Conducted t-test for equality of means ($t=-1,987$; $\text{sig}=0,051$) indicate that there is statistically significant difference in working capital management between trade companies in wholesale and retail industry. However, this difference could be also assigned to the different groups of consumers rather than difference in working management policies.

4.2. Multivariate analysis

OLS regression data analysis as multivariate analysis method is used to test hypotheses about impact of working capital management components and cash conversion cycle on company's profitability. The variables of debt ratio, size of the company and working capital to total assets ratio have also been used for controlling the working capital management policy. Based on Deloof (2003) methodology, general form of empirical model is:

$$\text{Profitability}_i = \beta_0 + \beta_1 * \text{WCM}_i + \beta_2 * \text{DR}_i + \beta_3 * \text{SG}_i + \beta_4 * \text{WCTA}_i + \beta_5 * \text{LSIZE}_i + e_{it} \quad (1)$$

where:

Profitability_i = two alternative performance measures of profitability of company i
return on assets (ROA) and return on equity (ROE)

WCM_i = four measures of working capital management of company i in year t

DR_i = debt ratio of company i

SG_i = sales growth of company i

WCTA_i = working capital to total assets of company i

LSIZE_i = size of company i

e_i = error term of the model.

Namely, in accordance with Deloof (2003), Charitou et. al (2010) and Kaddumi and Ramadan (2012) methodology, WCM_i variable displayed in basic form of the model above is changed with its components ACP_i , APP_i , INVT_i and CCC_i in turn in order to test following statistical hypotheses:

$H_{1,1}$ – Working capital management component of number of days inventories has statistically significant negative impact on company's profitability

$H_{1,2}$ – Working capital management component of number of days accounts receivable has statistically significant negative impact on company's profitability

$H_{1,3}$ – Working capital management component of number of days accounts payable has statistically significant positive impact on company's profitability

$H_{1,4}$ – Working capital management comprehensive measure of the cash conversion cycle has statistically significant negative impact on company's profitability

The results of hypotheses testing are presented in the table below.

Table 4: OLS Regression analyses results

Dependent	ROA				ROE			
	INVT	ACP	APP	CCC	INVT	ACP	APP	CCC
Constant	0.183 (0.210)	0.138 (0.347)	0.161 (0.277)	0.185 (0.204)	0.261 (0.790)	-0.289 (0.763)	-0.104 (0.917)	0.235 (0.812)
INVT	-0.135 (0.207)	-	-	-	-0.163 (0.149)	-	-	-
ACP	-	-0.079 (0.481)	-	-	-	-0.255* (0.028)	-	-
APP	-	-	0.034 (0.763)	-	-	-	-0.098 (0.403)	-
CCC	-	-	-	-0.154 (0.165)	-	-	-	-0.154 (0.189)
WCTA	0.497 (0.000)	0.493 (0.000)	0.461 (0.001)	0.485 (0.000)	0.390 (0.005)	0.434 (0.002)	0.377 (0.007)	0.372 (0.007)
SG	-0.049 (0.651)	-0.058 (0.599)	-0.048 (0.665)	-0.078 (0.478)	-0.397 (0.001)	-0.439 (0.000)	-0.377 (0.002)	-0.426 (0.000)
LSIZE	-0.085 (0.426)	-0.056 (0.607)	-0.076 (0.487)	-0.089 (0.405)	-0.082 (0.464)	-0.019 (0.865)	-0.046 (0.687)	-0.083 (0.462)
DR	-0.084 (0.520)	-0.087 (0.508)	-0.103 (0.442)	-0.109 (0.406)	0.427 (0.003)	0.439 (0.002)	0.436 (0.003)	0.400 (0.005)
R	<i>0.563</i>	<i>0.553</i>	<i>0.549</i>	<i>0.567</i>	<i>0.496</i>	<i>0.528</i>	<i>0.479</i>	<i>0.492</i>
R Square	<i>0.317</i>	<i>0.306</i>	<i>0.301</i>	<i>0.321</i>	<i>0.246</i>	<i>0.278</i>	<i>0.230</i>	<i>0.242</i>
D-W test	<i>1.910</i>	<i>1.873</i>	<i>1.871</i>	<i>1.898</i>	<i>2.325</i>	<i>2.328</i>	<i>2.176</i>	<i>2.384</i>
F test	<i>5.954</i>	<i>5.633</i>	<i>5.515</i>	<i>6.053</i>	<i>4.186</i>	<i>4.937</i>	<i>3.819</i>	<i>4.090</i>
Sig.	<i>0.000</i>	<i>0.000</i>	<i>0.000</i>	<i>0.000</i>	<i>0.002</i>	<i>0.001</i>	<i>0.004</i>	<i>0.003</i>

Note: **. Correlation (2-tailed) is significant at the 0.01 level, *at the 0.005 level respectively.

Source: Estimated according to data from authors' database (2013)

Presented results show R value of approx. 0.5 and R Square value of approx. 0.3 in ROA models and 0.25 in ROE models. It indicates that between 23% and 32% of the variance in independent variables are explained by the models and relatively good models fit are indicated. ANOVA regression results indicate that the all ROA and ROE overall models are statistically significant (F test 3.819 – 6.053), significant at least at 95% level. Durbin-Watson tests results show that autocorrelation of residuals is not presented. In addition, in order to detect potential multicollinearity problem among independents, Variance Inflation Factor (VIF) are calculated. VIF values range from 1.047 to 1.638 and suggests that collinearity is not serious issue.

Analyses show that only the number of days accounts receivable has statistically significant impact on the profitability of the company in trade industry, measured by return on equity. The association is negative, indicating that shortening of average number of days which firm waits to receive payment from customers will have positive effect on its profitability. This finding is consistent with previous research results and traditional working capital management policy. However, number of days accounts

payable, inventory turnover and cash conversion cycle are not found statistically significant correlated with firm's profitability. This is not consistent with the view of the traditional working capital theory and previous research results that assume inverse association of inventory turnover and cash conversion cycle and positive association of number of days accounts payable with firm's profitability. The possible cause of this discrepancy could be the ongoing global financial crisis which put a number of companies into liquidity and solvency problems and call in question efficiency of working capital management policy. Therewithal, shortening of cash conversion cycle in a way of policies of strict collections and relax payments could also cause negative implications on sustainability of business and on the firm's reputation.

5. CONCLUSION

This paper provided insights into working capital management of trading companies in Croatia. Traditional working capital theory suggest that utilization of the firm's resources, i.e. short-term assets and liabilities, will lead to increased profitability because effective working capital management shortens the time capital is tied up in the business process and consequently reduces all related costs. However, obtained results are not consistent with the above assumptions. Our findings show that only the number of days accounts receivable statistically significant affect profitability measured by return on equity while statistically significant relation between other variables examined have not been found. Further, it is proved that average cash gap statistically significant differ in wholesale and retail trade companies but this difference could be primarily assigned to the different groups of consumers as well as methods and conditions of payments, rather than difference in working management policies.

The main limitations of our research that do not allow generalization of conclusions are related to the selected sample: (1) although trade industry represents the most common type of industry, it has specificities related to the nature of the business; (2) a single period of the data examined disregard the long-term effects from the economic environment (e.g. financial crisis). However, despite these limitations this paper offers a contribution to the existing literature by examining the determinants of the working capital management in trade industry in Croatia, as a case of bank oriented economy with emerging capital market, which are still rather unexplored.

Finally, a number of additional analyses could be done, so the following recommendations for the future researchers can be derived: (1) to explore specificities of working capital management policies in different industries; (2) to explore the effects of financial crisis on changes in working capital management policies; (3) to explore differences in working capital management policies in different institutional and economic environments.

REFERENCES

- Afeef, M. (2011), *Analyzing the Impact of Working Capital Management on the Profitability of SME's in Pakistan*, International Journal of Business and Social Science Vol. 2 No. 22; (December), pp. 173-183.

- Anand, M. and Malhotra, K. (2007), *Working Capital Performance of Corporate India: An Empirical Study*, ICAFI Journal of Applied Finance, Vol. 13, No. 1 (January), pp. 46-81.
- Binti Mohamad, N.E.A. and Binti Mohd Saad, N.(2010), *Working Capital Management: The Effect of Market Valuation and Profitability in Malaysia*, International Journal of Business and Management, Vol. 5, No. 11 (November), pp. 140-147
- Charitou, M.S., Elfani, M. and Lois, P. (2010), *The Effect of Working Capital Management on Firm's Profitability: Empirical Evidence From An Emerging Market*, Journal of Business & Economics Research, Vol. 8, No.12 (December), pp. 63-68
- Charitou, M., Lois, P. and Santoso, H.B.(2012), *The Relationship Between Working Capital Management and Firm's Profitability: An Empirical Investigation For An Emerging Asian Country*, International Business & Economics Research Journal, Vol. 11, No.8 (August), pp. 839-847
- Dellof, M. (2003), *Does Working Capital Management Affect Profitability of Belgian Firms?*, Journal of Business Finance & Accounting, Vol. 30, Issue3/4 (April/May), pp. 573-587.
- Ding, S., Guariglia, A. and Knight, J. (2010), *Investment and financing constraints in China: does working capital management make a difference?*, Department of Economics Discussion Paper Series (Ref. 521), Available at <http://www.economics.ox.ac.uk/> (accessed 01.03.2013.)
- Dong, H.P. and Su, J. (2010), *The Relationship between Working Capital Management and Profitability: A Vietnam Case*, International Research Journal of Finance and Economics, Vol 49. Iss. 1
- Eljelly, A.M.A. (2004), *Liquidity - Profitability Tradeoff: An empirical Investigation in An Emerging Market*, International Journal of Commerce and Management, Vol. 14 Iss. 2, pp. 48-61.
- Falope, O.I. and Ajilore, O.T. (2009), *Working capital management and corporate profitability: evidence from panel data analysis of selected quoted companies in Nigeria*, Research Journal of Business Management, Vol. 3, Iss. 3:73-84.
- Gill, A., Biger, N., Mathur, N.(2010), *The Relationship Between Working Capital Management And Profitability: Evidence From The United States*, Business and Economics Journal, pp. 1-9, Available at http://astonjournals.com/manuscripts/Vol2010/BEJ-10_Vol2010.pdf (accessed 27.02.2013.)
- Kaddumi, T.A. and Ramadan, I.Z. (2012), *Profitability and Working Capital Management: The Jordanian Case*, International Journal of Economics and Finance, Vol. 4, No.4, pp 217-226
- Lazaridis, I., and Tryfonidis, D. (2006), *Relationship between Working Capital Management and Profitability of Listed Companies in the Athens Stock Exchange*, Journal of Financial Management and Analysis, Vol.19, No 1 (Jan-Jun), pp 26-35.
- Mathuva, D.M.(2010), *The influence of working capital management components on corporate profitability: a survey on Kenyan listed firms*, Research Journal of Business Management, Vol. 4:pp. 1-11.
- Alam, H. M., Ali, L., Rehman, A., Akram, M. (2011), *Impact of Working Capital Management on Profitability and Market Valuation of Pakistani Firms*, European Journal of Economics, Finance & Administrative Sciences; Vol. 5, Issue 32 (may), pp. 48-54.
- Nazir, M.S. (2007), *Working Capital Requirements and the Determining Factors in Pakistan*, ICAFI Journal of Applied Finance, Vol. 15, No. 4 (April), pp. 28-38.
- Nobanee, H. and Al Hajjar, M. (2009), *Optimizing Working Capital Management*, Available at SSRN: <http://ssrn.com/abstract=1528894> or <http://dx.doi.org/10.2139/ssrn.1528894> (accessed 25.02.2013.)
- Padachi, K. (2006), *Trends in working capital management and its impact on firms performance: an analysis of Mauritian small manufacturing firms*, International Review of Business Research Paper, Vol. 2, No. 2, pp. 45-58.
- Pouraghajan, A. and Emamgholipourarchi, M. (2012), *Impact of Working capital Management on Profitability and Market Evaluation: Evidence from Tehran Stock Exchange*, International Journal of Business and Social Science, Vol. 3, No. 10. (Special Issue – May), pp. 311-318.
- Raheman, A. and Nasr, M.(2007), *Working Capital Management and Profitability – Case of Pakistani Firms*, International Review of Business Research Papers, Vol 3, No.1, (March), pp 279-300.

- Raheman, A., Afza, T., Qayyum, A. And Bodla M.A. (2010), *Working Capital Management and Corporate Performance of Manufacturing Sector in Pakistan*, International Research Journal of Finance and Economics, Iss. 47, pp. 151-163.
- Ray, S. (2012), *Evaluating the Impact of Working Capital Management Components on Corporate Profitability: Evidence from Indian Manufacturing Firms*, International Journal of Economic Practices and Theories, Vol. 2, No. 3 (July), pp. 127-136
- Samson, A.A., Mary, J., Yemisi, B-F. And Erekpitan, I.O. (2012), *The Impact of Working Capital Management on the Profitability Small and Medium Scale Enterprises in Nigeria*, Research Journal of Business Management, Vol. 6, no. 2, pp. 61-69
- Shin, H.H., and Soenen, L.(1998), *Efficiency of working capital management and corporate profitability*, Financial Practice and Education, Fall/Winter, Vol. 8, Iss.2, pp. 37-45.
- Uyar, A. (2009), *The Relationship of Cash Conversion Cycle with Firm Size and Profitability: An Empirical Investigation in Turkey*, International Research Journal of Finance and Economics, No. 24, (Feb), pp. 186-193

PART IX

WORKSHOP for Doctoral Students of Central and South- East European PhD Network (CESEENET)

Kenan Spaho

Energoinvest d.d. Sarajevo, Department for Quality, Environment, Health and Security Management, Sarajevo, Bosnia and Herzegovina

CORPORATE SOCIAL RESPONSIBILITY, KEY FACTOR OF COMPANY SUCCESS

ABSTRACT

The European Union is a supranational, economic, political, customs, monetary, and defense integration in Europe. Despite the fact that advances to EU integrations are more oriented towards politics and legislation, the most important trigger for integration is economy. In other words, candidate countries are required to follow business trends in the EU. In this paper, we will focus on corporate social responsibility, a key feature of the business of the new era. The EU has published the Green Paper containing principles of corporate social responsibility which the EU companies are required to adhere to. Our task is to find out if companies in Bosnia-Herzegovina adhere to these principles and in what way. The sample of our research consists of 41 companies across several business branches in Bosnia-Herzegovina.

Keywords: *corporate social responsibility, stakeholders, Green Paper*

JEL classification: *M14*

1. INTRODUCTION

At the onset of the previous century, businessmen were primarily concerned with economy. However, today, that concern is not only economic, but also social. In other words, it is not important to merely implement the mission of a company, but the very process of doing it is quite relevant. Social responsibility is ethical, useful for the community, helps in increasing profit, and helps maintaining a good public image.

At present, corporate social responsibility has become obligatory on the market. After the development of the ISO 26000 standard for corporate social responsibility, it is expected that this standard will be introduced as obligatory as well.

The European Union has clearly defined principles on corporate social responsibility. These principles are defined in the Green Paper published by the EU Commission in 2001. The aim of this paper is to explore whether companies in Bosnia-Herzegovina adhere to these principles and in what way.

This paper consists of two parts, the theoretical and the practical part. In the theoretical part, we will present the theoretical basis on corporate social responsibility, focusing on corporate social responsibility in the EU. In the practical part, we will present our research results and conclude with recommendations.

2. CORPORATE SOCIAL RESPONSIBILITY – A REVIEW OF THEORIES

2.1. Definition and approaches

Corporate social responsibility could be defined in many ways, but for the purpose of this paper, we will define corporate social responsibility as a continuing commitment of businesses to behave according to business ethics and contribute to the economic development while improving the quality of life of the workforce and their families, as well as the local community and society at large (Uddin et al, 2008). Corporate social responsibility is manifested through active measures of protecting the environment, different donations for the social welfare, the development of human resources and giving equal possibilities to all employees through transfer of knowledge and technology, protection of consumers and other measures which are focused on the society (Aleksić, 2008).

There are several approaches to corporate social responsibility. First, we will start with Friedman's theory (1970), i.e. the following question: How can businesses or companies be responsible as it is known that only people can be responsible for something? However, as we know, companies are managed by people. Therefore, we can assume that managers are the carriers of a company's social responsibility or, according to Friedman, - 'agents of corporate social responsibility'. This theory can be considered as the agency theory of corporate social responsibility.

Another theory, referring to stakeholders, is mentioned in a paper by Donaldson and Preston (1995). According to this theory, it is very important for a company to be engaged in activities which will be perceived by non-financial stakeholders as important and in order to ensure their support. We will present here several approaches to stakeholders. According to Grayson and Hodges (2004), the most important stakeholders are:

- Employees
- Investors
- Consumers
- Business partners and suppliers
- Non-governmental organizations and media campaigns
- Governmental and inter-governmental organizations and regulatory pressures
- Community and the society.

On the other hand, Tomić (2008) presents the following most important stakeholders:

- Employees
- Families of employees
- Suppliers and distributors

- Consumers
- Financial centres (banks, stocks, shareholders etc.)
- Local social community
- City and local self-management
- Non-governmental organizations and groups for regulatory pressures
- Trade unions
- The media
- Leaders of public opinion
- Political institutions (president, government, parliament, political parties, political representatives, EU, MMF, World Bank etc.)

And, finally, we will also present the approach defined by the ISO standards. According to the ISO 9004:2009 (BAS EN ISO 9004:2011), the most important stakeholders are:

- Customers
- Owners/shareholders
- People in the organization
- Suppliers and partners
- The society

Apart from the agency theory and theory on stakeholders, Carrol (1991) developed a pyramidal theory of corporate social responsibility. According to this theory, despite the fact that the most important goal of the company is profit, every company has an economic, legal, ethical, and philanthropic social responsibility. According to this theory, the economic responsibility has the impact on other components of social responsibility. Whereas legal responsibility assumes respect of rules and law, ethical responsibility means that the company has obligations towards consumers, employees, investors etc. And finally, philanthropic responsibility means that the company has to act like a corporate citizen and, as such, be involved in programs for promoting human welfare and good will.

Another theory is the resource based theory (Hart, 1995) which includes ecological social responsibility, meaning that the ecological responsibility can be a very important element or resource in sustainable competitive advancement.

And, finally, there is an approach of corporate philanthropy developed by Porter and Kramer (2002) introducing two implicit assumptions of corporate social responsibility. The first is that social and economic objectives are regarded as separate and distinct; so that a corporation's social spending comes at the expense of its economic results. The second is that corporations, when addressing social objectives, provide no greater benefit than is provided by individual donors.

2.2. Corporate Social Responsibility in the European Union

The European Union is a supranational, economic, political, customs, monetary and defense integration in Europe (Smajić, 2005). Also, the EU is a specific union of international cooperation and integration, which has built its own legal order, different

from international or legal order of individual member states (EU Integration Strategy of Bosnia-Herzegovina, 2006). The EU has been founded in phases, i.e. by signing several treaties which regulated relations between member countries. We are familiar with the Founding Treaties such as: Treaty of Paris, Treaties of Rome and Maastricht, as well as Reform Treaties such as: Merger Treaty, Single European Act, Treaty of Amsterdam, and the Treaty of Nice. Through its constitution, the EU defined some principles which the member countries are invited to adhere to. For this reason, the EU has issued the Green Paper which is completely focused on corporate social responsibility. In further text, we will present its most important elements.

According to the European Commission (2001), corporate social responsibility is “a concept whereby companies integrate social and environmental concerns in their business operations and in their interactions with their stakeholders on a voluntary basis” (Green Paper, 2001). It includes two dimensions of corporate social responsibility: internal and external. The internal dimension includes employees and investment in human capital, health and safety, managing change and environmentally responsible practices related to the management of natural resources used in production. In further text, we will present elements of the internal dimension.

2.2.1. Elements of the Internal Dimension

- Human resources management. The most important for a company is to attract and retain skilled workers. In this context, it is important to enable life-long learning, further training for employees, better information exchange throughout the company, better balance between work, family and leisure, greater workforce diversity, equal pay and career prospects for women, profit sharing and shared ownership schemes, as well as concerns regarding employability and job security. Beside these, it is very important to establish responsible recruitment practices, involving non-discriminatory practices such as: recruiting people from ethnic minorities, senior workers, women, the long-term unemployed, and people with disabilities.
- Health and safety at work. The problem of health and safety is not only concerned about how to implement legislation and enforcement measures. In business, relations with customers and suppliers are also dependent on their safety and health, meaning that companies have to protect their own employees. On the other hand, it is expected from companies to promote health and safety at work through products and services. In order to promote health and safety, the best way is to adopt and implement the ISO 14000.
- Adaptation to change. In all spheres of life, as well as in business, changes occur naturally. It is not unusual to restructure a company after some period of time due to the market and cost-reducing demands. However, such restructuring should be carried out in a socially-responsible manner. Therefore, it is necessary to take into consideration the interests and concerns of all parties affected by the changes and decisions. All of the parties have to be involved in this process by means of access to information and consultation.
- Management of environmental impacts and natural resources. In general, it is advisable to reduce consumption of resources or polluting emissions. As a result, the company reduces energy and waste disposal bills and lowers de-pollution

costs. The companies have found that less spending can lead to increased profitability and competitiveness. Apart from the internal dimension, there is also the external dimension of corporate social responsibility. In addition to standard stakeholders (employees and shareholders), this dimension involves a wide range of stakeholders such as: business partners and suppliers, customers, public authorities and NGOs representing local communities, as well as the environment. In further text, we will present elements of the external dimension.

2.2.2. Elements of the External Dimension

- Local communities. Corporate social responsibility also means the integration of companies into their local setting, whether this is an EU or world-wide setting. Companies have to contribute to their (local) communities by providing jobs, wages and benefits, and generally contribute to the prosperity of the communities in which they operate. Also, companies interact with the local, physical environment. This implies maintaining clean environment for their products or services – either clean air or clean water, or clean roads. Moreover, businesses may be held responsible for a number of polluting activities: noise, light, and water pollution, emissions, contamination of the soil, and the environmental problems associated with transport and waste disposal.
- Business partners, suppliers and consumers. By working closely with business partners, companies can reduce complexity and costs and thus increase quality. It is not enough to build business partnerships through competitive biddings, but it is also recommended to build alliances, joint venture partners and franchise agreements. In building long-term partnerships, it is possible to enable fair commercial conditions in business contracts. The effects of corporate social responsibility will not remain limited to the company itself, but will also be reflected on its economic partners.
- Human rights. Corporate social responsibility has a strong human rights dimension, especially in international operations and global supply chains. The EU, within the framework of its *Co-operation Policy*, is obliged to ensure that labour standards are met, as well as the environmental protection and human rights within the development policy, trade policy, and the development of the private sector through a promotion of European investments.
- Global environmental concerns. Since many businesses are facing environmental problems, as well as issues related to the consumption of resources across the world, companies play an important role in the global environment. It means that they have to be socially responsible not only in the EU, but also socially responsible on the international level. For instance, companies can encourage a better environmental performance through a supply chain and enhance the use of the European and international management product-oriented tools. Also, this can encourage investments of the EU countries in the third-world countries.

Before presenting research results, we will present a methodology on how to implement corporate social responsibility in a company.

3. IMPLEMENTATION OF CORPORATE SOCIAL RESPONSIBILITY IN A COMPANY

Corporate social responsibility has become obligatory for all companies in the world. As we know, ISO has issued the ISO 26000 concerning corporate social responsibility. The standard is still not obligatory, but it is expected to be in 2013. It means that in the integrated management, the ISO 9001, ISO 14000 and ISO 18001 will be supplemented and expanded by the ISO 26000. In order to be ready for this, companies must start with preparations for establishing the system of corporate social responsibility. This system can be easily established in three phases (Anderson, 1989):

- Phase 1 – Commitment Phase. In this phase, top management acknowledges the corporation's responsibility in a certain area, or on a certain issue, and a policy statement is generated.
- Phase 2 – Learning Phase. Pertinent data are collected, analyzed and evaluated by top and middle management.
- Phase 3 – Institutionalization Phase. Responsibility for the program is transferred from the staff to the line organization. Resources are committed, performance and expectations are communicated, and evaluation is instituted.

In order to respond to expectations of the society, companies have to identify resources and activities in order to develop strategies of social corporate responsibility. The connection between the strategies and corporate social responsibility was established by Baron (1995, 2001). Baron insists on two components of businesses (with or without the market), and both are important for a company in its environment. Also, for Baron, it is the motivation for the action that identifies a socially, as opposed to a privately responsible action. To be more precise, if the action is focused to serve the society at the cost of profit, that action is socially responsible. However, if the aim of the action is motivated by reaching the ultimate goal, then the action is privately responsible.

McWilliams and Siegel (2001) insist on investing into corporate social responsibility. They think that corporate social responsibility, can, to some degree, maximize the profit while satisfying the demand for corporate social responsibility for some stakeholders. They suggest making a cost-benefit analysis in order to find out the level of corporate social responsibility. By doing so, the company will meet the demands of all the important stakeholders such as: consumers, employees, the community and shareholders.

4. METHODOLOGY

This paper is based on the case study method, comparative method, analysis method, and synthesis method.

The case study method is used in order to experience an individual case in a clearly defined scientific field. This method is not considered to be scientific because it is necessary to experience several cases in order to reach a general conclusion (Adapted from Zelenika, 1998). In this paper, we will focus on 41 companies from Bosnia-

Herzegovina which presented their practices of corporate social responsibility in a publication report, “DOBRE PRAKSE”, published by Global Compact Network in Bosnia-Herzegovina.

The comparative method is the act of comparing same or similar facts, phenomena, and relationships in order to establish their similarities in behavior and intensity, as well as the differences among them (Adapted from Zelenika, 1998). In this paper, we will compare how Bosnian-Herzegovina companies adhere to the Green Paper principles.

The analysis method is the act of scientific research and explanations of reality through distinguishing complex thoughts (terms, statements or conclusions) in their simple components and elements, as well as understanding each one of them individually and in relation to other parts and entities (Adapted from Zelenika, 1998). In this paper, we will apply the microeconomic analysis, since our targets are clearly-defined business subjects. We will also use the descriptive analysis in order to present concrete details pertaining to the business subjects in question.

The synthesis method is an act of scientific research that explains reality by means of putting together and assembling simple thoughtful solutions into compounds and more complex compounds by connecting separate elements, appearances, processes and relations to a unique totality the parts of which are mutually connected (Adapted from Zelenika, 1998). In this paper, we will apply the reproductive synthesis in order to collect research results collected by this method of analysis.

5. RESEARCH RESULTS

In the lines that follow, we will present the research results showing which principles from the Green Paper Bosnia-Herzegovina adheres to and in what way.

5.1. Human Resources Management

Out of 41 companies, 11 are working on the human resources management. These companies are investing in education of their employees, making sure that their employees maintain a balance between business and private life by conducting surveys about employees' level of satisfaction about the company's working conditions.

5.2. Health and Safety at Work

Out of 41 companies, 4 are working on keeping the working environment healthy and safe. For those companies the most important elements regarding health and safety are: permanent education, annual medical check-ups, and most importantly – the implementation of new technologies which enable healthy and safe working environment.

5.3. Adaptation to Change

No company presented examples of these adaptations.

5.4. Managing Environmental and Natural Resources

Out of 41 companies, 12 are working on raising awareness of the environment and natural resources. These companies insist on using natural resources in an economical way.

5.5. Local Community

Out of 41 companies, 33 are working on understanding the interests of the local community. This is done through different types of donations for schools, art and sports events.

5.6. Business Partners, Suppliers and Consumers

Out of 41 companies, 19 insist on maintaining good relations with business partners, suppliers, and consumers. The companies insist not only on good and quality products, but also on understanding customers and their needs.

5.7. Human Rights

Out of 41 companies, 26 insist on respecting human rights. These companies are working with orphans, elderly persons who need medical care, and disabled persons.

5.8. Global Environmental Concerns

Out of 41 companies, 15 express awareness on the global environment. This is done through the implementation of new technologies, destruction of waste materials, waste water purification and recycling.

6. CONCLUSION

The aim of this paper was to find out how companies from Bosnia-Herzegovina adhere to the principles of corporate social responsibility defined by the EU Green Paper. As a sample for this research, we took 41 companies which presented their corporate social responsibility in a report published by Global Compact Network in Bosnia-Herzegovina. As it may be concluded from the research results, the companies insist firstly on contribution to the local community (33/41) and human rights (26 /41), which is encouraging. However, the companies should definitely work more on the other elements in order to be completely socially responsible. The priority of these companies is to work on the human resources management, health and safety at work and adaptation to change, as these values refer to the most important stakeholders, viz. the employees. After they have established good communication and have further educated their employees, it would then be easy to adapt to changes. This will positively affect the motivation factor, which will result in building good relations with customers and suppliers. After good health and safety conditions have been ensured at work, employees will demonstrate more awareness regarding the environment and natural resources.

Bosnia-Herzegovina is a country in transition and needs some time to accept all the concepts which are specific for the EU business. Our research has shown that Bosnian-Herzegovina companies have entered the process of becoming familiar with the concept of corporate social responsibility. The companies understand that business is not only about making profit, but also about helping the local community, as well as helping to promote human rights. These can be considered as rules under which it is disgraceful to do any kind of business. However, before these rules, the most important is the care for employees. Only with satisfied employees can we count on successful business.

As we mentioned, Bosnia-Herzegovina is in transition. Therefore, it does not have an adequate social policy. Some companies are using this opportunity to behave irresponsibly by disobeying employees' rights. In this situation, the most important role is that of trade unions and non-governmental organizations. Their role is to exert pressure on the companies and government structures to enact legislation which will make sure that these rights are obeyed.

REFERENCES

- Aleksić, A., (2007), *Poslovna etika – element uspješnog poslovanja*, Zbornik Ekonomskog fakulteta u Zagrebu, Godina 5, p. 419-429
- Anderson, J. W. Jr (1989), *Corporate Social Opportunity*, Quorum Books
- Baron, D., (1995), *Integrated Strategy: Market and Nonmarket Components*, California Management Review, Vol 37 No 2, Winter, p. 47-65
- Baron, D., (2001), *Private Politics, Corporate Social Responsibility and Integrated Strategy*, Journal of Economics and Management Strategy, Vol. 10, No 1, Spring, p. 7-45
- Carroll, A. B. (1991), *The Pyramid of Corporate Social Responsibility: Toward the Moral Management of Organizational Stakeholders*, Business Horizons, 34, July-August, p. 39-48
- „Dobre Prakse” (2012), *Global Compact Network in Bosnia-Herzegovina*
- Donaldson, T., & L., Preston (1995), *The Stakeholder Theory of the Corporation: Concepts, Evidence and Implementations*, Academy of Management Review, Vol. 20, No 1, January, p. 65-91
- EU Integration Strategy of Bosnia-Herzegovina*, (2006), Directorate for EU Integrations of Bosnia and Herzegovina, Sarajevo
- Friedman, M., (1970), *The Social Responsibility of Business Is to Increase Its Profit*, The New York Times Magazine, September 13
- Grayson, D., Hodges, A., (2004), *Corporate Social Opportunity*, Greenfeet Publishing
- Green Paper* (2001), *Promoting a European Framework for Corporate Social Responsibility*, Luxembourg: Office for Official Publications of the European Communities
- Hart, S., (1995), *A Natural Resource Based View of the Firm*, Academic of Management Review 20, p. 986-1014
- ISO 9004:2009 (BAS EN ISO 9004:2011) (2011)*, *Upravljanje za održivi uspjeh organizacije – Pristup, upravljanje kvalitetom*, Institut za standardizaciju u BiH
- McWilliams A., & D., Siegel (2001), *Corporate Social Responsibility: A Theory of the Firm Perspective*, Academy of Management Review, Vol 26 No1, p. 117-127

- Porter M., & M., Kramer (2002), *The Competitive Advantage of Corporate Philantropy*, Harvard Business Review, December, p. 5-16
- Smajić, Z., (2005), *Evropska unija za svakoga*, Eurocontact, Sarajevo
- Tomić, Z., (2008), *Odnosi s javnošću, teorija i praksa*, Synopsis, Sarajevo
- Uddin, B., M., Hassan, R., Tarique, K., (2008), *Three Dimensional Aspects of Corporate Social Responsibility*, Daffodil International University Journal of Business and Economics, Vol 3, No 1, January, p. 199-212
- Zelenika R., (1998), *Metodologija i tehnologija izrade znanstvenog i stručnog djela*, Ekonomski fakultet u Rijeci, Rijeka

Miha Cimperman

University of Ljubljana, Faculty of Economics, Ljubljana, Slovenia

MODELING THE PROCESS OF ELDERLY TELEMEDICINE SERVICES ACCEPTANCE

ABSTRACT

Ageing population brings new challenges for services, products development and marketing. Understanding elderly consumer behavior and their adoption of new technology is still relatively unexplored. This paper investigates factors that influence elderly consumer's telemedicine services adoption. Telemedicine as one of the most prominent technologies to revolutionize the way healthcare is delivered, with elder user's healthcare needs in the locus of service development. A theoretical model was build, based on qualitative analysis using preliminary literature review indentified influential factors. Seven influential factors, underlying elderly acceptance of home telemedicine services were identified; effort expectancy, usefulness, social influence, facilitation conditions, computer anxiety and security issues are influencing elderly behavioural intention to adopt telemedicine. The findings are important both for companies developing such services and for government trying to stimulate their faster adoption.

Keywords: *elderly population, technology adoption, telemedicine*

JEL classification: *M15, M31, O33*

1. INTRODUCTION

In the context of ICT integration in health care, the term "Telemedicine" was established. Telemedicine can be defined broadly as the use of telecommunications technology to provide medical information and services (Bashshur 1995). This technology is often utilized to connect medically deprived or geographically distant areas with medical centers so that less highly trained on-site personnel can provide health services with long-distance help. The earliest objective of telemedicine was to assist in the delivery of health care to persons geographically remote from physicians or a geographically remote from physicians or a medical center. The major goals of telemedicine today are to develop next-generation telehealth tools and technologies to enhance healthcare delivery to medically underserved populations using telecommunication technology, to increase access to medical specialty services while decreasing healthcare costs, and to provide training of health care providers, clinical trainees, and students in health-related fields (Ackerman et al. 2010). The telemedicine 'value chain' describes how equipment suppliers, telecommunications operators and

health-care professionals deliver their products or services to the client, who is eventually the ultimate user (Wright and Androuchko 1996). A platform for service oriented telemedicine tools present Telemedicine Remote Patient Monitoring. It is defined as the use of information technology to monitor patients at a distance, also referring to Remote Patient Monitoring. Remote patient monitoring presents services where patients' vital signs (blood pressure, weight), other biometric data (pulse oximetry, blood glucose levels, etc.), subjective data (disease signs, medical or diet compliance), are collected by monitoring sensor devices, typically in the patients' residence. In this study the conceptualized telemedicine services for the older population are referred as Home Telemedicine Services (HTS in the continuation).

As HTS are targeted at the elderly population the elderly consumer behaviour plays an important role in defining the acceptance of new innovative services and products. People age biologically, psychologically, socially, and even spiritually. Cognitive functions physically decline with age (Mittenberg et al. 1989). These aging processes are manifested in differences in attitudes and behaviors even among people of the same age (Moschis 1992). In decision making, older individuals employ different heuristics in their approach to solving problems (Cole and Balasubramanian 1993). For example, seniors generally consider a smaller information set prior to making decisions and rely more on deductive than on inductive strategies as compared with younger people. Neurologically, elders involve both hemispheres of the brain in decision making, unlike younger adults who generally use either the left or the right side depending on the task (Cabeza 2002). With ageing, time perspective changes as for in youth, time is perceived as open-ended allowing expansive goals to be pursued (Lang and Carstensen 2002), as for the elderly time becomes perceived as bounded and goals selection becomes more emotionally meaningful, presumably because the payoff is in the contact itself, not promised at some unspecified time in the future (Carstensen, Fung, and Charles 2003). In terms of products vs. service orientation, elders spend a high proportion of their total expenditure on services (Moschis and Belgin 2008), presenting elderly population as a more service oriented consumer. Understanding older user's behaviour, demands addressing and integrating their behavioural specifics in their behavioural characteristics and decision making.

2. THEORETICAL BACKGROUND

2.1. Technology acceptance predictors

In the research of the technology adoption of health IT, many of researchers used Technology acceptance model (TAM). TAM, defined as one of the most prominent theories in information systems, specific to IS usage, was tested in various different contexts. The latest version of TAM was presented in 2003. Venkatesh et al. developed a new model for testing technology acceptance, Unified Theory of Acceptance and Use of Technology (UTAUT) (Venkatesh et al. 2003). Theoretical underpinnings include the theory of reasoned action, technology acceptance model, motivational model, theory of planned behavior, a combination of technology acceptance and theory of planned behavior models, model of PC utilization, innovation diffusion theory, and social cognitive theory. The core constructs asserted to impact behavioral intention to

use technology are Performance Expectancy, Effort Expectancy, Social Influence and Facilitating Conditions. In the context of HTS adoption, the construct of PU can be defined as the degree to which a user believes using HTS can improve one's quality of life. EE is conceptualized as the extent to which patients/users believe HTS will be easy to use. SI is the degree to which an individual perceives that important others believe he or she should use the system. And FC are defined as the extent to which an individual believes that an infrastructure exists to support use of the system (Venkatesh et al. 2003), including technical support, price and organizational support (Or and Karsh 2009).

Researchers who tested the UTAUT model report from 15 to 20 percent increase in variance explained by UTAUT model, over the TAM model (Zheng et al. 2007). UTAUT was used in healthcare context, testing doctor's acceptance of Electronic Health Record systems and proved as a robust theory for testing IT acceptance in inpatient care. In the research, the presented UTAUT model was used as a basic theory for modeling elderly acceptance of home telemedicine services.

2.2. Context-specific predictors

As the research is positioned in the context of healthcare, ICT and older users, possible additional predictors were reviewed in the literature. A review of factors underlying acceptance of telemedicine services was presented by Or and Karsh. A review of studies done in the area of consumer health technology adoption, revealed some of the key factors tested in the previous research. Most important (71%) were personal factors, including sociodemographic characteristics, health- and treatment-related variables, and prior experience or exposure to computer/health technology. Only ten variables were related to human-technology interaction; 16 were organizational factors; and one was related to the environment. In total, 62 (66%) were found to predict acceptance in at least one study. Existing literature focused largely on patient-related factors. No studies examined the impact of social factors, and few tested the effects of organizational or environmental factors on acceptance (Or and Karsh 2009). A review of previous research in the field of elderly consumer health technology acceptance reveals, four potential additional additional predicting factors were identified (Czaja and C. C. Lee 2006; Goodman and Lundell 2005; Or and Karsh 2009; Ryu, Kim, and E. Lee 2009): Self Efficacy (Czaja and C. C. Lee 2006; Rahimpour et al. 2008), Perceived Security (Agrell, Dahlberg, and Jerant 2000; Eysenbach et al. 2002; Menachemi, D. E. Burke, and Ayers 2004), Computer Anxiety (Chee Wei Phang et al. 2006; Ellis and Allaire 1999; Or and Karsh 2009; Or et al. 2011; Rahimpour et al. 2008), and Doctor's Opinion (Marteau 1989; Vick and Scott 1998). We assume these eight predicting factors will have a direct influence on elderly behavioral intention to use telemedicine services.

Based on UTAUT theory, four basic predictors define the user's behavioral intention to use. The predicting factors are defined as *Perceived Usefulness*, *Perceived Ease of Use*, *Social Influence* and *Facilitating Conditions* (Venkatesh et al. 2003). In this study, the UTAUT predictors are referred as standard or universal technology adoption predictors. The additional, four predicting factors identified are referred as additional or context-specific. Four additional contextual factors were identified (Czaja and C. C.

Lee 2006; Goodman and Lundell 2005; Or and Karsh 2009; Ryu, Kim, and E. Lee 2009): *Self Efficacy* (Czaja and C. C. Lee 2006; Rahimpour et al. 2008), *Perceived Security* (Agrell, Dahlberg, and Jerant 2000; Eysenbach et al. 2002; Menachemi, D. E. Burke, and Ayers 2004), *Computer Anxiety* (Chee Wei Phang et al. 2006; Ellis and Allaire 1999; Or and Karsh 2009; Or et al. 2011; Rahimpour et al. 2008), and *Doctor's Opinion* (Marteau 1989; Vick and Scott 1998). The two groups of eight predictors form a holistic model for analyzing older user's behavioral intention to use home telemedicine services.

3. METHODS

15 Focus Group Interviews (FGI) were conducted, using the first author acting as a moderator. FGIs consisted of 6 to 10 participants. The interviews were conducted in centers for senior's daily activities and centers for senior's education, both in rural and urban environments. The population included was 55 years and older. Consequently, a demo presentation of a home telemedicine system was presented (a computer presentation, including info graphics illustrations) and they responded to a list of key functionalities on a five point Likert scale (not useful/very useful). Since the audience had no prior experience with home telemedicine services, a list of functionalities was used as a tool for the systematical introduction of key functionalities to participants. We merged these functionalities into a set of three functionalities groups: 1 - Home access to the health system, enabling access to personal health records, e-procurement, access to general health information and access to an online pharmacy (Koch 2006), 2 - Integration of assisted living technologies (Chan et al. 2009; Daniel, Cason, and Ferrell 2009; Demiris et al. 2004). 3 - Remote patient monitoring and chronic disease management (Field and Grigsby 2002). Interview discussions were conducted for assumption testing to define relevant predicting factors.

4. RESULTS

The analysis of the interviews shows a strong confirmation of four basic factors; Perceived Usefulness, Perceived Ease of Use, Social Influence and Facilitating Conditions. Costs were exposed as the most important part of Facilitating Condition. Participants expressed concerns about financing the use of the system. Even the price range of 10 Euros per month presented a barrier: "even 10 Euros a month for us seniors can present a price many people cannot afford" An important part of Facilitating Conditions was also technical support, in terms of access to a call center, or somebody the user can turn to in case of a need for technical assistance. Comments were: "I think we would be able to use the system, especially if there was somebody we could call if we needed technical assistance" or "it is important that I have somebody I can call when I have problems using a computer". The two factors, Costs and Technical Support, are identified as sub dimensions of the predicting factor Facilitating Conditions.

Security issues, such as reliability and data integrity were frequently reported, and were usually the first concern exposed regarding the use of telemedicine technology. Despite

the fact that the concept was described as secure, on the level of e-banking, concerns regarding security were still a major question: it is important that I am the only one with access to my personal health data”, “I have to control who to give permission to see my personal data, and which par”. At least one participant in each group expressed anxiety about using a computer, despite the fact that it was explained that no computer knowledge is required to use the services: “it is different with you young people, we are not so keen on using compute”. In terms of the influence of a Doctor’s Opinion, the advice of a doctor was frequently reported as an important factor: “ in this case, it would probably be wise to ask my doctor whether it is really appropriate to use this system” However, Self Efficacy was not a relevant predictor. Often a statement was: “I think we would be able to use the system, they will probably make it simple enough for everyone to use it”, or “I think they will make it easy enough for everyone to use it, eventually” or “I think everyone can usually learn if we have support and motivation”, or “If one has motivation to use it, then most probably he/she will learn to use it”. For the behavioral intention to use telemedicine services, FGI results show the relevancy of UTAUT predicting factors and of three additional, contextual - telemedicine specific predicting factors: Perceived Security, Computer Anxiety and Doctor’s Opinion. The predicting factor Self Efficacy was not recognized as relevant. Additional, more in-depth report of focus groups interviews is reported in (Cimperman et al. 2013).

5. CONCLUSION

The results of the analysis also offer some interesting details in older user’s behavior, when introducing HTS. Security questions expose the concern older people have regarding the access to their personal health data from an unauthorized person, as to be able to control one's authorization for third party access to their own personal health record. These concerns were interestingly related also to family members, with the need of being able to limit the access to personal health record also to close family members and therefore being limited only to their personal doctor.

In terms of service design and development, some practical implications can be drawn as guidance for the development of HTS. The influence of CA will most probably result in the need to use different visual equipment, such as a tablet PC, to reduce the effect of HTS as a computer-based service. Special attention must be addressed to security issues, such as integrating secure mechanisms in the manner, the user can identify it.

Seven predicting factors with direct influence on elderly intention to use telemedicine services were identified: Perceived Usefulness, Perceived Ease of Use, Social Influence, Facilitating Conditions (sub dimensions: Costs and Technical Support), Computer Anxiety, Perceived Security and Doctor’s Opinion. The reported seven factors should be considered in the development, implementation and marketing of telemedicine services and technology. Services need to be considered to be reliable - enabling data integrity. Since Doctor’s Opinion shows a strong influence on the behavioral intention to use, implication for policy makers is that the promotion and incentives to use telemedicine, using health professionals as a proxy, plays an important role in acceptance of telemedicine by the end users: the elderly. Since Effort

Expectancy was most frequently exposed, we conclude that the simplicity and intuitiveness of graphical user interfaces (GUI) and the price for using HTS will probably be the two most important facilitators determining the success of engaging the older users in the initial process of using HTS. In the scale-up process, marketing interventions and technical support will moderate the scale-up process in the follow-up. Marketing interventions will moderate the scale-up process, where health professionals can be used as social agents.

Our research suffers from the usual limitations of qualitative research and should be viewed as exploratory rather than confirmatory. Further research should address these issues by considering a more quantitative approach to analyze the level of influence of individual predictors, and to evaluate cultural influences. Still, this and further similar studies should contribute to a better understanding of the ways in which older adults adopt HTS and which benefits they expect. Such studies can contribute to the development of sustainable business models for technology and services providers and, most importantly, to the higher quality of life for older adults.

REFERENCES

- Ackerman, Michael J et al. 2010. "Developing next-generation telehealth tools and technologies: patients, systems, and data perspectives." *Telemedicine Journal and E-Health: The Official Journal of the American Telemedicine Association* 16(1): 93–95.
- Agrell, Henrik, Sara Dahlberg, and Anthony F. Jerant. 2000. "Patients' Perceptions Regarding Home Telecare." *Telemedicine Journal and e-Health* 6(4): 409–415.
- Bashshur, R L. 1995. "On the definition and evaluation of telemedicine." *Telemedicine Journal: The Official Journal of the American Telemedicine Association* 1(1): 19–30.
- Cabeza, Roberto. 2002. "Hemispheric asymmetry reduction in older adults: The HAROLD model." *Psychology and Aging* 17(1): 85–100.
- Carstensen, Laura L., Helene H. Fung, and Susan T. Charles. 2003. "Socioemotional Selectivity Theory and the Regulation of Emotion in the Second Half of Life." *Motivation & Emotion* 27(2): 103–123.
- Chan, Marie et al. 2009. "Smart homes — Current features and future perspectives." *Maturitas* 64(2): 90–97.
- Chee Wei Phang et al. 2006. "Senior Citizens' Acceptance of Information Systems: A Study in the Context of e-Government Services." *IEEE Transactions on Engineering Management* 53(4): 555–569.
- Cimperman, Miha et al. 2013. "Older adults' perceptions of home telehealth services." *Telemedicine Journal and e-Health* (In press).
- Cole, Catherine A., and Siva K. Balasubramanian. 1993. "Age Differences in Consumers' Search for Information: Public Policy Implications." *The Journal of Consumer Research* 20(1): 157–169.
- Czaja, Sara J., and Chin Chin Lee. 2006. "The impact of aging on access to technology." *Universal Access in the Information Society* 5(4): 341–349.
- Daniel, Kathryn M., Carolyn L. Cason, and Sherry Ferrell. 2009. "Emerging Technologies to Enhance the Safety of Older People in Their Homes." *Geriatric Nursing* 30(6): 384–389.
- Demiris, George et al. 2004. "Older adults' attitudes towards and perceptions of 'smart home' technologies: a pilot study." *Informatics for Health and Social Care* 29(2): 87–94.
- Ellis, R. Darin, and Jason C. Allaire. 1999. "Modeling Computer Interest in Older Adults: The Role of Age, Education, Computer Knowledge, and Computer Anxiety." *Human Factors: The Journal of the Human Factors and Ergonomics Society* 41(3): 345–355.

- Eysenbach, Gunther et al. 2002. "Empirical Studies Assessing the Quality of Health Information for Consumers on the World Wide Web A Systematic Review." *JAMA: The Journal of the American Medical Association* 287(20): 2691–2700.
- Field, Marilyn J, and Jim Grigsby. 2002. "Telemedicine and Remote Patient Monitoring." *JAMA: The Journal of the American Medical Association* 288(4): 423–425.
- Goodman, Joy, and Jay Lundell. 2005. "HCI and the older population." *Interacting with Computers* 17(6): 613–620.
- Koch, Sabine. 2006. "Home telehealth--Current state and future trends." *International Journal of Medical Informatics* 75(8): 565–576.
- Lang, Frieder R., and Laura L. Carstensen. 2002. "Time counts: Future time perspective, goals, and social relationships." *Psychology and Aging* 17(1): 125–139.
- Marteau, Theresa M. 1989. "Framing of information: Its influence upon decisions of doctors and patients." *British Journal of Social Psychology* 28(1): 89–94.
- Menachemi, Nir, Darrell E. Burke, and Douglas J. Ayers. 2004. "Factors Affecting the Adoption of Telemedicine—A Multiple Adopter Perspective." *Journal of Medical Systems* 28(6): 617–632.
- Mittenberg, Wiley et al. 1989. "Changes in cerebral functioning associated with normal aging." *Journal of Clinical and Experimental Neuropsychology* 11(6): 918.
- Moschis, George P. 1992. *Marketing to older consumers: a handbook of information for strategy development*. Greenwood Publishing Group.
- Or, Calvin K L et al. 2011. "Factors affecting home care patients' acceptance of a web-based interactive self-management technology." *Journal of the American Medical Informatics Association* 18(1): 51–59.
- Or, Calvin K L, and Ben-Tzion Karsh. 2009. "A Systematic Review of Patient Acceptance of Consumer Health Information Technology." *Journal of the American Medical Informatics Association* 16(4): 550–560.
- Rahimpour, Mohammadreza et al. 2008. "Patients' perceptions of a home telecare system." *International Journal of Medical Informatics* 77(7): 486–498.
- Ryu, Min-Ho, Seongcheol Kim, and Euehun Lee. 2009. "Understanding the factors affecting online elderly user's participation in video UCC services." *Computers in Human Behavior* 25(3): 619–632.
- Venkatesh, Viswanath et al. 2003. "User Acceptance of Information Technology: Toward a Unified View." *MIS Quarterly* 27(3): 425–478.
- Vick, Sandra, and Anthony Scott. 1998. "Agency in health care. Examining patients' preferences for attributes of the doctor–patient relationship." *Journal of Health Economics* 17(5): 587–605.
- Wright, D, and L Androuchko. 1996. "Telemedicine and developing countries." *Journal of Telemedicine and Telecare* 2(2): 63–70.
- Zheng, Kai et al. 2007. "Evaluation of Healthcare IT Applications: The User Acceptance Perspective." In *Advanced Computational Intelligence Paradigms in Healthcare-2*, eds. S. Vaidya, L. C. Jain, and H. Yoshida. Berlin, Heidelberg: Springer Berlin Heidelberg, p. 49–78. <http://www.springerlink.com/content/n744p0747tgp4u28/> (Accessed May 18, 2011).

Dario Maradin

University of Rijeka, Faculty of Economics, Rijeka, Croatia

Nina Ponikvar

University of Ljubljana, Faculty of Economics, Ljubljana, Slovenia

Ljerka Cerović

University of Rijeka, Faculty of Economics, Rijeka, Croatia

RENEWABLE ELECTRICITY IN CROATIA AND SLOVENIA FROM THE ASPECT OF THE EU ENERGY AND CLIMATE TARGETS FOR 2020¹

ABSTRACT

Analyses show that in the EU the share of the renewable electricity could be around 35 percent in 2020. In this paper we focus on Croatia and Slovenia, the former becoming the 28th member state of the EU on July 1, 2013 and the latter being EU member state since 2004. The aim of our paper is to analyse how Croatia and Slovenia use different renewable sources in their electricity generation and to evaluate the extent at which both countries are achieving and/or will be able to achieve their 2020 targets in this field. In the recent years Croatia has made great movements in the use of wind power, which currently has the largest share of electricity generation from RES. Biomass and hydropower energy are used in equal proportion whereat biomass has great potential to become the most important RES by 2020. Further expansion of existing generating capacity, particularly a large using of solar energy, it is expected that Croatia could achieve the set target for 2020. We establish that favourable natural conditions and efficient energy policy measures allowed Slovenia to make notable progress in the usage of solar power, biomass and biogas in electricity generation, while large unused potentials remain for the usage of wind power and some for hydro power on the Sava river. We argue that these available RES potentials make Slovenia able to reach and perhaps even surpass the 2020 target.

Keywords: *renewable electricity, Croatia, Slovenia, generation*

JEL classification: *D24, Q28, Q42, Q47*

¹ The presented results are part of research projects (Economic impacts of regulatory reforms in electricity sector, No. 081-0361557-1455), supported by the Ministry of Science, Education and Sports of the Republic of Croatia.

1. INTRODUCTION

In the recent decades, several reasons for the public support of the generation of electricity from the renewable sources have been put forward. Besides socioeconomic reasons such as job creation, energy diversification, security and stability, the environmental motives in the form of pollution externalities from conventional energy sources have been the main argument for promoting electricity generation from solar, wind, and other renewable sources.

The European Union has the target to increase the share of renewable energy sources in its gross final consumption of energy to 20% by 2020. Besides electricity, primary energy consumption includes heating, cooling, and transportation. Increasing renewable sources in transportation is more costly than in electricity generation, and hence the share of renewable energy sources in electricity generation is likely to be significantly higher than 20%. It has been estimated, that the RES share in electricity sector could be around 35% in 2020. On the global level the renewable electricity production amounted to 19.6 percent of the global electricity production already in 2010 (Observ'ER, 2012). Currently, each member state of the EU has a separate support scheme for renewable electricity policy stimulation that is a part of National Renewable Energy Action Plans while data on electricity production across member states exhibits substantial differences in the usage in the renewables.

In this paper we focus on Croatia and Slovenia, both countries that had been a part of the former Yugoslav federation and gained its sovereignty in 1991. The first decade of sovereignty of both countries was characterized by the economic transition. However, they parted economically in 2004, when Slovenia became a member of the EU. Croatia is set to become the 28th member state of the EU on July 1, 2013. Both countries have favourable natural potential for RES usage. Therefore relatively high target shares of renewables in energy as well as in electricity generation have been set for Slovenia (25 % RES in energy) and Croatia (20 % RES in energy) (Eurostat, 2012).

The aim of our paper is to compare usage of the renewable sources for electricity generation between Croatia and Slovenia and to evaluate the rate at which both countries are (will be able to achieve) achieving their 2020 goals. For both countries we therefore analyse the current usage of the renewable sources for electricity generation. Further, we investigate the growth in the quantity of the electricity from renewable sources in the 2007-2011 period. Both the current state and the dynamics of the electricity from renewable sources are then evaluated in the light of the set energy targets for 2020 and the relative position of the analysed countries is assessed within the comparison of Croatia and Slovenia other EU member states. Our analysis is based on data available from Eurostat and from national data sources such as Agency for Energy of the Republic of Slovenia, Statistical Office of Slovenia and Annual energy report of Croatia.

The remainder of the paper is organised as follows. In the next section we describe the renewable electricity regulatory framework in the EU, Slovenia and Croatia. In section 3 we show the structure and dynamics of the electricity generation from the renewable resources in the 2007-2011 period for Croatia and in section 4 for Slovenia, while in

section 5 we compare the relative importance of the renewables in electricity generation in both countries. We further compare the countries' achievements with their targets for 2020. In section 6 we conclude and discuss policy implications of our findings.

2. REGULATORY FRAMEWORK IN THE EU, SLOVENIA AND CROATIA

Electricity is a vital service in the economy; it is an input in the production of nearly all other goods and services, and it is also an important final good, consumed by households. Lately, besides energy security, price stability, and job creation, the pollution externalities from conventional energy sources have been the main argument for promoting electricity generation from solar, wind, and other renewable sources (Observer, 2012). The European Union (EU) has set ambitious energy and climate targets for 2020 within the Directive 2009/28/EC, called also the „second Renewables Directive“ (Official Journal of the European Union, 2009). It requires to reach 20 percent share of energy from renewable energy sources (RES) in gross final energy consumption and 35 percent share of RES in electricity generation by 2020 (Nicolosi and Fuersch, 2009). This Directive was adopted by the EU Parliament in December 2008, but passed into legislation in April 2009. The Renewables Directive defines the RES targets for all individual member states. These targets have been set by the European Commission with consideration of the 2005 RES share and additional elements. For example, the largest share of renewables has been set for Sweden (49 %) and Latvia (40 %). Malta (10 %) and Luxembourg (11 %) have the lowest RES targets for 2020 (Eurostat, 2012). In 2010, member states had to submit National Renewable Energy Action Plans, outlining how they would reach their national targets under the overall 20 percent goal (Eurelectric, 2011). The allocation of renewable shares between the electricity and other energy activities like heating, cooling as well as transport sectors is the responsibility of the individual member states (Nicolosi and Fuersch, 2009). In these plans, member states set out sectoral targets, the technology mix they expect to use, the reforms and measures they will undertake to overcome the barriers to developing renewable energy. According to their forecast documents, it is expected that at least ten member states will have a surplus in 2020 compared to their binding target for the share of renewable energy in their final energy consumption. Additional twelve member states will probably meet their goals and just five countries are predicted to miss their targets using domestic RES alone (European Commission, 2009).

The current Slovenian National Energy Programme was adopted in 2004 and defines long-term development goals of energy demand and supply, security of supply, competitiveness of energy markets and sustainability. In July 2007 Slovenian parliament adopted the changes and the modification of Energy Act (70/2008) primarily in chapters dealing with the electricity from RES and from cogeneration which led to the modification of the scheme in 2009. Accordingly, the target of Slovenian policy is to increase electricity generation from RES from 32% in 2002 to 39.3% by 2020. A new National Energy Programme with new long-term goals for 2030 is however in progress and is expected for the first half of 2013. The Energy Act sets priority to renewable energy before supplying energy from non-renewable energy resources. It also defines, that the energy policy is orientated toward renewable energy

resources by ensuring appropriate measures and support mechanisms. Under the current support system RES electricity is promoted by feed-in tariffs (guaranteed purchase) for RES plants up to 5 MW. Operators can choose between feed-in tariff and feed-in premium. RES plants above 5 MW receive feed in premiums (operation support).

The view of the status and further development of the Croatian electricity sector can be observed within certain laws and documents, primarily the Energy Sector Development Strategy. In previous years, several energy programs and strategies were published whereby as early as in 1998 the Energy Sector Development Strategy of the Republic of Croatia envisages the objectives and policies on the use of renewable energy sources (RES) as well as other aspects of energy and economic development (Granić et.al 1998). In 2002, a new Energy Sector Development Strategy which strategically supports the use and development of new, clean and efficient renewable energy technologies was established. This consequently seeks to achieve diversification of the forms of energy and energy resources, i.e. resources and technologies of electricity generation, but also to realize the positive impact of renewable sources on the environment (Narodne novine, 2002). The near accession of Croatia to the EU and the simultaneous ratification and acceptance of the agreement about Energy Community in June 2006 and the Kyoto Protocol to the United Nations Framework Convention on Climate Change in April 2007, resulted in the adoption of new Energy Sector Development Strategy of the Republic of Croatia in 2009. The above mentioned strategy is planned for the period up to 2020 in order to align with the goals and the timeframe of the EU strategic documents. Since the objective of the Strategy is building a sustainable energy system, the increase of investments and use of RES is directly emphasized (Narodne novine, 2009). In accordance with the methodology prescribed by Directive 2009/28/EC on the promotion of use of RES, Croatia set a goal that the share of total final energy consumption from renewable energy sources in total final power consumption will be 20 percent by 2020. Building on that goal, it is determined that the share of electricity generated from renewable energy sources, including large power plants, in total power consumption will amount to 35 percent (Ministarstvo gospodarstva, rada i poduzetništva, 2010). The development and application of RES is a measure which is contributing to reducing greenhouse gas emissions, but also a measure which increases the security of supply by using different energy forms and sources, and is essential for creating incentives for local economy development. Croatia thus chooses to focus on the exploitation of renewable energy sources in accordance with the principles of sustainable development.

3. ELECTRICITY FROM THE RENEWABLE SOURCES IN CROATIA

The use of renewable energy sources for electricity generation in Croatia is based solely on hydropower, followed wind energy and bioenergy, and a small share of solar energy. Geothermal energy is not used in the production of electricity, but only thermal energy.

Figure 1 shows the structure of the RES electricity by source in Croatia in 2007 and 2011. The piecharts would suggest a large structural change in the usage of different

RES in electricity generation in the analysed period. In 2007 small hydropower energy represented the largest share of RES with more than 60 percent, while four years later, wind energy have had almost equal share. Extensive utilization of wind energy can indicate by the fact that the production of electricity from wind power was higher in 2011 (201 GWh), than the production of electricity from all renewables together in 2007.

Figure 1: Electricity from RES in Croatia in 2007 and 2011 by source



Source: Energy in Croatia 2007, Energy in Croatia 2011

It is believed that at the present stage of technological development, hydropower represents the most important source of all renewable sources, and the only one that is competitive to fossil energy sources and nuclear energy. However, all forms of hydropower are not supposed to be renewable. In relation to how much power they produce, hydropower plants are divided basically into small and large plants. Large hydropower plants require construction of hydroelectric dams which cause negative effects and damages due to changes of the entire ecosystem which is why they do not really count as RES when "recent" newer RES are mentioned. The commonly accepted value for small hydropower plants is installed capacity of up to 10 MW (Paish, 2002), and this specific value is taken as relevant and accepted in Croatia, although large hydropower plants are also taken into account as a "renewable" source of energy. In linking water with energy production structure of the Croatian electricity system, it should be noted that more than 50 percent of all manufacturing facilities and power plants are hydroelectric power plants (<http://www.hep.hr/proizvodnja/osnovni/hidroelektrane/default.aspx>). Therefore, Croatia has favorable hydrological conditions, and belongs to the leading countries in terms of electricity generation from RES. For example, in 2010, due to the very good hydrological conditions, the share of electricity generated from RES, including large hydropower plants, accounted for 45.1 percent, while during 2011, that share due to the very dry hydrological year, only accounted for 25.6 percent (Eurostat, 2013). Croatia actually has a relatively small number of small hydroelectric power plants, that participated with 20.82 percent, or 67 GWh in the total production of electricity from renewable sources in 2011. There are 22 small hydropower plants, with the total installed capacity of about 30 MW, that can be divided into those that are the part of HEP group² and those that are in private

² HEP group (Croatian Electricity Company, croatian language „Hrvatska elektroprivreda“) is a concern that operates with electric power activities (generation, transmission, distribution and supply of electricity) and other energy operations, and owns a company HEP Renewable Energy Sources.

ownership (Energy in Croatia, 2011). A certain number of small hydropower plants are a part of large hydropower, i.e. complex hydroelectric system, so therefore they are not observed separately in the capacity of power and energy and it is very difficult to access their individual indicators. They exploit the remaining flows of water that large hydropower cannot use in the production of electricity (Bašić, 2010).

Besides hydropower energy, the most promising RES technology is wind energy. Both in the EU and in Croatia, wind power represents the most advanced renewable technology, which is available at a large scale. This is confirmed by the fact that in 2009 and 2010 the EU installed more wind power plants than any other power plant types or sources of electricity (Međimorec, 2010). Since renewable energy and wind farms themselves are of great importance, it is anticipated that they may become competitive with other technologies in electricity production. This primarily implies thermal power plants which are largely polluting the environment with greenhouse gases. In Croatia, the first wind farm began to work in 2004 (Jerkić, 2010). Out of total electricity produced from renewable sources, as much as 62.38 percent it was produced from wind energy in 2011. In absolute terms this amounted to 201 GWh. (Energy in Croatia, 2011). Thus wind farms are by far the leading electricity generation from RES. Currently in Croatia, 9 wind farms are in operation with total installed power of 140 MW and two more wind farms are operating in the test run, with power of 64 MW (http://www.hep.hr/ops/usluge/sustav/VE_u_pogonu_i_sa_sklopljenim_UOP_om_02_2013.pdf). Although the presented list projects of wind power plants that will be built in the future and connected to the electric grid of approximately 200 MW, Croatia still needs to build an additional 800 MW of wind power plants if the goals of using RES by 2020 year want to be achieved (Jerkić, 2012). According to the Register of renewable energy sources and cogeneration (reported over 4000 MW of wind farm projects until now), planned wind farms are located on islands and coastal areas of Croatia, mostly in the south, because a very good wind potential is present there (Ministarstvo gospodarstva, rada i poduzetništva, 2013). A large number of sites are located in the Dalmatian hinterland, in demographically devastated and economically deprived areas (Međimorec, 2010). As a profitable and fast-growing technology, wind power plants would certainly stimulate the local economy, but also the national economy, either during the construction of buildings, either during any subsequent maintenance and development of electricity infrastructure and a number of linked manufacturing and service industries.

The following RES that is significantly present in Croatia and has great potential is bioenergy, i.e. energy generated from biomass. Biomass can be considered as a strategic resource because not only is it renewable, but it is also available everywhere, it can be stored and also it may raise benefits for the environment and for socio-economic development, particularly in a rural areas. It should be noted that the use of biomass primarily gives thermal energy, and only secondarily electricity. However, cogeneration plants, which simultaneously produce thermal energy and electricity, today represent the most significant way of electricity production from biomass (Šilić et.al 2004). Croatia has a great forest potential for electricity generation with almost 45 percent of forest land. Out of biomass of different origin, there is a significant share of agriculture, livestock and even wine growing and numerous wood processing activities that can be used for energy production (Šljivac and Šimić, 2009). The timber industry

should not forget the great potential of wood residues, i.e. wood waste available for energy use. It is believed that wood waste and firewood are a major source of biomass (Coenraads et.al 2008). In Croatia, the utilization of biomass as a RES is primarily used for the generation of thermal energy and biofuels, but in 2011, in the total production of electricity from all RES, also 16.76 percent (54 GWh) of electricity was produced from biomass (Energy in Croatia, 2011). It can be concluded that the conditions for the increased electricity generation from biomass are favorable and promising, and the ways of exploiting and the essential technology are known. Recently, the interest in this source of energy has increased, new projects are initiated and the existing plants are being renewed. However, it can be concluded that biomass does not significantly affect electricity generation and that it has not yet taken an important place in the energy policy of Croatia.

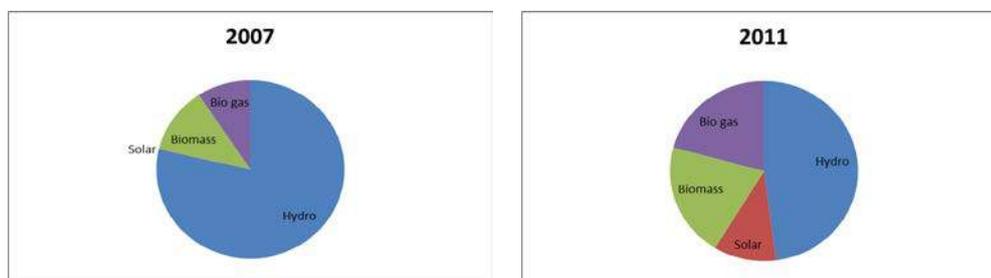
In Croatia, solar energy, with apparently great potential with respect to the number of sun hours a year, is still in the initial stage of development. Electricity production from photovoltaic energy systems is negligible with a very slow growth of this renewable energy technologies. According to data available from the Overview of projects registered in the Register of renewable energy sources and cogeneration and eligible producers are registered solar (photovoltaic) power plants up to 87 MW (Ministarstvo gospodarstva, rada i poduzetništva, 2013). By the beginning of 2013, the signed contracts on the purchase of electricity from solar energy are worth only a few hundred kW, meaning 0 MW, but according to the above mentioned Register, an installation of more solar panels can be expected in the near future (Hrvatski operator tržišta energije, 2013). The fact that only 0.04 percent of electricity is generated from solar energy of all RES, i.e. a small number of 137 MWh, illustrates that energy generation from solar energy is negligible in Croatia (Energy in Croatia, 2011). Although solar power is one of the most accessible forms of RES due to the possibility of the use of technology, reasonable price, which will eventually reduce even more, and the geographical distribution of energy in Croatia, significant financial investments and incentives, along with a favorable legal framework, are essential in Croatia, in order to create conditions for the development of solar technology market.

4. ELECTRICITY FROM THE RENEWABLE SOURCES IN SLOVENIA

In Slovenia, the same as in Croatia, renewable energy sources for electricity generation are primarily based on hydropower energy. However, with the exception of large hydroelectric plants, by observing only small hydro plants, wood and other biomass constitute a significant proportion of RES. The solar energy represents a relatively small share in electricity production. Wind energy and geothermal energy in Slovenia are not specially analyzed, because their production capacities are very small. The first wind turbine with capacity of 2.3 MW was installed in October 2012.

Figure 2, presenting the structure of the RES electricity by source in Slovenia in 2007 and 2011, shows that the relative importance of particular types of RES has changed in the analysed period. The position of the hydroelectricity became relatively less significant, while biomass, bio gas and especially solar sources of electricity generation gained more importance.

Figure 2: Electricity from RES in Slovenia in 2007 and 2011 by source



Source: Statistical office of the Republic of Slovenia, 2012

By observing the share of electricity generated from RES, an interconnection between Slovenia and Croatia can be noticed. It can be inferred from the geographical location and common climate surroundings because both countries in large part exploit hydro energy for electricity generation. In 2011, Slovenia had an almost identical share of electricity generated from RES (including large hydro plants) as Croatia. Due to poor hydrological conditions in 2011, the stated share was 26.2 percent. In the previous 2010, due to high river water level, electricity generated from RES was higher in Slovenia, and amounted to 33.1 percent (Eurostat, 2013). The role and importance of hydropower energy can best be noted in the fact that over 92 percent of electricity from all renewable energy sources was obtained precisely from hydropower (Statistični urad Republike Slovenije, 2012). That share of electricity is so vast because hydropower represents electricity generation from small hydroelectric plants up to 10 MW, and also large hydropower plants and pumping hydro plants. Production and supply of electrical energy from small hydro-electricity power distribution stations in Slovenia, which are owned by the national electricity distribution enterprises, are divided into 36 electricity power plants (Bojnec and Papler, 2012). These small hydroelectric plants, with included national and small private enterprises, represent significant electricity generation if only "newer" RES are considered. In that respect, they contain nearly half of total electricity generation from RES in 2011 or 47.94 percent, or above 290 GWh (Statistični urad Republike Slovenije, 2012). Although in Slovenia hydropower is an important natural potential for energy use, it is largely unused due to which it will be essential to further improve and develop the energy sector in order to achieve the goals envisaged by 2020.

Compared to the other EU member states, Slovenia has another good natural potential for the use of RES. It is reported that 54 percent of the landscape is covered by forests, which ranks Slovenia in European summit (Paksoy et.al). Therefore, wood and other hard biomass (organic waste from agricultural and food industry and municipal waste disposal activities) are an important source of primary energy in Slovenia, whereby the increase in their share is one of the priorities of national energy and environmental policy. The use of wood for energy purposes has to be systematically determined on the basis of the estimated effective forest management and the possible use of wood in technical production process with relatively high value added. The use of wood biomass in Slovenia has not been entirely successful so far. The main limitations can be

found in the dispersed ownership structure, lack of motivation of private owners of forest areas for the use or sale of biomass, exports of logs and other wood biomass, etc. (Regionalna gospodarska komora sjeverne Primorske). Nevertheless, in 2011 Slovenia produced approximately 125 GWh of electricity from wood and other hard biomass. Thereby, biomass represents 20.52 percent of electricity generated from total "newer" RES. If the use of landfill gas, sewage gas and other biogas is added, then the electricity generation amounts to 41.28 percent of RES (Statistični urad Republike Slovenije, 2012). As the largest renewable source, the sun represents an unlimited energy potential equal to no other energy source. Photovoltaics is regarded as one of the fastest growing industry branches in the world and the most acceptable renewable source praised for its economic and price-related competitiveness. In Slovenia, the solar power plants market came to life in 2005 and has been recording about one hundred percent growth in the previous years (Nemac, 2009). The total production of electricity from photovoltaic power systems in 2011 was above 65.5 GWh, i.e. 10.77 percent of RES (Statistični urad Republike Slovenije, 2012). Although by 2020 a slowdown in growth is anticipated, the growth will still be at a relatively high level, the construction of additional solar power plants will certainly contribute to the achievement of goals, but will also enable further development, not only the electricity industry, but also other related manufacturing and service industries.

5. THE ROLE OF RES IN ELECTRICITY GENERATION IN CROATIA AND SLOVENIA

As shown above, while in the recent years Slovenia has been investing effort to increase the usage of the solar energy for the electricity generation, in Croatia, as well as at the global level, significantly has been increasing the share of wind energy, which currently produces the most quantity of electricity from "newer" RES. In this section we compare the situation in Slovenia and Croatia and observe the dynamics of the RES electricity generation in Croatia and Slovenia during the 2007-2011 period. Table 1 shows the renewable electricity by source, generated in 2007 and in 2011 in Slovenia and Croatia.

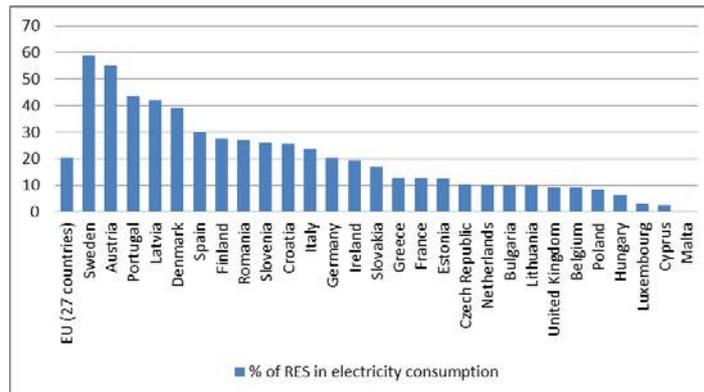
Table 1: RES Electricity by source in Slovenia and Croatia in years 2007 and 2011

	Slovenia (GWh)		Croatia (GWh)		
	2007	2011	2007	2011	
Small hydropower energy	409,7	292,3	83	67,1	Small hydropower energy
Solar energy	0,432	65,7	0,052	0,136	Solar energy
Biomass	62,7	125,1	7,02	54	Biomass
Biogas	48,1	126,6	34,91	201	Wind energy
Total	521,0	609,8	124,9	322,2	Total

Source: Statistical office of the Republic of Slovenia, 2012; Energy in Croatia, 2007; Energy in Croatia, 2011

In Figure 3 we show the relative position of Slovenia and Croatia from the viewpoint of the RES usage in the electricity generation. Both Croatia and Slovenia were in a relatively favourable position compared to the other EU member states in 2011.

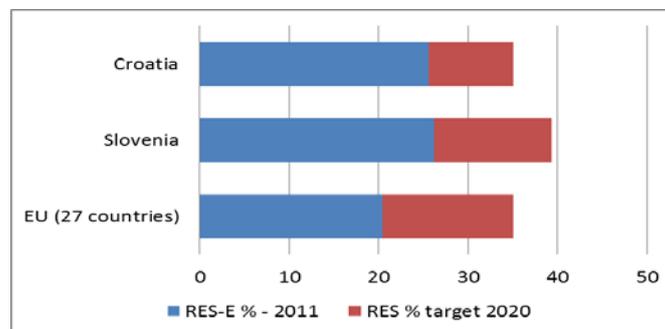
Figure 3: Shares of the electricity generated from RES in 2011 in the EU member states



Source: Eurostat, 2013

In Figure 4 we further show the extent at which each of the analysed countries has been achieving the 2020 target in 2011. It can be perceived that Croatia and the EU-27 have to achieve an equal share of electricity from renewable sources, which amounted 35% (Ministry of Economy, Labour and Entrepreneurship, 2010). That goal is assumed at the level of the average EU for RES 2020 target, because Croatia does not yet have the National Renewable Energy Action Plan. Although in 2011 the share of electricity generated from renewable sources was only 25%, it is expected that Croatia will reach the 2020 target, primarily due to the inclusion of large hydropower in RES and the relatively high rates of growth in renewable energy sector.

Figure 4: Shares of the electricity generated from RES in 2011 in Croatia, Slovenia and the EU compared to 2020 target



Source: Eurostat, 2013

Similar to the relatively high 2020 target for the share of RES in energy generation, Slovenia has set high goals also in the field of electricity generation. Namely, the 2020 target has been set on 39.3 percent (National Renewable Energy Action Plan 2010-2020, 2010). It is evident from Figure 4 that in 2011 in Slovenia already more than 26 percent of the consumed electricity has been generated from RES. Yet, this means that in the next nine years, Slovenia will have to increase this share by more than 13 percentage points, which in the circumstances of growing electricity demand means even steeper dynamics in the RES electricity generation.

6. POLICY IMPLICATIONS AND CONCLUSION

Renewable energy sources represent the key element towards sustainable development of European energy policy. The countries of the EU are one of the global leaders in the development and promoting the use of RES. They have recognized the importance of using RES and the opportunities and benefits that the renewables have in the national economy. In this manner, the EU has set the target of use the RES in electricity sector of around 35% in 2020. Slovenia and Croatia, the current and the future EU member states, have set up an ambitious plan to use RES and they are committed to their implementation.

In its energy strategy, Croatia has accepted the basic EU guidelines in electricity area. In the recent years, major steps have made in meeting set goals, especially when it comes to the construction of new wind farms, but there is still a need for further investment and active involvement of all economic and other stakeholders. It is expected that wind farms, due to their competitive technology and advantages in terms of energy utilization, will by 2020 become the most important RES generating capacity in the Croatian electric energy sector. In addition to getting a certain amount of clean electrical power from this source, it also represents a great opportunity to potential improvements and developments within the domestic economy. Besides energy benefits and the reduction in greenhouse gas emissions, the RES can also bring economic benefits, if the investment and the use of renewable energy are based on domestic industry and innovation. This is where Croatia should seek for its energy and economic opportunity. In addition to wind farms, it is necessary to additionally build and modernize bioenergy plants primarily due to Croatia's real potential in wood and other biomass use. It is believed that by 2020, biomass will become the largest single renewable source of energy, primarily thermal and then electrical energy. If this is so, biomass should have an important place in the Croatian energy policy. Although there are a great number of water courses in Croatia, there are certain limitations to the potential construction of small hydroelectric power plants. In most cases, the convenient locations for the construction of such plants are located in the upper reaches, which when Croatia is concerned means that they are sparsely populated and located in inaccessible nature areas, where there is almost no consumption of energy and/or where there's no quality distribution network. This does not presume significant construction of new small hydropower plants. The generation of electricity from solar energy has not yet been fully realized in Croatia. Regardless the huge potential, there are just individual households or smaller farms exploiting this energy, mainly for their own purposes. Significant use of solar energy as well as other forms of RES in

realizing energy goals can be achieved through specific measures and incentives. These may involve allocating more financial resources as incentives for using RES, greater investment in the energy infrastructure and RES industry, simplification of administrative procedures for obtaining required permits and other measures.

In Slovenia, since 2006 the situation in the field of RES electricity improved to a large extent. A favourable landscape and other natural conditions allowed the country to set ambitious targets and favourable economic conditions enabled economic policy to stimulate economic agents with various support schemes to act to achieve these targets. Important progress has been done in the usage of solar power for electricity generation. A lot has been done in stimulating the usage of the solar power and the data show that energy policy measures were successfully targeted and applied. Due to landscape that is in more than 50 percent covered by forests, there is still relatively large potential for the increase in the usage of biomass. Yet, wind energy remained almost completely unused although hopefully the environmental restrictions will loosen, providing the opportunities for exploitation of wind power. So far, only one wind turbine has been installed in Slovenia. Plans of hydroplants' construction in the Middle part of Sava river will hopefully also come closer to realisation soon.

We believe that all these available potentials of RES usage in the electricity generation make Slovenian economy and society able to reach and perhaps even surpass the 2020 target. What we regard as most important at this point is setting the targets for 2030 in a new National Energy Plan in 2013.

REFERENCES

- Bašić, H. (2010), *Male hidroelektrane*, Energetski institut Hrvoje Požar, South East Europe Program, Projekt Ener-Supply
- Bojnec, Š. and Papler, D. (2012), *Renewable Sources of Energy: Hydro-Electricity in Slovenia*, Technical Gazette, Vol. 19, No. 4, p. 795-800
- Coenraads, R., et.al (2008), *Renewable Energy Country Profiles*, PROGRESS - Promotion and Growth of Renewable Energy Sources and Systems, Utrecht, The Netherlands
- Energy in Croatia (2011), *Annual energy report*, Ministry of Economy Republic of Croatia, Zagreb, Croatia
- Energy in Croatia (2007), *Annual energy report*, Ministry of Economy, Labour and Entrepreneurship Republic of Croatia, Zagreb, Croatia
- Eurelectric (2011), *Power Statistics and Trends 2011 – Synopsis*, Belgium
- European Commission (2009), *Summary of the Member State Forecast Documents*, http://ec.europa.eu/energy/renewables/action_plan_en.htm
- European Renewable Energy Council (2011), *Mapping Renewable Energy Pathways towards 2020*, Belgium
- Eurostat (2013), *Electricity generated from renewable sources - annual data*
- Eurostat (2012), *Renewable energy statistics*, http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Renewable_energy_statistics
- Granić, G. et.al (1998), *Strategija energetskega razvika Republike Hrvatske: nacrt*, Ministarstvo gospodarstva Republike Hrvatske, Energetski institut „Hrvoje Požar“, Zagreb, Croatia

- Hrvatski operator tržišta energije (2013), *Ograničenje kvote za sunčane elektrane za 2013. godinu*, <http://www.hrote.hr/default.aspx?id=190>
- http://www.hep.hr/ops/usluge/sustav/VE_u_pogonu_i_sa_sklopljenim_UOP_om_02_2013.pdf
- <http://www.hep.hr/proizvodnja/osnovni/hidroelektrane/default.aspx>
- Jerkić, E. (2012), *Vjetroelektrane u Hrvatskoj u 2013.*, <http://www.vjetroelektrane.com/aktualno/1047-vjetroelektrane-u-hrvatskoj-u-2013>
- Jerkić, N. (2010), *Vjetroelektrana Ravne 1, Pag* <http://www.vjetroelektrane.com/vjetroelektrane-u-regiji/234-vjetroelektrana-ravne-1-pag>
- Medimorec, D. (2010), *Zašto graditi vjetroelektrane u Hrvatskoj*, HRO CIGRE
- Ministarstvo gospodarstva, rada i poduzetništva (2013), *Registar obnovljivih izvora energije i kogeneracije te povlašćenih proizvođača*, <http://oie-aplikacije.mingo.hr/pregledi/PopulIzvjestaj.aspx?ReportId=5b47346e-67aa-4df2-9603-fa83c47061e3>
- Ministarstvo gospodarstva, rada i poduzetništva (2010), *Nacionalni akcijski plan poticanja proizvodnje i korištenja biogoriva u prijevozu za razdoblje 2011. – 2020.*, Zagreb, Croatia
- Narodne novine (2009), *Strategija energetskeg razvoja Republike Hrvatske*, 130/09, Zagreb, Croatia
- Narodne novine (2002), *Strategija energetskeg razvitka Republike Hrvatske*, 38/02, Zagreb, Croatia
- National Renewable Energy Action Plan 2010-2020 (2010), Slovenia
- Nemac, F. (2009), *The Slovenian Technological Platform for Photovoltaics and RES*, Renewable Energy Sources (RES) in Slovenia – Zbirka Zelena Slovenija, Fit media
- Nicolosi, M. and Fuersch, M. (2009), *Implications of the European Renewables Directive on RES-E Support Scheme Designs and its Impact on the Conventional Power Markets*, International Association for Energy Economics
- Observ'ER (2012), *Worldwide electricity production from renewable energy sources*, <http://www.energies-renouvelables.org/observ-er/html/inventaire/Eng/conclusion.asp>
- Official Journal of the European Union (2009), Directive 2009/28/EC of the European Parliament and of the Council of 23 April 2009 on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC, L 140
- Paish, O. (2002), *Small hydro power: technology and current status*, Renewable and Sustainable Energy Reviews, Vol. 6, Issue 6, p. 537–556
- Paksoy, H. et.al *Solar Energy and Thermal Energy Storage – presentation of situation in Slovenia and Turkey*, Univerza v Ljubljani Fakulteta za strojninstvo
- Regionalna gospodarska komora sjeverne Primorske, *Green economy – obnovljivi viri energije v Sloveniji*, iCON project, Program prekogranične suradnje Slovenija-Italija 2007-2013
- Šilić, Đ. et.al (2004), *The possibilities of Croatian industrie in device and system production for renewable energy sorces*, Brodarski institute
- Statistical office of the Republic of Slovenia (2012), *Gross production of electricity from renewable sources and waste (MWh)*, Slovenia
- Šljivac, D. and Šimić, Z. (2009), *Obnovljivi izvori energije – Najvažnije vrste, potencijal i tehnologija*, Ministarstvo gospodarstva, rada i poduzetništva

Tanja Fatur

University of Rijeka, Faculty of Economics, Rijeka, Croatia
County of Primorsko-goranska, Rijeka, Croatia

THE ANALYSIS OF CAUSALITY BETWEEN GDP, CO² EMISSIONS AND RENEWABLE ENERGY CONSUMPTION: THE CASE OF CROATIA

ABSTRACT

Fossil fuelled economic growth, through its release of carbon dioxide (CO₂) into the atmosphere, is the main driver behind global warming. If left unchecked, the continuous release of CO₂ into the atmosphere will lead to catastrophic consequences that will affect all aspects of society. Climate change is one of the great challenges of the 21st century. According to the World Resources Institute, 61,4 percent of global greenhouse gas (GHG) emissions come from the energy sector which means that any serious attempt to control GHG emissions will have to reduce fossil fuel consumption and increase renewable energy consumption.

This paper examines the relationship between real GDP per capita, CO₂ emissions per capita and renewable energy consumption per capita in Croatia over the period from 1950 to 2008. It employs a modified version of Granger causality test proposed by Toda-Yamamoto (1995). This approach provides the possibility of testing for causality between integrated variables based on asymptotic theory.

In the analysis of the time series it is evident that there is a structural break in the level of the series. Results of unit root tests show that all variables are non-stationary at their level form and stationary in first difference form. Cointegration analysis, analysed through Johansen-Juselius test (1990), shows that there is no evidence of cointegration among the test variables. Toda-Yamamoto approach performed for Croatia indicates unidirectional causality running from GDP to CO₂ emissions. It is interesting to notice that there is a unidirectional causality running from renewable energy consumption to GDP.

Keywords: *renewable energy, economic growth, CO₂, Toda-Yamamoto, Croatia*

JEL Classification: *Q42, C32, O44*

1. INTRODUCTION

The ratification of the Kyoto protocol and subsequent negotiations over the future of the process has re-ignited debate on the relationship between carbon dioxide emissions (CO₂) and economic growth. GHGs particularly CO₂ emissions, are considered to be the main causes of global warming. By ratifying the Kyoto Protocol in May 2007 Croatia pledged to reduce greenhouse gases (GHG) by 5 percent in the first commitment period, 2008-2012, from the amount released into the atmosphere in 1990. Allowed emissions for Croatia in the period from 2008 to 2012 are 164.4 million t CO₂ equivalent, or 32.9 Mt CO₂ per year (Boromisa, 2011). Total emissions in 2011 in Croatia were estimated at 20.5 million tons, out of which 88 percent is the result of fuel combustion. After an increase in CO₂ emission over a number of years, in the last 4 years there was a decline of CO₂ emissions. The estimated CO₂ emissions in 2011 were 3 percent lower in comparison with the emissions in the previous year and 11 percent lower than the emissions in 1990 (Energy in Croatia 2011).

The increase in temperature as well as a dramatic increase in the frequency of natural disasters cannot longer be explained only by natural fluctuations of climate. Temperatures throughout Arctic region grew by 12 degrees, and 2010 was the warmest year since the beginning of monitoring climate, 140 years ago. The undisputable fact is that change in climate is consequence of human activities.

Today, all countries around the world are concerned with energy security issues and global warming and increasing the usage of renewable energy offers one way to address both of these problems. According the International Energy Agency (2006), the renewable energy category comprised of geothermal, solar, wind, tidal and wave energy is projected to be the fastest growing energy source to 2030 with an average annual growth rate of 6,7 percent (IEA, 2007, page 74).

The following analysis attempts to give some perspective on future projections by examining previous trends in carbon dioxide emissions and in income for Croatia while including renewable energy consumption.

Section 2 briefly reviews the theoretical and empirical literature on the relationship between GDP, CO₂ and renewable energy consumption. Section 3 considers the issues surrounding the selection of data for the analysis and methodology. Empirical results are presented and discussed in section 4. Section 5 concludes the paper.

2. LITERATURE REVIEW

In a number of recent studies, the causal relationship between renewable energy consumption and economic growth has been investigated. Chien and Hu (2007) use data envelope analysis to analyse the effects of renewable energy on the technical efficiency of 45 economies over the period 2001-2002. They find that increasing the use of renewable energy improves an economy's technical efficiency while increasing the use of traditional energy (fossil fuel) decreases technical efficiency.

Chien and Hu (2008) have studied the effects of RES on GDP for 116 economies in 2003 through the Structural Equation Modeling (SEM) approach. They concluded that RES had a positive indirect effect on GDP through the increase in capital formation; however, RES did not show any improvement on the trade balance with no import substitution effect.

Chang et al., (2009) by using Panel Threshold Regression (PTR) model for the OECD countries over the period 1997-2006 asserted that there was no direct and simple relationship between GDP and the contribution of RES to energy supply. They concluded by documenting that the level of economic growth of a country influenced the use of RES as a way to respond to oil price shocks. High-economic growth countries used RES to minimize the effects of adverse price shock, but low-economic growth countries were unable to do so. Therefore, the first countries exhibited a substitution effect towards RES to avoid the negative relationship between oil prices and GDP.

Sadorsky (2009a) used a vector autoregression techniques to analyze the relationship between renewable energy consumption, income, oil prices and CO₂ emissions in the Group of 7 (G7) economies over the period 1980-2005. He found that in the long-term, increases in real GDP per capita and carbon dioxide emissions per capita are found to be major drivers behind increases in G7 renewable energy consumption per capita.

Sadorsky (2009b) studied the relationship between RES (wind, solar and geothermal power, wood and wastes) and economic growth in a panel framework of 18 emerging economies for the period 1994-2003 and found that increases in real GDP had a positive and statistically significant effect on renewable energy consumption per capita.

Apergis and Payne (2010a) used panel cointegration techniques to examine the relationship between renewable energy consumption and economic growth for a panel of 20 OECD countries over the period 1985-2005. The theoretical framework uses an aggregate production function relating output to labour, capital, and renewable energy. They found evidence of bidirectional causality between renewable energy consumption and economic growth in both the short-run and the long-run.

Menyah and Wolde-Rufael (2010) used vector autoregression techniques to study the relationship between carbon dioxide emissions, renewable energy consumption, nuclear consumption and real GDP for the US over the period 1960-2007. They found causality running from nuclear energy consumption to CO₂ emissions but no causality running from renewable energy consumption to CO₂ emissions. There is evidence of causality running from GDP to renewable energy.

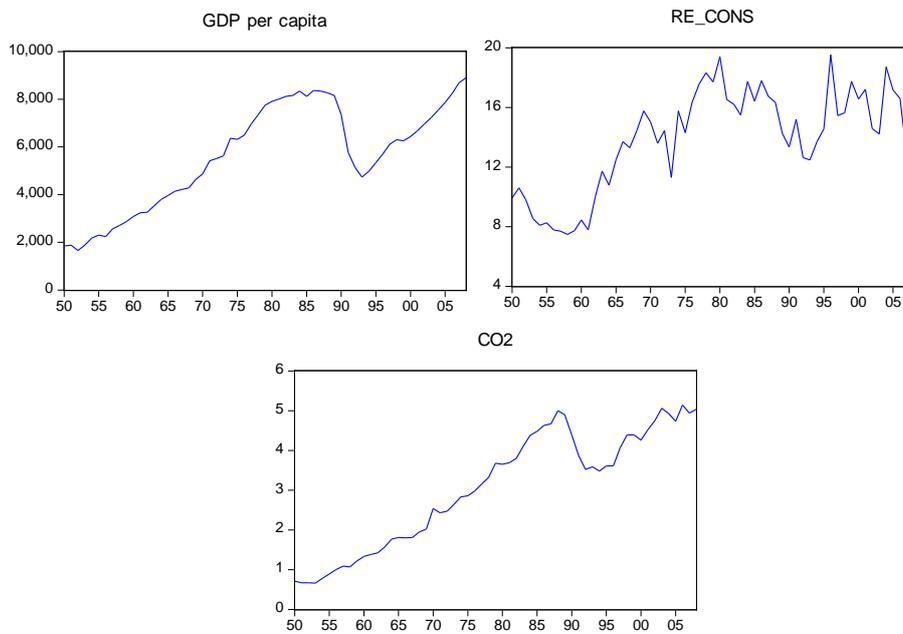
3. METHODOLOGY AND THE DATA

For this article, annual data over the period 1950-2008 is collected on renewable energy consumption (RE_CONS), income (GDP), and carbon dioxide emissions (CO₂) for Croatia. Data on renewable energy consumption (renewables and hydro energy) is collected from report "Energy in Croatia 1945 – 2010" written by Energy institute

Hrvoje Požar. Data on total carbon dioxide emissions from the consumption of energy is available from online data provider Timetric (2012). Data on GDP is available from article written by Tica (2004). Renewable energy is measured in petajoules (PJ), real GDP is measured in 1990 US dollars, total carbon dioxide emissions from the consumption of energy are measured in million metric tons. All variables are divided by the total number of people in Croatia and expressed in natural logarithms.

Figure 1 shows how variables GDP per capita, renewable energy consumption per capita (from renewables and hydropower plants) and CO₂ emissions per capita (in million metric tons) have changed in period from 1950 – 2008. It is evident that all variables experience large growth from 1950 till 1989 but in 1990 there is structural break in data because a war started in Croatia.

Figure 1: GDP per capita (in 1990 US dollars), renewable energy consumption per capita (in petajoules) and CO₂ emissions per capita (in million metric tons) in period from 1950 – 2008



In this paper the methodology of Toda and Yamamoto (1995) is used for testing causality between renewable energy consumption, CO₂ emissions and GDP. Toda and Yamamoto ignores any possible non-stationarity or cointegration between series when testing for causality, and fits a standard VAR in the levels of the variables, thereby minimising the risks associated with possibility of wrongly identifying the orders of integration of the series, or the presence of cointegration, and minimizes the distortion of the tests' sizes as a result of pre-testing (Iorio, Triacca, 2011).

The Toda and Yamamoto (1995) augmented Granger causality test does not require pre-testing for cointegration between the variables and can accommodate VAR models where some variables have unit roots and some variables are stationary. Toda and Yamamoto (1995) method is based on the following equations:

$$Y_t = \alpha + \sum_{i=1}^{h+d} \beta_i Y_{t-i} + \sum_{j=1}^{k+d} \gamma_j X_{t-j} + u_{yt} \quad (1)$$

$$X_t = \alpha + \sum_{i=1}^{h+d} \theta_i X_{t-i} + \sum_{j=1}^{k+d} \delta_j Y_{t-j} + u_{xt} \quad (2)$$

where d is the maximal order of integration order of the variables in the system, h and k are the optimal lag length of Y_t and X_t , u_{yt} and u_{xt} are error terms that are assumed to be white noise with zero mean, constant variance and no autocorrelation.

The TY procedure steps are as follows (Lotfalipour et al. 2010):

- Finding the maximal order of integration (d) of variables by conducting unit root tests.
- Determining the optimum lag length (k) of a VAR.
- Estimating the lag-augmented VAR ($k + d$) model.
- Checking robustness of augmented VAR ($k + d$) by diagnostic tests
- Conducting a Wald test on the first k parameters instead of on all parameters in the augmented VAR ($k + d$) model.

4. EMPIRICAL RESULTS

In order to find maximal order of integration, two tests without structural breaks are employed: the ADF test (Dickey and Fuller, 1979) and the PP test (Phillips and Perron, 1988). The results are presented in Table 1.

Table 1: Unit root test results for Croatia

Levels	Augmented Dickey-Fuller test statistic		Phillips-Perron test statistic	
	Constant included	Constant and trend included	Constant included	Constant and trend included
LGDP	-1.961042 0.3029	-1.753861 0.7138	-1.911093 0.3251	-1.505433 0.8165
LRE_CONS	-1.448707 0.5521	-1.579925 0.7887	-1.760094 0.3963	-2.236564 0.4608
LCO2	-2.538842 0.1118	-0.953712 0.9422	-2.362268 0.1568	-1.064229 0.9261

First differences	Augmented Dickey-Fuller test statistic		Phillips-Perron test statistic	
	Constant included	Constant and trend included	Constant included	Constant and trend included
ΔLGDP	-4.694687 0.0003	-4.833532 0.0013	-4.665724 0.0003	-4.811724 0.0014
ΔLRE_CONS	-10.278370 0.0000	-10.218750 0.0000	-10.278370 0.0000	-10.218750 0.0000
ΔLCO2	-5.855164 0.0000	-6.503999 0.0000	-5.855164 0.0000	-6.470321 0.0000

Notes: Δ is the difference operator. MacKinnon (1996) critical values are used for rejection of the hypothesis of a unit root (p-values in brackets). The optimal lag length is chosen by Schwarz Information Criterion.

The table shows that the presence of a unit root in levels at 5 percent significance level cannot be rejected for any of the variables. First differences are found to be stationary, therefore all the series are integrated of order one I(1). Moreover, the Zivot and Andrews (1992) unit root test with one structural break is applied to confirm the results obtained by ADF and PP tests.

Table 2: Zivot and Andrews (1992) unit root test with one structural break

Variables	Breakpoint	Number of lags	t-statistics
LGDP	1990	1	-3.554413
LRE_CONS	1981	1	-3.847975
LCO2	1990	0	-3.308692

Notes: Breaks in both the intercept and trend

All the series include intercept and trend, and according to all tests the existence of unit root in the levels of the series and stationary in the first differences is proven, this meaning that variables LGDP, LRE_CONS and LCO2 for Croatia are integrated of order one, or are I(1). To account for structural break dummy variable is implemented.

Next, the model for Croatia is specified by determining the optimal lag length of the levels of variables in the model. Akaike's information criterion is used to select the optimum lag. The results are presented in Table 3.

Table 3: Optimum lag structure

Lag	LogL	LR	FPE	AIC	SC	HQ
0	28.76079	NA	7.73e-05	-0.954103	-0.843604	-0.911488
1	209.0559	333.8798	1.36e-07	-7.298366	-6.856370*	-7.127905
2	223.1028	24.45203*	1.13e-07*	-7.485289*	-6.711795	-7.186982*
3	225.9904	4.705666	1.43e-07	-7.258902	-6.153911	-6.832751
4	230.6678	7.102714	1.71e-07	-7.098806	-5.662317	-6.544809
5	234.4688	5.349643	2.12e-07	-6.906253	-5.138267	-6.224410

Note: * indicates lag order selected by the criterion
 LR: sequential modified LR test statistic (each test at 5% level)
 FPE: Final prediction error
 AIC: Akaike information criterion
 SC: Schwarz information criterion
 HQ: Hannan-Quinn information criterion

For the renewable energy consumption, income and CO₂ emissions VAR model, the AIC selects a lag length of two.

Since our series are non-stationary in levels, it can be assumed that a cointegration relationship is possible between variables. In order to determine the number of cointegrating vectors, the Johansen multivariate cointegration procedure (1988, 1991) is used. The procedure is based on the two test statistics for the number of cointegrating vectors: the trace (λ_{trace}) and the maximum eigenvalue statistics (λ_{max}). Table 4 reports the estimation results for the number of cointegrating vectors containing one lag.

Table 4: Estimation of cointegration vectors

Unrestricted Cointegration Rank Test (Trace)

Hypothesized No. of CE(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob.**
None	0.295486	29.10513	29.79707	0.0599
At most 1	0.098895	9.491285	15.49471	0.3219
At most 2	0.063264	3.659831	3.841466	0.0557

Trace test indicates no cointegration at the 0.05 level
 * denotes rejection of the hypothesis at the 0.05 level
 **MacKinnon-Haug-Michelis (1999) p-values

Unrestricted Cointegration Rank Test (Maximum Eigenvalue)

Hypothesized No. of CE(s)	Eigenvalue	Max-Eigen Statistic	0.05 Critical Value	Prob.**
None	0.295486	19.61385	21.13162	0.0804
At most 1	0.098895	5.831454	14.26460	0.6349
At most 2	0.063264	3.659831	3.841466	0.0557

Max-eigenvalue test indicates no cointegration at the 0.05 level
 * denotes rejection of the hypothesis at the 0.05 level
 **MacKinnon-Haug-Michelis (1999) p-values

Under both test statistics the null hypothesis of zero cointegration equation is accepted. Therefore, there is no cointegration equation among LCO2, LGDP and LRE_CONS.

The Toda-Yamamoto test involves the addition of one extra lag of each of the variables to each equation and the use of a standard Wald test to see if the coefficients of the lagged 'other' variables (excluding the additional one) are jointly zero in the equation. Therefore, a VAR model in the level of the data with a lag length of three was set up and then a Granger causality test was performed using a standard Wald test. The results of the Wald test are given in Table 5.

Table 5: VAR Granger Causality (Modified Wald test/ χ^2)

	LCO2	LGDP_PC	LRE_CONS
LCO2	-	3.9445	0.400375
LGDP_PC	11.25782*	-	0.450379
LRE_CONS	4.581692	6.546612*	-
ALL	18.67797*	10.73268*	2.819853

Note: (1) CO₂ denotes CO₂ emissions per capita; GDP_PC denotes Gross domestic product per capita and L denotes natural log transformation of the series.
 (2)*, **and ***denotes significant at 1%, 5%, and 10% level respectively.

It is evident from Table 5 that there is unidirectional causality running from GDP to CO₂. This implies that the economic growth can be used as a leading indicator for future CO₂ emissions in Croatia. This means that economic policies that speed economic growth and development will lead to increased pollution.

It is interesting to notice that renewable energy consumption Granger-causes GDP. This is consistent with the findings of Apergis and Payne (2010) who found a long-run equilibrium relationship between real GDP and renewable energy. In concrete, a 1 percent increase in renewable energy consumption increased real GDP by 0.76 percent. From a policy perspective, government policy at the national level aimed at increasing renewable energy consumption is good for increasing income. While these policies need to be enacted at the national level, international organizations like the IMF, World Bank, and United Nations need to promote the benefits of sound economic and environmental policies to their member countries.

No causality was found running from renewable energy consumption to CO₂ emissions, and from GDP to renewable energy consumption.

Increases in real GDP per capita are found to be major drivers behind carbon dioxide emissions per capita. Renewable energy consumption per capita causes increases in GDP per capita.

The results of robustness test on the augmented VAR (3) are in appendix. The Residual Serial Correlation LM Tests reveal that there is no serial correlation up to 12 lags. The Jarque–Bera test results show that there are no violations of normality. The White test indicates that there is no heteroscedasticity for all equations. Furthermore the estimated VAR is stable (stationary) as all roots have modulus less than one and lie inside the unit circle.

5. CONCLUSION

This paper investigates the causal relationships between GDP, carbon dioxide emission (CO₂) and renewable energy consumption, using the relatively new time series technique known as the Toda-Yamamoto method for Croatia over the period from 1950 to 2008.

Empirical results suggest a unidirectional Granger causality running from GDP to CO₂ emissions, and from renewable energy consumption to GDP. There is no Granger causality between renewable energy consumption and CO₂ emissions. This means that economic policies that speed economic growth and development will lead to increased pollution. As a result, Croatia is able to substitute conventional fossil fuel by alternative energy sources, since renewable energy is a stimulus for economic growth. The empirical findings of unidirectional Granger causality from renewable energy consumption to real GDP implies that the government can implement alternative energy policy and speed up economic growth while reducing CO₂ emissions. In 2011, the share of renewables in total primary energy supply in Croatia was around 17,3

percent (according to EIHP methodology), or around 10,6 percent according to EUROSTAT methodology.

Though global warming depends on worldwide GHG emissions, its consequences differ among countries, based on their social and natural characteristics. Stern et al. (2006) pointed out that if no action is taken to reduce emissions, the concentration of GHG in the atmosphere could double as early as 2035. from its pre-industrial level. This implies that in the short run, global average temperature may rise by over 2°C. In the longer term, there is a greater than a 50 percent chance that the rise in temperature would exceed 5°C. Stern et al. (2006) emphasize that this radical change in temperatures would affect all countries. Among them, the earliest and the hardest hit would be the poorest and populous nations, even though they contributed least to GHG emissions.

REFERENCES

- Apergis, N. and Payne, J.E. (2010), *Renewable energy consumption and economic growth: evidence from a panel of OECD countries*, Energy Policy 38, 656–660.
- Boromisa, A. (2011), *Strateške odluke za energetska budućnost Hrvatske*, IMO, Zagreb
- Chang, T.H., Huang, C.M. and Lee, M.C. (2009), *Threshold Effect Of The Economic Growth Rate On The Renewable Energy Development From A Change In Energy Price: Evidence From OECD Countries*, Energy Policy, Vol.37, No.12, (December), pp. 5796-5802,
- Chien, T. and Hu, J.L. (2007), *Renewable Energy And Macroeconomic Efficiency Of OECD And Non-OECD Economies*, Energy Policy, Vol.35, No.7, (July), pp. 3606-3615
- Dickey, D. and Fuller, W. (1979), *Distribution of the estimators for autoregressive time series with a unit root*, Journal of the American Statistical Association 74, 427–431.
- Energy institute Hrvoje Požar (2010), *Energy in Croatia 1945 – 2010*, available at www.eihp.hr/...od.../Energiya%20u%20HR%201945_2010.pdf (15.04.2012.)
- Giles D.E.A. (1997), *Causality between the measured and underground economies in New Zealand*, Applied Economics Letters, Vol. 4, 63-67.
- Granger, C.W.J. (1969), *Investing causal relations by econometric models and cross- spectral methods*, Econometrica 37, 424–438.
- Granger, C.W.J., (1988), *Some recent developments in a concept of causality*, Journal of Econometrics 39, 199–211.
- Halicioglu, F. (2009), *An econometric study of CO₂ emissions, energy consumption, income and foreign trade in Turkey*, Energy Policy, Elsevier, vol. 37, No.3 (March).
- International Energy Agency, 2007, *World Energy Outlook*, IEA, Paris
- Iorio, F. and Triacca, U. (2011), *Testing for non-causality by using the Autoregressive Metric*, University Library of Munich, Germany.
- Johansen, S. (1988), *A statistical analysis of co-integration vectors*, Journal of Economic Dynamics & Control, 12 (2-3): 231–254.
- Johansen, S. (1991), *Estimating and hypothesis testing of cointegration vectors in Gaussian vector autoregressive models*, Econometrica, 59 (6), 1551–1580.
- Lotfalipour, M., Ali Falahi, M. and Ashena, M. (2010), *Economic growth, CO₂ emissions, and fossil fuels consumption in Iran*, Energy, Vol. 35, No. 12 (December), 5115–5120

- Menyah, K. and Wolde-Rufael, Y. (2010), *CO₂ Emissions, Nuclear Energy, Renewable Energy And Economic Growth In The US*. *Energy Policy*, Vol.38, No.6 (June), pp. 2911-2915,
- Phillips, P.C.B. and Perron, P. (1988), *Testing for unit root in time series regression*, *Biometrika* 5, 335–346.
- Sadorsky, P., (2009a), *Renewable energy consumption, CO₂ emissions and oil prices in the G7 countries*, *Energy Economics* 31, 456–462.
- Sadorsky, P. (2009b), *Renewable Energy Consumption And Income In Emerging Economies*, *Energy Policy*, Vol.37, No.10 (October), pp. 4021-4028,
- Soytas, U., and Sari, R. (2009), *Energy consumption, economic growth, and carbon emissions: Challenges faced by an EU candidate member*, *Ecol. Econ.* 6, 1667–1675.
- Stern, N., (2006) *The Economics of Climate Change: The Stern Review*, Report to the Cabinet Office, HM Treasury. Cambridge university Press, Cambridge.
- Tica, J. (2004) *The Estimation of 1910-1989 Per Capita GDP in Croatia*, *International Review of Economics and Business*, Vol.7 , No.1, Zagreb
- Timetric, (2012), available at <http://timetric.com/index/co2-emissions-metric-tons-per-capita-croatia-wb/> (30.04.2012.)
- Toda, H.Y., Yamamoto, T. (1995), *Statistical inference in vector autoregressions with possibly integrated processes*, *Journal of Econometrics* 66, 225–250.
- Zivot, E., Andrews, D.W.K. (1992), *Further evidence on the great crash, the oil-price shock and the unit-root hypothesis*, *Journal of Business and Economic Statistics* 10, 251–270.

APPENDIX:

Figure 2: VAR Residual Serial Correlation LM Test

Lags	LM-Stat	Prob
1	16.56787	0.0559
2	12.85518	0.1693
3	5.191275	0.8173
4	5.092946	0.8261
5	7.101282	0.6266
6	3.471990	0.9426
7	8.701135	0.4653
8	10.76529	0.2921
9	11.45644	0.2457
10	1.313322	0.9983
11	5.916401	0.7483
12	11.98118	0.2144

Notes: Probs from chi-square with 9 df.

Figure 3: VAR Residual Normality Tests

Component	Skewness	Chi-sq	df	Prob.
1	0.033051	0.010196	1	0.9196
2	-0.599163	3.350634	1	0.0672
3	0.068233	0.043454	1	0.8349
Joint		3.404283	3	0.3334

Component	Kurtosis	Chi-sq	df	Prob.
1	2.947730	0.006375	1	0.9364
2	3.960699	2.153532	1	0.1422
3	2.983129	0.000664	1	0.9794
Joint		2.160571	3	0.5398

Component	Jarque-Bera	df	Prob.
1	0.016571	2	0.9917
2	5.504165	2	0.0638
3	0.044118	2	0.9782
Joint	5.564854	6	0.4737

**Figure 4: VAR Residual Heteroskedasticity Tests: No Cross Terms
(only levels and squares)**

Joint test:

hi-sq	df	Prob.
130.6778	114	0.1360

Individual components:

Dependent	R-squared	F(19,36)	Prob.	Chi-sq(19)	Prob.
res1*res1	0.101581	0.214231	0.9996	5.688542	0.9986
res2*res2	0.480409	1.751855	0.0723	26.90290	0.1069
res3*res3	0.472943	1.700199	0.0835	26.48479	0.1172
res2*res1	0.400917	1.267993	0.2628	22.45137	0.2624
res3*res1	0.267480	0.691865	0.8021	14.97890	0.7239
res3*res2	0.374230	1.133114	0.3624	20.95690	0.3392

Metka Kogovšek

University of Ljubljana, Faculty of Economics, Ljubljana, Slovenia

Mojca Kogovšek

University of Ljubljana, Faculty of Economics, Ljubljana, Slovenia

GLOBALIZATION AND HIGHER EDUCATION: A NEW PARADIGM FOR EDUCATIONAL MANAGEMENT

ABSTRACT

The impact of globalization and development of knowledge based economy have caused changes for higher educational institutions. The educational institutions have no option but to adapt to the era in which they function in the frame of international knowledge-based competition. Educational institutions should not only deliver knowledge, but also help students to cope with changes which are caused by the process of globalization, preparing them for a job in the 21st century. Higher educational institutions have to provide relevant learning environment where students develop high level of knowledge and upgrade current skills in accordance with rapid changes. The paper aims to highlight the development of educational management according to experiential learning theory satisfying students' needs. Consequently, the problems and obstacles are examined and finally the conclusion provides recommendations for future research regarding development of educational management strategies which seem to be extremely important when striving for attaining pedagogical excellence.

Keywords: *globalization, higher education, educational management, teaching and learning methods*

JEL classification: *I23*

1. INTRODUCTION

Globalization has affected almost all aspects of human life, not only the productive sector but also the environment, health, education and society as a whole. It is a complex process that causes creation of networks of capital, technology, and information through enhanced competition as well as stronger interdependence and interconnection and it creates competitive pressure caused by rapid technological changes that induce new demands (Mumford and Licuanan, 2004). Education sector, being a part of service sector, cannot escape the challenges of globalization. Since the early 1990s different higher education systems went through similar reforms. The government funding is reduced and higher educational institutions are becoming increasingly market oriented and financially independent (Kwiek, 2001). The dual

nature of globalization causes institutional globalization characterized by uniform model of rationalization toward growing uniformity and setting similar goals within regulatory frameworks that stresses decentralization (Astiz et.al 2002). The key point of decentralizing reforms in many nations is the control over the content of curricula and its implementation (Astiz et.al 2002). Increasing cross-border activities do not have just positive impacts but rather causes blurred national systems with questionable elements like loosing cultural heritage and linguistic diversity, reducing heterogeneity of academic structures and cultures, and even quality decline (Teichler, 2004).

Many European higher educational institutions perceive globalisation as pressure toward standardizing study programmes and length of study and thereby reducing direct government control with increasingly performance-based funding. Globalization forces educational institution to use its resources and deliver a quality service which requires finding new learning environment that prepares all graduates to be effective in a diverse society (Wood et.al 2005).

This paper has three parts. First, it outlines theoretical part of the study, summarizing the importance of globalization in higher education system. Second, it covers qualitative analysis, based on imperative review, on contemporary learning techniques in higher education, including the framework of blended education as the answer to increasingly demanding higher education environment. Finally, it discusses the importance of the application of blended education model as the crucial toll for achieving pedagogical excellence.

2. GLOBALIZATION AND HIGHER EDUCATION

The process of globalization and formation of knowledge society poses pressure on education system. Higher educational institutions are facing institutional changes triggered by globalization linked to the frame of international knowledge-based competition (Vaira, 2004). They had to modify their curricula and strategies to meet the needs of diverse learners and to prepare all graduates to be effective in a diverse society (Morey, 2000). Therefore higher educational institutions, driven by competition, examine the quality of their services, redefine their products and measure the results while pursuing their own pedagogical objectives and their mission of dissemination of knowledge (Wood et.al 2005). Their survival solely depends on the quality level of their services (Aviram, 2001). Pedagogic excellence correlates with the concern for student's growth (Gibbs and Iacovidou, 2004) because student's achievement is the core concept paradigm of quality. There is a need for establishment of teaching and learning processes based on common purpose that is designed to assure continuous quality improvement (Henderson-Smart et.al 2006). However, quality assurance is a long-term commitment to constantly enhance quality (Bui and Baruch, 2010).

It is asserted that among different stakeholders, students are the most important and when examining service quality, their perception of quality is the most relevant (McCuddy et.al 2008; Yeo, 2008; Gallifa and Batallé, 2010; Reid, 2010; Tsinidou et.al 2010). From quality perspective, researchers focus on quality by measuring students' academic and personal growth as well as achievements in professional life (Tam, 2002;

Voss et.al 2007; Wongsurawat, 2011). Educational excellence is examined in terms of adequate promotion of knowledge as well as the development of values and skills for personal and social transformation helping students to cope with changes preparing them for job in the 21st century (Kaplan and Flum, 2012).

3. CONTEMPORARY LEARNING TECHNIQUES

Pedagogic excellence correlates with the concern for student's growth because student's achievements are of greatest importance (Gibbs and Iacovidou, 2004;). However there are different ways to reach the quality threshold. The question is given: how to assure quality of teaching and provide more effective learning? In fact, the students with different characteristics like intelligence, social and cultural backgrounds and learning styles require different teaching approaches. Learners use auditory, visual and kinaesthetic modalities (Penger et.al 2011) to receive knowledge and experiences. Therefore there is consequently no single way of teaching. Examining pedagogic excellence means to analyze educational methods and learning styles (Shaw and Marlow, 1999; Wintergerst et.al 2001; Lu et.al 2003; Gracia et.al 2007, Penger and Tekavčič, 2009; Anderson and Gilmore, 2010; Butler and Reddy, 2010; Heck and Mahoe, 2010), whether the applied methods adequately transfer the knowledge. Not even one of them is designed in a way that it would assure equal learning results for all.

According to experiential learning theory, students absorb information differently and learn better when they absorb information in a way that suits their personal preferences (Penger et.al 2011). Learning techniques should meet students' needs regarding course design, teaching methods and didactical approach (Rovai and Barnum, 2003; Liao and Wang, 2008). A holistic theory that identifies learning style differences and experiential learning as a process of constructing knowledge and creative tension among experiencing, reflecting, thinking and acting has been developed (Kolb and Kolb, 2005). By considering the elements of experiential learning theory and the concept of change in learning processes, professors can guide students to improve learning through student centred model of teaching that focuses on supporting students to attain deeper understanding (Butler and Reddy, 2010). In this way pedagogic excellence pursuing students' growth as the core concept paradigm of quality is achieved by scrutinizing whether the applied methods transfer knowledge adequately (Shaw and Marlow, 1999; Wintergerst et.al 2001; Gibbs and Iacovidou, 2004; Penger and Tekavčič, 2009; Samy and Cook, 2009; Brauckmann and Pashiardis, 2010; Butler and Reddy, 2010). The goal of educational management is to enable students' successful entry into business world (Penger et.al 2008). The development of these new skills and knowledge requires a variety of teaching methods and learning strategies in order to match students' learning style preferences. Therefore, educators need an awareness of the learning style preferences of students in order to develop effective and efficient teaching and pedagogical strategies and methods. Recognizing students' learning styles allows educators to effectively lecture to a diverse population of students with different learning style preferences (Felder, 1993; Liao and Wang, 2008; Anderson and Cartafalsa, 2012).

3.1. Teaching and learning methods according to Experiential learning theory

The first author that suggested that students' conceptions of knowledge that develops progressively through education experiences was William Perry in early 70s (Entwistle and Peterson, 2004). However, learning style models have been developed since the 1940s (Okur and Bahar, 2010). The most frequently cited researcher who examined learning methods is Kolb. He based his theory of experiential learning on persons' different approaches to perceiving, processing and integrating information. According to the doctrine various disciplines are localized in different learning styles requiring specific learning strategies to be successful (Jones et.al 2003). Kolb build experiential learning theory on a set of theories namely Dewey's pragmatism, Maslow's humanism, Piaget's cognitive development, Ruger's client centred therapy, Lewin's social psychology, and Perls' Gestalt therapy. The theory is widely accepted and thus his Learning Styles Inventory presents learning framework (Demirbas and Demirkan, 2007). Experiential learning theory as a holistic theory that identifies learning style differences and experiential learning as process of constructing knowledge and creative tension among experiencing, reflecting, thinking and acting (Kolb and Kolb, 2005). Kolb's model classifies learners into four learning style categories namely accommodating, diverging, converging and assimilating. Besides its popularity some critics of empirical limitation of this theory emerged claiming it lacks validity and reliability (Bergsteiner et.al, 2010) and it fails to consider relationships between social and personal aspects of learning (Demirbas and Demirkan, 2007; Bergsteiner et.al 2010; Berggren and Söderlund, 2011).

By knowing about and implying diverse learning styles professors can help students retain information, increase self awareness, achieve higher level of thinking, higher level of understanding, and critical thinking, moving beyond memorizing to more meaningful learning, synthesising, analysing and applying knowledge (Jacobson, 2001). When the learning style is compatible with the teaching style information is retained longer and more effective (Felder, 1993).

Table below presents conclusions drawn by different researchers on the research field of experiential learning.

Table 2: Research on experiential learning

Authors/no of observation	Research area	Measuring scale	Results
Rudd et.al (2000); Florida, 174 students.	Exploring relationship between learning style and student disposition toward critical thinking.	California Critical Thinking Disposition Inventory having 7 sub-scales consisting of 75 items.	No relationship between critical thinking disposition and learning style confirmed. Gender differences in critical thinking (greater for female).
Jones et.al (2003); USA, 105 students.	Determining learning style preferences. Active experimentation, reflective observation, abstract conceptualization, concrete experience.	Kolb Learning Style Inventory modified to discipline specific (English, math, science and social studies).	No significant differences for gender and subject area confirmed. Each mode showed significant differences across disciplines; 81% participants switched learning style.
Wang et.al (2006); Taiwan, 455 students.	Summative assessment: pre-test achievements as the entry behaviour of learning and post-test achievements.	Kolb Learning Style Inventory	Learning styles and formative assessment strategy confirmed to be significant factors impacting student achievement in web-based environment. Diverger performs best.
Demirbas and Demirkan (2007); Turkey, 274 students.	Examination of distribution of the four original learning styles and determining relationship between genders.	Kolb's Learning Style Inventory test (third version).	Learning style preferences not differ by gender. Males performed better in technology based courses, females in artistic and fundamental courses.

Authors/no of observation	Research area	Measuring scale	Results
García et.al (2007); 27 students.	Different student behaviours that determine learning style preference, model is obtained by analyzing students' log files.	Evaluate Bayesian networks' precision for detecting students' learning style; Felder and Silverman model.	Bayesian networks' determine the perception of student learning style with high reliability.
Voss et.al (2007); 2004/05, 82 students.	Teaching skills, teaching methods, communication skills, approachability, enthusiasm, expertise, humour and friendliness.		Students prefer organized, knowledgeable, encouraging, helpful, caring environment that is needed for their learning progress.
Koçakoğl et.al (2010); 120 students.	Examining the effect of problem-based learning and motivational styles.	Experimental study.	Significant difference between motivational styles. No effects of problem-based learning and learning style found.
Okur and Bahar (2010); 168 students.	Academic success, dominant learning styles and anxiety during learning Math.	Kolb Learning Style Inventory (adapted by Aşkar and Akkoyunlu) and Spilberger's Trait Anxiety Inventory.	Converger and assimilator most frequently represented. Anxiety sates do not vary with respect to learning style.
Jabbarifar and Elhambakhsh (2012); 213 students & 38 teachers.	English course. Teaching and learning, beliefs and motivation behind the preferences. Teaching and learning styles.	Multiple methods and sources: interviews, direct observation and quantitative data.	Some points of agreement and disagreement between students and teachers in terms of preferred learning/teaching styles.

3.2. Blended learning

The higher education landscape is changing beyond recognition and the ubiquity of the internet and digital technologies are driving these imperatives, offering new opportunities for the application of information communication technologies (ICTs) in support of flexible learning environment (Richards, 2004). The employability agenda also impacts the needs of student population who require key skills in order to live and work in an increasingly technologically focussed, complex workplace (Weaver, 2006).

New ICTs have the impact on global economy and have a potential to reshape the nature of study environments regarding both, conventional and contemporary learning methods (Guri-Rosenblit, 2005). Higher educational institutions are challenged by modern ICTs shaping teaching and learning environments.

The new economy demands learning new knowledge and skills in timely and effective manner and it provides heterogeneous means to support modern teaching and learning in a more flexible, personalized manner. Countries have to adapt to the demands of the internet economy and educational institutions have to offer innovative study programs (Gunasekaran et.al 2002). Universities can benefit from new technologies to enhance the teaching/learning processes.

First progress regarding new approaches in access to university courses is distance learning. It exists since 1858 when University of London introduced it as an alternative to traditional education (Reeves et.al 2012) and Issac Pitman is considered to be the first modern distance educator who began teaching by correspondence in 1840 (Williams et.al 2004). Distance learning allows student access to learning without constraints of location or time and as such it is also a new paradigm of modern education. It was initially designed for part-time students (Singh et.al 2005; McPhee and Söderström, 2012) but last two decades more diverse, self-directed and self-motivated learners decided for distant learning (Rahim and Finch, 2011). It is rapidly growing within the countries as well as internationally (Sun et.al 2008). In modern era distance education requires usage of computer-based learning methods and it is an alternative to traditional education (Guri-Rosenblit, 2005). However, only students with real problems attending regular courses choose only distance learning, but most students like better to study in classrooms or combining those two due to the fact that essential need of a person is to socialize (Guri-Rosenblit, 2006). But generation Y born from 1977 to 1994 grown up with ever-changing technology enjoying spending time with media and do not respond adequately to training using traditional lecture methods (Eisner, 2011). Nevertheless, the increasing numbers of online students will influence the onsite learning. Over 75% colleges and universities in US offer some kind of online classes that annually increase by 30% (Reeves et.al 2012).

E-learning is a promising alternative to conventional classroom learning and is still growing as an essential part of professional and academic education. It can be defined as a wide set of applications and processes applied while learning that includes computer-based learning, online learning, virtual classrooms and digital collaboration (Teo et.al 2009). Educational institutions have to understand the importance of e-learning and make decisions on how to adopt e-learning techniques in their

environments. Unfortunately e-learning requires more self-discipline from students and therefore this can explain the higher rates of dropouts in e-learning programs in comparison with traditional programs (Zhang et.al 2004).

The same dimension of teaching and learning style preferences in onsite and online environment and consequently the effectiveness and quality can be attained by keeping e-learning preferences in accordance with individual e-teaching styles (Anderson and Cartafalsa, 2012). There is a need to engineer efficient methods to synthesize multimedia content and understand the impact of different factors on e-learning effectiveness (Zhang et.al 2004). E-learning technologies can afford enhanced experience in terms of improved quality of learning and also improved attitudes to learning (Alexander and Golja, 2007).

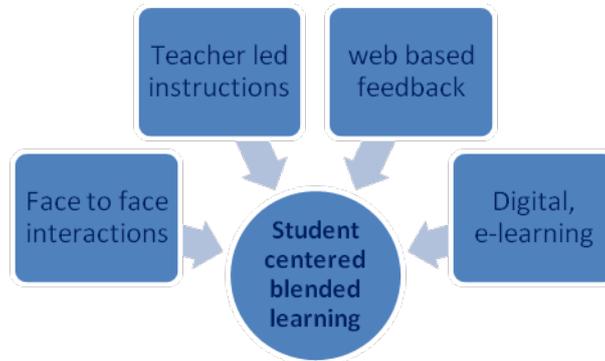
With consistence of the literature regarding differences between online, distance and face-to-face learning, it is not possible to affirm the last as best education option (McPhee and Söderström, 2012). New technologies can be utilized to create dynamic courses and integrating new technologies and multimedia within learning settings may help prepare students for technologically demanding careers (Courts and Tucker, 2012). It can be useful in gaining interest of students as well as opportunity to share ideas and much quicker assimilate knowledge (Eastman et.al 2009).

However, the key drivers in achieving pedagogic excellence are application of mixed teaching styles and methods (Selim, 2007) by application of blended education. Blended learning introduces various mixes of technology with conventional learning approaches usually in conventional settings (Oliver, 2005). According to cognitive theories, blended education provides certain information through different channels across different contexts and from different perspectives leading to creation of powerful mental models that facilitate retrieval of memory.

According to several researchers, blended learning is a flexible learning method with low risk and effective strategy of integration in classroom with online learning experience requiring reorganization of teaching and learning dynamic (Garrison and Kanuka, 2004; Sharpe and Benfield, 2005; Sethy, 2008). It makes learning effective since it facilitates open communication, critical debate and limitless access to information. Online discussion serves as student centred learning approach and supports and encourages even more silent individuals to participate more actively (Davies and Graff, 2005).

According to several researchers, blended learning is a flexible learning method with low risk and effective strategy of integration in classroom with online learning experience requiring reorganization of teaching and learning dynamic (Garrison and Kanuka, 2004; Sharpe and Benfield, 2005; Sethy, 2008). It makes learning effective since it facilitates open communication, critical debate and limitless access to information. Online discussion serves as student centred learning approach and supports and encourages even more silent individuals to participate more actively (Davies and Graff, 2005).

Figure 1: Model of blended learning



Source: adopted by Martyn, 2003; Oliver, 2005

Some research evidence confirms benefit of students developing better understanding through discussion with their peers engaged in authentic tasks (Teo et.al 2009). Still some students would rather get direction and control from teachers whereas distinct students seek autonomy when learning (Olaniran, 2009). But in case of distance learning, there is no face-to-face communication with professor or peers therefore scholars argue that it can result in creating an impersonal attitude toward learning. However, virtual interactions between students might be superior to direct contact because students are more open expressing their opinion and often bring about experience through discussion (Peltier, et.al 2007). Some students prefer learning alone, others working in pairs or within a group or even with experienced adults. Many research studies were conducted validating the effectiveness of cooperative learning over individualistic that shift from passive, competitive to active and cooperative learning (Rovai and Barnum, 2003). Due to social interdependence theory cooperation with positive relationships between individuals results in reaching mutual goals while according to cognitive development theory cooperation results in cognitive development and growth (Morgan et.al 2010). Some researchers emphasise positive experiences and consequently better outcomes to be generally related to reciprocal interdependence and working together as a team leads toward collective learning experience (Schneider and Lieb, 2004) or to problem-based learning as a student oriented method that focuses on cognitive process (Koçakoğlu et.al 2010).

Blended education that integrates different learning approaches is the answer to increasingly demanding environments because it optimizes learning by applying various learning technologies that match personal learning styles and easily transfer knowledge and development of adequate skills. Students have to be engaged in technology-driven learning environment that facilitates learning by finding creative and innovative solutions from new and different paradigms and in this way provide educational opportunities to diverse spectrum of students. The final goal for the educators is to provide meta-cognitive support for students, enabling them to reflect not just on what they learn but also how and why, thereby helping them to 'learn how to learn'. Knowing about learning styles can enhance teaching and enable students' to perform better and much easier master the learning task.

4. CONCLUSION

Application of ICTs in education setting comes from the irresistible power of globalization and the effects of technological innovations. Technologies are the products of the emergent technical capacities and therefore provide conditions under which e-learning is being introduced into education and shaped by the needs of the market.

The lack of government funding and demands for passing from elite to mass education introduced e-learning courses that give students greater access to education. Digital revolution brings the opportunity to apply new and varied learning and teaching methods. ICTs can be used efficiently and effectively in facilitating learning and serve as a powerful means for potential change in educational systems where links between practice and theory are firmly grounded.

The blended concept of learning provides opportunities for a new learning environment that is learning-centred, with emphasis on active learning through collaboration and social construction of understanding. With the pressure to introduce contemporary learning methods, blended learning model is ascertained to offer excellent learning setting. Blended education model is the fitting answer for achieving pedagogic excellence where ICTs serve as a powerful tool of potential change in educational systems where links between practice and theory are firmly grounded and through which contemporary blended learning can be applied as the means to develop appropriate teaching and pedagogical strategies to meet the student's needs.

REFERENCES

- Alexander, S. and Golja, T. (2007), *Using Students' Experiences to Derive Quality in an e-Learning System: An Institution's Perspective*, Educational Technology and Society, Vol. 10 (2), 17-33.
- Anderson, L. and Cartafalsa, J. (2012), *Practical Lens for Teachers in Their High Tech Learning Environment*, Journal of Research in Innovative Teaching, Vol. 5 (1), 39-33.
- Anderson, V. and Gilmore, S. (2010), *Learning, experienced emotions, relationship and innovation in HRD*, Journal of European Industrial Training, Vol. 34 (8/9), 753-771.
- Astiz, M.F., Wiseman, A.W., and Baker, D.P. (2002), *Slouching toward Decentralization: Consequences of Globalization for Curricular Control in National Education Systems*, Comparative Education Review, Vol. 46 (1), 66-88.
- Aviram, A. (2001), *From »Computers in the classroom« to mindful radical adaptation by education systems to the emerging cyber culture*, Journal of Educational Change, Vol. 1, 331-352.
- Berggren, C. and Söderlund, J. (2011), *Management Education for Practicing Managers: Combining Academic Rigor With Personal Change and Organizational Action*, Journal of Management Education, Vol. 35 (3), 377-405.
- Bergsteiner, H., Avery, G.C., and Neumann, R. (2010), *Kolb's experiential learning model: critique from a modelling perspective*, Studies in Continuing Education, Vol. 32 (1), 29-46.

- Brauckmann, S. and Pashiardis, P. (2010), *The clash of evaluations In search of the missing link between school accountability and school improvement – experiences from Cyprus*, International Journal of Educational Management, Vol. 24 (4), 330-350.
- Bui, H. and Baruch, Y. (2010), *Creating learning organizations in higher education: applying a systems perspective*, The Learning Organization, Vol. 17 (3), 228-242.
- Butler, M.J.R. and Reddy, P. (2010), *Developing critical understanding in HRM students: Using innovative teaching methods to encourage deep approaches to study*, Journal of European Industrial Training, Vol. 34 (8/9), 772-789.
- Courts, B. and Tucker, J. (2012), *Using Technology To Create A Dynamic Classroom Experience*, Journal of College Teaching and Learning, Vol. 9 (2), 121-128.
- Davies, J. and Graff, M. (2005), *Performance in e-learning: online participation and student grades*, British Journal of Educational Technology, Vol. 36 (4), 657-663.
- Demirbas, O.O. and Demirkan, H. (2007), *Learning styles of design students and the relationship of academic performance and gender in design education*, Learning and Instruction, Vol. 17, 345-359.
- Eastman, J.K., Iyer, R., and Eastman, K.L. (2009), *Interactive Technology In The Classroom: An Exploratory Look At Its Use And Effectiveness*, Contemporary Issues In Education Research, Vol. 2 (3), 31-38.
- Entwistle, N.J., and Peterson, E.R. (2004), *Conceptions of learning and knowledge in higher education: Relationships with study behaviour and influences of learning environments*, International Journal of Educational Research, Vol. 41, 407- 428.
- Felder, R.M. (1993), *Reaching the second tier. Learning and teaching styles in college science education*, Journal of College Science Teaching, Vol. 23 (5), 286-290.
- Gallifa, J., and Batallé, P. (2010), *Student perceptions of service quality in a multi-campus higher education system in Spain*, Quality Assurance in Education, Vol. 18 (2), 156-170.
- García, P., Amandi, A., Schiaffino, S. and Campo, M. (2007), *Evaluating Bayesian networks' precision for detecting students' learning styles*, Computers and Education, Vol. 49, 794-808.
- Garrison, D.R. and Kanuka, H. (2004), *Blended learning: Uncovering its transformative potential in higher education*, The Internet and Higher Education, Vol. 7, 95-105.
- Gibbs, P. and Iacovidou, M. (2004), *Quality as pedagogy of confinement: is there an alternative?* Quality Assurance in Education, Vol. 12 (3), 113-119.
- Gunasekaran, A., McNeil, R.D., and Shaul, D. (2002), *E-learning: research and applications*, Industrial and Commercial Training, Vol. 34 (2), 44-53.
- Guri-Rosenblit, S. (2005), *Distance education' and 'e-learning': Not the same thing*, Higher Education, Vol. 49, 467-493.
- Guri-Rosenblit, S. (2006), *Eight paradoxes in the implementation process of e-learning in higher education*, Distances et savoirs, Vol. 4 (2), 155-179.
- Heck, R. H. and Mahoe, R. (2010), *Student course taking and teacher quality: their effects on achievement and growth*, International Journal of Educational Management, Vol. 24 (1), 56-72.
- Henderson-Smart, C., Winning, T., Gerzina, T., King, S. and Hyde, S. (2006), *Benchmarking learning and teaching: developing a model*, Quality Assurance in Education, Vol. 14(2), 143-155.
- Jacobson, M.H.S. (2001), *A Primer on Learning Styles: Reaching Every Student*, Seattle University Law Review, Vol. 25, 139-177.
- Jones, C., Reichard, C., and Mokhtari, K. (2003), *Are students' learning styles discipline specific?* Community College Journal of Research and Practice, Vol. 27, 363-375.
- Kaplan, A., and Flum, H. (2012), *Identity formation in educational settings: A critical focus of education in the 21st century*, Contemporary Educational Psychology, Vol. 37 (3), 171-175.

- Koçakoğlu, M., Türkmen, L. and Solak, K. (2010), *Motivational styles in problem-based learning*, *Procedia Social and Behavioral Sciences*, Vol. 2, 615-619.
- Kolb, A.Y. and Kolb, D.A. (2005), *Learning Styles and Learning Spaces: Enhancing Experiential Learning in Higher Education*, *Academy of Management Learning and Education*, Vol. 4 (2), 193-212.
- Kwiek, M. (2001), *Globalization and Higher Education*, *Higher Education in Europe*, Vol. 26 (1), 27-38.
- Liao, H.C. and Wang, Y. (2008), *Applying The ARCS Motivation Model In Technological And Vocational Education*, *Contemporary Issues In Education Research*, Vol. 1 (2), 53-58.
- Lu, J., Yu, C.S. and Liu, C. (2003), *Learning style, learning patterns, and learning performance in a WebCT-based MIS course*, *Information and Management*, Vol. 40, 497-507.
- Martyn, M. (2003), *The hybrid online model: good practice*, *Educause Quarterly*, Vol. 26 (1), 18-23.
- McCuddy, M.K., Pinar, M., and Gingerich, E.F.R. (2008), *Using student feedback in designing student-focused curricula*, *International Journal of Educational Management*, Vol. 22 (7), 611-637.
- McPhee, I. and Söderström, T. (2012), *Distance, online and campus higher education: reflections on learning outcomes*, *Campus-Wide Information Systems*, Vol. 29 (3), 144-155.
- Morey, A.I. (2000), *Changing Higher Education Curricula for a Global and Multicultural World*, *Higher Education in Europe*, Vol. 25 (1), 25-39.
- Morgan, B.M., Rosenberg, G.P., and Wells, L. (2010), *Undergraduate Hispanic Student Response To Cooperative Learning*, *College Teaching Methods and Styles Journal*, Vol. 6 (1), 7-12.
- Okur, M. and Bahar, H.H. (2010), *Learning styles of primary education prospective mathematics teachers: states of trait-anxiety and academic success*, *Procedia Social and Behavioral Sciences*, Vol. 2, 3632-3637.
- Olaniran, B.A. (2009), *Culture, learning styles, and Web 2.0*, *Interactive Learning Environments*, Vol. 17 (4), 261-271.
- Oliver, R. (2005), *Quality assurance and e-learning: blue skies and pragmatism*, *Research in Learning Technology*, Vol. 13 (3), 173-187.
- Peltier, J.W., Schibrowsky, J.A., and Drago, W. (2007), *The Interdependence of the Factors Influencing the Perceived Quality of the Online Learning Experience: A Causal Model*, *Journal of Marketing Education*, Vol. 29 (2), 140-153.
- Penger, S., Tekavčič, M., and Dimovski, V. (2008), *Comparison, validation and implications of learning style theories in higher education in Slovenia: an experiential and theoretical case*, *International business and economics research journal*, Vol. 7 (12), 25-44.
- Penger, S. and Tekavčič, M. (2009), *Testing Dunn and Dunn's honey and Mumford's learning style theories: The case of the Slovenian higher education system*, *Management*, Vol. 14 (2), 1-20.
- Penger, S., Žnidaršič, J. and Dimovski, V. (2011), *Experiential Learning and Management Education: Empirical Research and Implications for Practice in Higher Education in Slovenia*, *International Journal of Management and Information Systems*, Vol. 15 (1), 23-34.
- Rahim, E. and Finch, A. (2011), *Adult Learning Styles and Technology-Driven Learning for Online Students*, *Academic Leadership Journal*, Vol. 9 (2), 21-28.
- Reeves, J., Amin, M., Turqueti, M., and Dey, P.P. (2012), *Improving Laboratory Effectiveness in Online and Onsite Engineering Courses at National University*, *Journal of Research in Innovative Teaching*, Vol. 5 (1), 26-38.
- Reid, K. (2010), *An evaluation of an internal audit on student feedback within a British university: A quality enhancement process*, *Quality Assurance in Education*, Vol. 18 (1), 47-63.
- Richards, C. (2004), *From old to new learning: global imperatives, exemplary Asian dilemmas and ICT as a key to cultural change in education*, *Globalization, Societies and Education*, Vol. 2 (3), 337-353.

- Rovai, A.P. and Barnum, K.T. (2003), *On-Line Course Effectiveness: An Analysis of Student Interactions and Perceptions of Learning*, Journal of Distance Education, Vol. 18 (1), 57-73.
- Rudd, R., Baker, M., and Hoover, T. (2000), *Undergraduate agriculture student learning styles and critical thinking abilities: is there a relationship?* Journal of Agriculture Education, Vol. 41 (3), 2-12.
- Samy M. and Cook, K. (2009), *Perceived school effectiveness: case study of a Liverpool collage*, International Journal of Educational Management, Vol. 23 (2), 185-198.
- Schneider, M. and Lieb, P. (2004), *The Challenges of Teaching Strategic Management: Working Toward Successful Inclusion of the Resource-Based View*, Journal of Management Education, Vol. 28 (2), 170-187.
- Sharpe, R. and Benfield, G. (2005), *The Student Experience of E-learning in Higher Education: A Review of the Literature*, Brookes eJournal of Learning and Teaching, Vol. 1 (3), 1-9.
- Shaw, G. and Marlow, N. (1999), *The role of student learning styles, gender, attitudes and perceptions on information and communication technology assisted learning*, Computer and Education, Vol. 33, 223-234.
- Selim, H.M. (2007), *Critical success factors for e-learning acceptance: Confirmatory factor models*, Computers and Education, Vol. 49, 396-413.
- Sethy, S.S. (2008), *Distance Education in the Age of Globalization: An Overwhelming Desire towards Blended Learning*, Turkish Online Journal of Distance Education, Vol. 9 (3).
- Singh, G., O'Donoghue, J., and Worton, H. (2005), *A Study Into The Effects Of eLearning On Higher Education*, Journal of University Teaching and Learning Practice, Vol. 2 (1), 13-24.
- Sun, P.C., Tsai, R.J., Finger, G., Chen, Y.Y., and Yeh, D. (2008), *What drives a successful e-Learning? An empirical investigation of the critical factors influencing learner satisfaction*, Computers and Education, Vol. 50, 1183-1202.
- Tam, M. (2002), *Measuring the effect of higher education on university students*, Quality Assurance in Education, Vol. 10 (4), 223-228.
- Teichler, U. (2004), *The changing debate on internationalisation of higher education*, Higher Education, Vol. 48, 5-26.
- Teo, T., Lee, C.B. and Chai, C.S. (2008), *Understanding pre-service teachers' computer attitudes: applying and extending the technology acceptance model*, Journal of Computer Assisted Learning, Vol. 24, 128-143.
- Tsinidou, M., Gerogiannis, V., and Fitsilis, P. (2010), *Evaluation of the factors that determine quality in higher education: an empirical study*, Quality assurance in Education, Vol. 18 (3), 227-244.
- Vaira, M. (2004), *Globalization and higher education organizational change: A framework for analysis*, Higher Education, Vol. 48, 483-510.
- Voss, R., Gruber, T. and Szmigin, I. (2007), *Service quality in higher education: The role of student expectations*, Journal of Business Research, Vol. 60, 949-959.
- Wang, K.H., Wang, T.H., Wang, W.L., and Huang, S.C. (2006), *Learning styles and formative assessment strategy: enhancing student achievement in Web-based learning*, Journal of Computer Assisted Learning, Vol. 22, 202-217.
- Weaver, M. (2006), *Exploring conceptions of learning and teaching through the creation of flexible learning spaces: the Learning Gateway - a case study*, New Review of Academic Librarianship, Vol. 12 (2), 109-125.
- Williams, P., Nicholas, D., and Gunter, B. (2004), *E-learning: what the literature tells us about distance education. An overview*. Aslib Proceedings, Vol. 57 (2), 109-122.
- Wintergerst, A.C., DeCapua, A. and Itzen, R.C. (2001), *The construct validity of one learning styles instrument*, System, Vol. 29 (3), 385-403.
- Wongsurawat, W. (2011), *What's a comment worth? How to better understand student evaluations of teaching*, Quality Assurance in Education, Vol. 19 (1), 67-83.

- Wood, B.J.G., Tapsall, S.M., and Soutar, G.N. (2005). *Borderless education: some implications for management*, International Journal of Educational Management, Vol. 19 (5), 428-436.
- Yeo, R.K. (2008), *Brewing service quality in higher education. Characteristics of ingredients that make up the recipe*, Quality Assurance in Education, Vol. 16 (3), 266-286.
- Zhang, D., Zhao, J.L., Zhou, L., and Nunamaker, J.F. (2004), Can e-learning replace classroom learning? Communications of the ACM, Vol. 47 (5), 75-79.

Mojca Kogovšek

University of Ljubljana, Faculty of Economics, Ljubljana, Slovenia

Metka Kogovšek

University of Ljubljana, Faculty of Economics, Ljubljana, Slovenia

HUMAN CAPITAL AS THE SOURCE OF GREATEST COMPETITIVE ADVANTAGE IN KNOWLEDGE SOCIETY: AGEING WORKFORCE AND SKILL SHORTAGES

ABSTRACT

Knowledge based economy focuses on human capital as the key source of companies' strongest competitive advantage. Human resource managers have to find ways to maximize human capital since companies that succeed in the future are those that view learning as priority. However the workforce is aging in all developed countries and subsequent trend of workforce aging will continue for decades. In this context older workers do play dominant role since the supply of younger workers is becoming depleted especially regarding specific fields. The loss of experienced workforce might cause serious difficulties in pursuing the development strategies of the companies. Using the scanning method, emergent trends and issues were identified and emphases put on age management practices for maintenance of workability, stressing the importance of learning. The conclusion supports the key role of learning paradigm within retention of mature workers. Considering future research agenda there is a lack of evidence on how learning can be arranged to motivate aging individuals in pursuance of employability maintenance.

Key words: *knowledge society, older workers, retention, lifelong learning, age management.*

JEL classification: *M12*

1. INTRODUCTION

In global economy organisations can overcome competition issues only if workforce attains high levels of knowledge and skills. However the workforce is aging in all developed countries and subsequent trend of workforce aging will continue for decades. In this context older workers do play dominant role in workforce since the supply of younger workers is becoming depleted especially regarding specific fields (Callan and Greenhaus, 2010). Companies that retain older workers will achieve competitive edge over those that ignore demographic trends (Allen and Hart, 1998; Callahan et.al, 2003; James et.al 2011) and take advantage of the diverse workforce as

the greatest contributor of human capital to companies success (Guest and Shacklock, 2006). Aging of workforce poses challenges for the companies because of labour and skill shortages therefore human resource managers need to understand how working life could adopt to ageing workforce (Žnidaršič and Dimovski, 2009). Organisations, by applying lifelong learning practices to retain mature workers, will be able to rely upon the human capital potential of mature workers (Bangali, 2004, Jalette and Villeneuve, 2002). Continuous training of mature workers is one of the most important agents of prolonging working life because up-to date knowledge and skills are, above adequate health status, factors of workability which by appropriate work settings enable their employability (Allen and Hart, 1998; Callahan et.al 2003; Picchio and van Ours, 2013).

In knowledge-based environment organizations' valuable assets are more in employees than in machinery (Mellander, 2001). The rise of knowledge work has emerged in all developed countries. Therefore there is a growing importance of knowledge as an economic resource that reflects technological development. We witness the shrinkage of jobs in manufacture of material goods in comparison to professional and service occupations that involve working with knowledge or people. In new economies' success no longer lies in improving efficiency, but rather on human capabilities (Pyöriä, 2005; Loretto and White, 2006). Organisations in knowledge based economy largely depend on its human capital which is generally worth five to ten times more than physical capital (Gill, 2009). Therefore human capital investment evaluation should have been set according to increased value of knowledge as a key economic resource of contemporary workplace.

The purpose of the research is to gain deeper understanding the ways to maintain workability of mature workers. In rapidly changing knowledge environment there is an absolute need to offer quality training programs to all employees regardless of age in pursuance of maintaining their employability. The research method is based on two major sections, namely identifying emergent concepts and issues and the discussion accumulation of human capital that does not end with schools but rather a constant process of education and training. Accumulation of human capital is a key lever to augmentation and adaption of existing knowledge and skills of individuals as an answer to the process of globalization and rapid technological changes.

2. HUMAN CAPITAL INVESTMENT

According to human capital theory, (Lazear, 1998) lifelong learning increases human capital, therefore organisations have to encourage all their workers to participate in training and development actions regardless of age (Wild et.al 2002; Beaver and Hutchings, 2005; Ong and Lai, 2006; Githens, 2007). Human resource departments provide learning opportunities that help employees to be ready for competition within a global economy since employees who acquire a wider range of skills become the organizations' valuable assets. Trained employees can much quicker adapt to internal and external business demands and at the same time preserve productivity under any conditions (Abrams and Berge, 2010). Contemporary assumptions are built on cognitive abilities of employees (Ballot et.al 2001) as intangible assets that appear in a

form of training stock which was proved to be a significant input of production function. Education and training in particular have become the key priority of labour upon which future economic growth is built upon (Pyöriä, 2005). In knowledge society high-skilled occupations are growing while there is less routine-intensive and less abstract jobs (Bosch and ter Weel, 2013). Knowledge work requires extensive formal education and continuous training since knowledge becomes a primary production factor (Pyöriä, 2005).

However, employers should have arranged for and pay training because there is strong relationship between learning and performance outcomes (Kock and Ellström, 2011). The level of human capital is a contributory factor that importantly impacts productivity therefore the need for lifelong learning is the prerequisite when pursuing high performance of an individual.

2.1. Investment in human capital of mature workers

The most effective ways found to encourage organizations growth is the implementation of training programs. Organisations implemented training programs to better utilize ageing workforce already in the late nineties. When estimating the probability of workers gaining training opportunities researchers concluded that individuals with higher human capital are more likely to participate in further education and training according to accumulative perspective of lifelong learning (Fouarage and Schils, 2008). Mature workers have completed formal education long ago therefore their knowledge has most probably become obsolete therefore they have to be trained. However, mature employees should have been regarded not as short-term costs but rather long-term investments particularly in respect of training (Brooke, 1995). Updating their skills is found to be even more cost-effective than hiring a non-experienced worker (Ennis-Cole and Allen, 1998). Mature workers' continuous education and training is undoubtedly beneficial since the organisations report increased motivation, retention and reduced absenteeism (Newton et.al 2005)

Human capital theory acknowledges depreciation of knowledge and skills to be a key determinant of early retirement. However human capital investments are more likely substantively lower for mature employees compared to younger co-workers as they are expected to stay within work environment for considerable shorter period of time. Nevertheless, due to population aging and labour shortages, employers have to increase investments in training to enhance productivity and enable active aging (Fouarage and Schils, 2008).

3. LIFELONG LEARNING

Continuous changes in working life, exacerbated by technological development, will continue to impact general competence requirements (Billett, 2011). A new line of thought in vocational education and training has surfaced in which traditional focus on younger individuals shifted to view that encompasses integral part of working life therefore lifelong learning is defined as continuous organized learning process of improving employees' performance to upgrade knowledge after initial education is

complete. It should be continuous endeavour by employees and management to anticipate the needs of changing environment (Kleinman et.al 2001; Bernardin, 2003, Tikkanen, 2009). A broad, holistic concept of lifelong learning encompasses individual education and training, but also entails participative collective workplace learning that is actively supported by employers (Walker, 2005).

Employers have to become sensitive about the key issues related to training employees and provide access to all throughout their working life (Paul and Townsend, 1993; Torrington and Hall, 1995; Armstrong-Strassen and Templer, 2005; Walker, 2005; Paloniemi, 2006). As knowledge and skills, based on formal training, have been judged inadequate, the need for lifelong learning of mature employees who are increasingly important segment of the workforce is inevitable (Callanan and Greenhaus, 2008, Tones et.al 2011). Continuous education is essential for mature workers who want to keep up with technological and scientific advances (Billett, 2011). Employers must offer a variety of learning programs to accommodate mature workers in pursuance for prolonging their working life (Armstrong-Stassen and Schlosser, 2008; Claes and Heymans, 2008). Lifelong learning has to become a reality for mature workers as organisations become places of learning. There is no unique formula to successfully implement knowledge management programs but managers have to create an atmosphere that enables continuous learning that captures employees' minds in a rewarding working environment which needs to be shaped to enhance motivation, encourage adequate efficient information delivery, processing and feedback (Mellander, 2001; Linz, 2004; Bohlinger and van Loo, 2010). Organizational climate by its values and norms affects knowledge management practices since it determines knowledge generation, utilization and sharing within an organization. In learning organization which is characterised by its support for learning for all employees through its policies and practices human capital can be optimized (Kleinman et.al 2001; Lowe, 2002).

3.1. Mature workers' learning capabilities

When organizing learning activities, characteristics of adult learners have to be taken into account. Adults are independent individuals, internally motivated learners with wealth of experience therefore links between acquired knowledge with previous experience are highly recommended. They prefer goal-oriented training that has immediate effect at their workplaces (Cole, 2012).

By knowing the learning style of individual learner and adopting it accordingly, newly acquired knowledge can be maximized. Technology based approaches offer opportunities to accommodate individual learning style preferences (Rahim and Finch, 2011; Graff, 2012). While learning at work, experiences develop during the process and provide a foundation for reflection and comparison to previously encountered knowledge (Gray, 2004). Learning at work through work experience is an important way of competence development related to job itself and is seen as a bridge between formal education and practical competences (Gray, 2004; Fouarage and Schils, 2008). Although work experience is found to be of a great importance, it is still not sufficient therefore to achieve optimal results, education and experience need to be connected (Paloniemi, 2006).

Trend of workforce ageing and rapid changing work environments have contributed to the development of a highly ambiguous view of competence of mature workers (Tikkanen et.al 2001). The value of traditional training systems has been challenged and there is an emerging need to adjust educational systems to the requirements of working life. Related to this, the focus on competence development has changed on a much broader range of learning environments. In particular, the workplace is now acknowledged as of considerable importance. Mature individuals cannot be all lumped into the same category but rather be paid attention to regarding facilitation of their special needs (Ennis-Cole and Allen, 1998). Differences in learning ability between individuals become greater with ageing and are based on personality differences, class differences and educational differences therefore mature learners have to receive even greater consideration in the delivery of training programs (Maurer, 2001). Table below presents scientific conclusions about mature employees' learning capabilities although stereotypical stance still persists (Brough et.al 2011).

Table 1: Mature employees' learning capabilities

Author(s)	Conclusions
Paul and Townsend, 1993	Older adults' capacity to learn is not considerably lower than that of younger individuals since intelligence does not decline with age.
Johnson, 1999	As individuals mature, they increase their capacity to learn.
McIntosh, 2001	Mature employees are trainable even in high technology skills and are reported to be comfortable learning them.
Rocco et.al 2003	The mature employees' ability to learn is not diminished in the process of aging according to education and physiology research conclusions. The shift of recent literature which emphasises the need of training when pursuing an extension of productive working life has been reported. Mature employees should be treated as re-trainable and retainable.
Patrickson and Razijin, 2005	Mature individuals employed in knowledge occupations are more likely to update their knowledge and skills with increasing age, possibly until 70 years of age.
Peterson and Spiker, 2005	Mature individuals are exceptional learners.
Walker, 2005	Mature workers relate their competence to individual characteristics and work related issues rather than purely to age.
Paloniemi, 2006	Research findings do not support stereotypical view of decline competence neither competence development. Rather educational background has significant impact on both.
Githens, 2007	Mature adults usually do not experience cognitive decline problems but rather vision or hearing problems.
Chen, et.al 2008	Adult education was already in the seventies viewed as optimistic field of gerontology because of the confidence that older individuals are capable to learn. Researches report older individuals to be capable learners who generally do not suffer cognitive decline although arguing that minority of those with problems should be treated differently considering limitations.
Smith et.al 2010	Several mature individuals reported to become better learners over the time and be able to relate newly acquired knowledge to experience and apply it to the workplaces. They even report about being even more successful learners than their younger colleagues due to variety of experience.
Brough et.al 2011	Researchers did not find any differences in cognitive abilities between mature and younger workers and assures that mature employees' human capital is as valuable compared to younger peers. Overall findings assist in diminishing stereotypical assumptions.

There is no reason to believe that elderly persons are incapable learners although some research results testify it because there exists confirmations of longitudinal research

which confirmed that potential for learning remains intact while aging unless learning abilities are impacted by neuropsychological disease (Staudinger and Lindenberger, 2003). However, in 19th and 20th century, gerontology literature reported cognitive decline with ageing whereas recent studies contradict these conclusions. Many researchers have concluded that significant declines in cognition often manifest when people are in their 60s to 70s (Staudinger and Lindenberger, 2003; Patrickson and Razijin, 2005). Mature individuals may suffer a slight decline in some areas of cognitive abilities but they develop compensatory mechanisms for any sort of decline (Smith et.al 2010).

3.2. Lifelong learning and workability

The key issue regarding whether a worker is capable of prolonging working life is the maintenance of individual workability (Ilmarinen and Rantanen, 1999). Continuous training of mature workers is one of the most important agents of prolonging working life because up-to date knowledge and skills are, above adequate health status, a key factor of workability. Adequate levels of investment in lifelong learning results in mental fitness (Jorgnesen, 2005). Employers have the duty to create the conditions in which individuals can learn whereas workers themselves have a parallel duty to take advantage of all opportunities to improve working ability like educational qualifications and skills, ability to work in teams, ability to work autonomously, commitment to continuous training and lifelong learning, flexibility and mobility (Walker, 2005). The concept of workability that presents how able a worker is, have been proposed. However workability is not really related to age but it is rather about how a worker performs (Ilmarinen, 2001). Human resources of a worker encompass appropriate health status, knowledge and skills, values and attitudes, and motivation. These factors relate to work demands, management settings and work environment that gives a complete picture of the concept of workability.

In maintenance of workability a worker contributes in terms of taking actions for health preservation and engages in lifelong learning programs to maintain adequate level of knowledge and skills whereas human resource managers have to apply measures to enhance workers' intrinsic motivation and apply appropriate age management practices to assist individuals in prolonging their working life. Individuals that are physically and mentally fit are able to decide whether or not to prolong their working life (Žnidaršič, 2010).

4. EMPLOYABILITY AND RETENTION OF OLDER WORKERS

Aging and its effects on economy resulted in mature individuals being treated in a new fashion as valuable human resource and as such organizations' policies need to facilitate their participation in lifelong learning to foster their employability (Bohlinger and van Loo, 2010).

Many mature individuals will now have to extend their working lives therefore there is a need to maintain their employability longer than previous generations of workers. Individual employability comprises of the abilities of individual under the

consideration of his/her labour market ability to manage his/her own career, continuous learning and emerges in forms of initial employment, employment maintenance and ability to get new employment when required (Bangali, 2004). When employee's knowledge and skills aren't lacking it is most likely that he/she stays in paid employment (Patrickson and Ranzijin, 2005).

From the employee prospective employability can be interpreted as possessing an appropriate set of skills whereas employer understands employability as a set of skills offered by a job applicant that can add value to his business (Patrickson and Ranzijin, 2003). Thus, lifelong learning of mature employees must address today's issues and challenges with appropriate learning tools that are flexible, adaptable, and easily updated (Maurer, 2001). It has been proven that among other conditions, continuous learning help improve attachment of mature individuals to labour market (Bangali, 2004). Continuous training also significantly impacts future employment prospects regardless educational attainment (Fouarage and Schils, 2008; Picchio and van Ours, 2013) therefore organization sponsored training is proved to be important measure for mature employee retention.

Demographic changes clearly demand the raise of retention rates of mature workers (Shacklock et.al 2009). Human resource solutions play a critical role in mature workers' readiness to continue working through fostering continuous learning and promoting age friendly workplaces. Many researchers believe that mature workers can be motivated to remain working by the means of supportive training and development strategies that maximize their potential (Maurer, 2001; Bangali, 2004; Walker, 2005; Žnidaršič and Dimovski, 2009). Nevertheless the population of mature workers is highly heterogeneous regarding their respected aptitude with technology and openness to change. Mature learners have different needs and interests (Githens, 2007).

To firmly establish organizational learning approaches work organization, job design, organizational culture and business strategy needed to be redefined. Human resource managers are advised to shape organizational culture that accepts mature individuals as valuable workers (Rocco et.al 2003). Policy priorities for promotion of continuous learning demand organizational culture where learning is highly valued (Lowe, 2002).

According to life-cycle theory when mature workers are offered flexible and generous early retirement schemes there is a reduction of possibility that they will participate in training and also a reduction of returns of training since there is higher probability that they will retire earlier (Midtsundstad, 2011). Nevertheless, knowledge workers usually decide to retire later (Fouarage and Schils, 2008; Midtsundstad, 2011).

5. CONCLUSION

The emerging knowledge society is increasingly becoming a greying society therefore there is a need to change attitudes towards ageing and its effects. The workforce ageing trend raises questions about productivity and competitiveness of organisations in global economy. When implementing training programs, human resource departments

enhance developments of workforce in terms of flexibility and growth and at the same time prepare companies for emergencies, recessions, and increased competition.

In the near future, organizations will become increasingly reliant upon mature-age workers to secure their economic and social development. The conclusion goes to necessity of human resource departments' adoption of new requirements regarding learning and working life, building inclusive and learning supportive workplaces. Human resource departments that offer training opportunities, flexible employment patterns, and other supportive policies for their mature worker are those which enable mature workers to become capable, productive, and lifelong learning workers. Basic conclusion of the paper goes to the importance of continuous education and learning of mature workers while emphasizing numerous benefits that life-long learning brings to companies. These findings open new ways to arranging for initiatives to improve mature workers employment and add new insights.

The real challenge for future research is to ascertain the way of creation learning environment where experiences are acknowledged, valued and shared and how to establish appropriate life-course learning programs. Through holistic approach to learning organizations that makes transition of workforce from employment to employability perspective. Future research agenda should be shaped to find answers and insights to open questions on how learning can be arranged to motivate ageing individuals while developing novel concepts of sustainable approaches to continuous competence development in pursuance of employability maintenance. In this respect gap in current research exists which becomes even more important when focusing on bridging age-related issues by application of knowledge management strategies.

REFERENCES

- Abrams, C. and Berge, Z. (2010), *Workforce cross training: a re-emerging trend in tough times*. Journal of Workplace Learning, Vol. 22(8), 522-529.
- Allen, J.M. and Hart, M. (1998), *Training Older Workers: Implications for HRD/HPT Professionals*, Performance Improvement Quarterly, Vol. 11 (4), 91-102.
- Armstrong-Stassen, M. and Templer, A. (2005), *Adapting training for older employees, The Canadian response to an aging workforce*, Journal of Management Development, Vol. 24 (1), 57-67.
- Armstrong-Stassen, M and Schlosser, F. (2008), *Benefits of a supportive development climate for older workers*, Journal of Managerial Psychology, Vol. 23 (4), 419-437.
- Ballot, G., Fakhfakh, F. and Taymaz, E. (2001), *Firms' human capital, R and D and performance: a study on French and Swedish firms*, Labour Economics, Vol. 8, 443-462.
- Bangali, L. (2004), Working paper, *Are Older Workers Genuine Assets for the Economy? Strategies and Possibilities for the Effective Use of their Human Resource Potential*. Institute for Political Science, Tuebingen.
- Beaver, G. and Hutchings, K. (2005), *Training and developing an age diverse workforce in SMEs, The need for a strategic approach*, Education + Training, Vol. 47 (8/9), 592-604.
- Bernardin, H.J. (2003), *Human resource management: an experiential approach (3rd ed.)*, McGraw-Hill Companies, New York.

- Billett, S., Dymock, D., Johnson, G. and Martin, G. (2011), *Overcoming the paradox of employers' views about older workers*, The International Journal of Human Resource Management, Vol. 22 (6), 1248-1261.
- Bohlinger, S. and van Loo, J. (2010), *Lifelong learning for ageing workers to sustain employability and develop personality*, In European Centre for the Development of Vocational Training: Working and ageing: Emerging theories and empirical perspectives, (28-57), Publications Office of the European Union, Luxembourg.
- Bosch, N. and ter Weel, B. (2013), *Labour market outcomes of older workers in the Netherlands: Measuring job prospects using the occupational age structure*, CPB Discussion Paper 234, CPB Netherlands Bureau for Economic Policy Analysis, Hague.
- Brooke, C. (1995), *Volcanoes and trees: identifying a suitable working environment*, Management Decision, Vol. 33 (4), 5-11.
- Brough, P. Johnson, G., Drummond, S., Pennisi, S. and Timms, C. (2011), *Comparison of cognitive ability and job attitudes of older and younger workers*, Equality Diversity and Inclusion: An International Journal, Vol. 30 (2), 105-126.
- Callahan, J.S., Kiker, D.S., and Cross, T. (2003), *Does Method Matter? A Meta-Analysis of the Effects of Training Method on Older Learner Training Performance*, Journal of Management, Vol. 29 (5), 663-680.
- Callanan, G.A. and Greenhaus, J.H. (2008), *The Baby Boom Generation and Career Management: A Call to Action*, Advances in Developing Human Resources Vol. 10 (1), 70-85.
- Chen, L.K., Kim, Y.S., Moon, P. and Merriam, S.B. (2008), *A Review and Critique of the Portrayal of Older Adult Learners in Adult Education Journals, 1980-2006*, Adult Education Quarterly, Vol. 59 (1), 3-21.
- Claes, R. and Heymans, M. (2008), *HR professionals' views on work motivation and retention of older workers: a focus group study*, Career Development International, Vol. 13 (2), 95-111.
- Cole, K.S. (2012), *Promoting Cooperative Learning In An Expository Writing Course*, Journal of International Education Research, Vol. 8 (2), 113-124.
- Ennis-Cole, D. and Allen, J.M. (1998), *The Challenges of Training and Retraining Mature Learners*, Journal for Vocational Special Needs Education, Vol. 20 (3), 35-42.
- Fouarage, D. and Schils, T. (2008), *Training older workers, Does it help make them work longer?* OSA-publication A230, February 2008, 1-55.
- Gill, A. (2009), *Knowledge management initiatives at a small university*, International Journal of Educational Management, Vol. 23 (7), 604-616.
- Githens, R.P. (2007), *Older Adults and E-learning: Opportunities and Barriers*, Quarterly Review of Distance Education, Vol. 8 (4), 329-338.
- Graff, J. (2012), *Is the grass greener on the other side? Experiential learning, lifelong learning and career shift*, On the horizon, Vol. 20 (1), 74-83.
- Gray, H. (2004), *Older people and the process of learning: New needs and discredited approaches*, Development and learning in organizations, Vol. 18 (2), 3-5.
- Guest, R. and Shacklock, K. (2006), *The impending shift to an older mix of workers: Perspectives from the management and economics literatures*, International Journal of Organisational Behaviour, Vol. 10 (3), 713-728.
- Ilmarinen, J. and Rantanen, J. (1999), *Promotion of work ability during ageing*, American Journal of Industrial Medicine, Vol. 36 (1), 21-23.
- Ilmarinen, J. (2001). *Ageing Workers in Finland and in the European Union: Their Situation and the Promotion of their Working Ability, Employability and Employment*. The Geneva Papers on Risk and Insurance, 26(4), 623-641.
- Jalette, P. and Villeneuve D. (2002), *Taking Action on the Aging of the Labour Force*, Workplace Gazette, Vol. 6 (1), 57-67.

- James, J.B., McKechnie, S., Swanberg, J. (2011), *Predicting employee engagement in an age-diverse retail workforce*, Journal of Organizational Behavior, Vol. 32 (2), 173-196.
- Johnson, D. (1999), "A learning model for learning organizations", *Futurics*, Vol. 23 (1-2), 74-75.
- Jorgensen, B. (2005), *The ageing population and knowledge work: a context for action*, *Foresight*, Vol. 7 (1), 61-76.
- Kleinman, G., Siegel, P.H. and Eckstein, C. (2001), *Mentoring and learning: the case of CPA firms*, *Leadership and Organization Development Journal*, Vol. 22 (1), 22-33.
- Kock, H. and Ellström, P.E. (2011), *Formal and integrated strategies for competence development in SMEs*, *Journal of European Industrial Training*, 35(1), 71-88.
- Lazear, E.P. (1998), *Personnel Economics for Managers*, John Wiley and Sons, New York.
- Linz, S.J. (2004), *Motivating Russian workers: analysis of age and gender differences*, *Journal of Socio-Economics*, Vol. 33, 261-289.
- Loretto, W. and White, P. (2006), *Population Ageing and Older Workers: Employers' Perceptions, Attitudes and Policies*, *Population, Space and Place*, Vol. 12, 341-352.
- Lowe, G.S. (2002), *Leveraging the Skills of Knowledge Workers*, *Isuma*, Vol. 2, 79-86.
- Maurer, T.J. (2001), *Career-relevant learning and development, worker age, and beliefs about self-efficacy for development*, *Journal of Management*, Vol. 27, 123-140.
- McIntosh, B. (2001), *An employer's guide to older workers: how to win them back and convince them to stay*, Department of Labour, Employment and Training Administration, Washington DC.
- Mellander, K. (2001), *Engaging the human spirit: a knowledge evolution demands the right conditions for learning*, *Journal of Intellectual Capital*, 2(2), 165-171.
- Midsundstad, T.I. (2011), *Inclusive workplaces and older employees: and analysis of companies' investment in retaining senior workers*, *The International Journal of Human Resource Management*, Vol. 22 (6), 1277-1293.
- Newton, B., Hurstfield, J., Miller, L. and Bates, P. (2005), *Training a Mixed-Age Workforce: Practical Tips and Guidance*, Department for Work and Pensions, Institute for Employment Studies, Brighton.
- Ong, C.S. and Lai, J.Y. (2006), *Gender differences in perceptions and relationships among dominants of e-learning acceptance*, *Computer in Human Behavior*, Vol. 22, 816-829.
- Paloniemi, S. (2006), *Experience, competence and workplace learning*, *Journal of Workplace Learning*, Vol. 18 (7-8), 439-450.
- Patrickson, M. and Ranzijn, R. (2003), *Employability of Older Workers*, *Equal Opportunities International*, Vol. 22 (5), 50-63.
- Patrickson, M. and Ranzijn, R. (2005), *Workforce Ageing: The Challenges for 21st Century Management*, *International Journal of Organisational Behaviour*, Vol. 10 (4), 729-739.
- Paul, R.J. and Townsend, J.B. (1993), *Managing the older worker – don't just rinse away the gray*, *Academy of Management Executive*, Vol. 7 (3), 67-74.
- Peterson, S.J. and Spiker, B.K. (2005), *Establishing the Positive Contributory Value of Older Workers: A Positive Psychology Perspective*, *Organizational Dynamics*, Vol. 34 (2), 153-167.
- Picchio, M. and van Ours, J.C. (2013), *Retaining through training even for older workers*, *Economics of Education Review*, Vol. 32 (February), 29-48.
- Pyöriä, P. (2005), *The concept of knowledge work revisited*, *Journal of Knowledge Management*, Vol. 9 (3), 116 – 127.
- Rahim, E. and Finch, A. (2011), *Adult Learning Styles and Technology-Driven Learning for Online Students*, *Academic Leadership Journal*, Vol. 9 (2),

- Rocco, T.S., Stein, D., and Lee, C. (2003), *An Exploratory Examination of the Literature on Age and HRD Policy Development*, Human Resource Development Review, Vol. 2 (2), 155-180.
- Shacklock, K., Brunetto, Y. and Nelson, S. (2009), *The different variables that affect older males' and females' intentions to continue working*, Asia Pacific Journal of Human Resources, Vol. 47 (1), 79-97.
- Smith, E., Smith, A. and Smith C.S. (2010), *Old dogs, new tricks: training mature manufacturing workers*, Journal of Workplace Learning, Vol. 22 (5), 277-291.
- Staudinger, U., and Lindenberger, U. (2003). *Understanding human development: lifespan psychology in exchange with other disciplines*, Kluwer Academic, Berlin.
- Tikkanen, T., Lahn, L.C., Withnall, A., Ward, P. and Lyng, K. (2001), *Working life changes and training of older workers*, Norwegian Institute for Adult Education, Trondheim.
- Tikkanen, T. (2009), *The learning society as a greying society: perspectives for older workers and lifelong learning*, Modernising Vocational Education and Training, Vol. 2, 194-238.
- Tones, M., Pillay, H., and Kelly, K. (2011), *The Link between Age, Career Goals, and Adaptive Development for Work-Related Learning Among Local Government Employees*, Journal of Career Assessment, Vol. 19 (1), 92-110.
- Torrington, D. and Hall, L. (1995), *Personnel management: HRM in action* (3rd ed.), Prentice Hall International, Hertfordshire.
- Walker, A. (2005), *The emergence of age management in Europe*, International Journal of Organisational Behaviour, Vol. 10 (1), 685-697.
- Wild, R.H., Griggs, K.A. and Downing, T. (2002), *A framework for e-learning as a tool for knowledge management*, Industrial Management and Data Systems, Vol. 102 (7), 371-380.
- Žnidaršič, J., and Dimovski, V. (2009), *Active aging on the company level: The theory vs. the day-to-day practice in Slovenia*, Economic and Business Review, Vol. 11 (2), 137-158.
- Žnidaršič, J. (2010), *Age management in Slovenian enterprises: the viewpoint of older employees*, Zb.rad. Ekon. fak. Rij. Vol. 28 (2), 271-301.

Aleksandar Zdravković
University of Ljubljana, Faculty of Economics, Ljubljana, Slovenia

STOCHASTIC APPROACH TO DEBT SUSTAINABILITY ANALYSIS APPLIED TO SERBIA

ABSTRACT

This paper examines the public debt sustainability of Serbia, based on integration of financial gap analysis approach and stochastic modeling and forecasting of relevant macroeconomic and fiscal variables. Within this analytical framework, sustainability is interpreted as whether underlying policies can be sustained under plausible macroeconomic conditions without endangering solvency (Debrun, Celasun and Ostry, 2006).

Conventional debt sustainability analysis is conducted as a simple accounting exercise, based on deterministic forecasts of variables that are included into debt accumulation equation and arbitrary scheduled bound tests. However, because debt sustainability is a forward-looking concept, it cannot be assessed with certainty (Wyplosz, 2011). Stochastic approach to debt sustainability as an alternative to conventional debt analysis takes into account the high degree of uncertainty surrounding medium-term debt trajectories, which cannot be captured by simple bound tests as these are limited in number (ECB, 2012). The recent research in this area (Garcia and Rigobon, 2004; Debrun et al., 2006; Kawakami and Romeu, 2011) mainly uses a Vector Autoregression (VAR) modeling as a basic framework for econometric estimation of the relationships among interest and exchange rates, inflation and primary balance and their forecasting and simulation. In addition, impulse response analysis is based on calibrated shocks obtained by Cholesky decomposition of variance-covariance matrix of the regression residuals.

We apply stochastic approach to Serbian monthly data, run simulations of debt-to-GDP ratio and compare the results with IMF and Serbian Government mid-term projections. Our projections of debt-to-GDP ratio in two years ahead based on VAR approach gives the similar forecast relative to those given by IMF, while projections based on AR(1) approach seem to overestimate debt-to-GDP ratio with increase of forecast horizon. Yet, our forecasts strongly suggest that projection of Serbian government of debt-to-GDP ratio is too low and consequently misleading.

Keywords: *debt sustainability assessment, debt-to-GDP forecast, Vector Autoregression model, stochastic simulations, Serbia*

JEL classification: *H63, H68*

1. INTRODUCTION

The financial crisis and subsequent recession have led to rapid deterioration of government finances in many European countries, which has caused interest rates to rise strongly in some of them. Self-reinforcing effect on the deficits, the higher interest rates and declines in the creditworthiness of sovereign issuers have reduced the sustainability of future debt dynamics. The escalating yield spreads in the euro area in 2010 have underlined how suddenly these mechanisms can cut off a sovereign borrower from the capital markets. Threat of sovereign debt crisis in current worldwide economic circumstances clearly increases importance of proper debt management and debt sustainability analysis.

Conventional debt sustainability analysis is conducted as a simple accounting exercise, based on deterministic forecasts of variables that are included into debt accumulation equation and arbitrary scheduled bound tests. However, because debt sustainability is a forward-looking concept, it cannot be assessed with certainty (Wyplosz, 2011). Stochastic approach to debt sustainability as an alternative to conventional debt analysis takes into account the high degree of uncertainty surrounding medium-term debt trajectories, which cannot be captured by simple bound tests as these are limited in number (ECB, 2012). The recent research in this area (Garcia and Rigobon, 2004; Debrun et al., 2006; Kawakami and Romeu, 2011) mainly uses a Vector Autoregression (VAR) modeling as a basic framework for econometric estimation of the relationships among interest and exchange rates, inflation and primary balance and their forecasting and simulation. In addition, impulse response analysis is based on calibrated shocks obtained by Cholesky decomposition of variance-covariance matrix of the regression residuals.

In this work we analyze stochastic approach to debt sustainability assessment. Section 2 is dealing with framework of conventional debt analysis and its shortcomings. Section 3 introduces methodology of stochastic approach to public debt sustainability and provides empirical evidence on its application to forecasting of Serbian debt-to-GDP ratio.

2. CONVENTIONAL APPROACH TO PUBLIC DEBT SUSTAINABILITY ANALYSIS

Conventional debt sustainability analysis is a simple accounting exercise, based on the standard debt accumulation equation (ECB, 2012):

$$\Delta d_t = \frac{i_t - g_t}{1 + g_t} d_{t-1} + pb_t + dda_t \quad (2.1)$$

where:

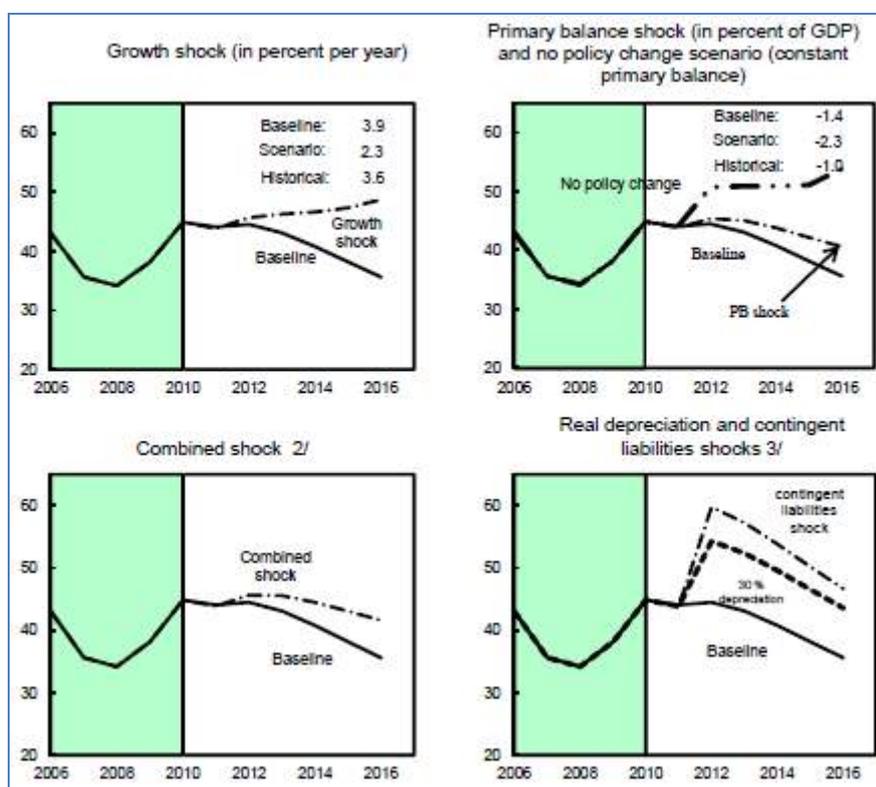
- $\frac{i_t - g_t}{1 + g_t} d_{t-1}$ is the “interest-growth differential”, which captures the impact of the debt ratio-increasing interest rate as well as the impact of the debt ratio-reducing GDP growth rate
- pb_t is the primary deficit
- dda_t is the deficit-debt adjustment The deficit-debt adjustment relates to that part of the change in the debt-to-GDP ratio which is not reflected in the deficit.

Probably the most used conventional approach in practice is IMF Debt Sustainability Assessment framework (DSA). Basically, DSA methodology imposes assessment of debt sustainability as the medium-term simulations of the debt-to-GDP ratio given specific macroeconomic forecasts and fiscal policy assumptions. Within this analytical framework, sustainability is interpreted as whether underlying policies can be sustained under plausible macroeconomic conditions without endangering solvency (Debrun, Celasun and Ostry, 2006). IMF country teams impose routinely this framework and publish the results as the part of report on “Article IV Consultations”³.

According to the DSA, change in public debt could be decomposed into the regular part, comprised of identified debt-creating flows and irregular, comprised of unidentified residuals and change of asset. Identified part is further decomposed to automatic debt dynamics, i.e. contribution of interest rate, real GDP growth and change of exchange rate, then primary balance contribution and other identified flows, mainly privatization receipts and recognition of contingent liabilities. Decomposition of public debt, according to this methodology allows sensitivity analysis of public debt under different scenarios of economic policies and macroeconomic development and stress testing of debt dynamic assuming some arbitrary market or fiscal shocks (so-called bound tests), as it is shown in Figure 1.

³ The IMF consults annually with each member government. Through these contacts, known as “Article IV Consultations,” the IMF attempts to assess each country’s economic health and to forestall future financial problems.

Figure 1: Example of bound tests of Serbian government debt according to IMF DSA methodology



Source: IMF Country Report No. 11/311 (2011)

However, use of such conventional approach like DSA suffers from several shortcomings:

- it neglects country-specific correlation between main drivers of public debt and does not include these correlation patterns in forecasting (deterministic scenarios do not consider the effects of correlation);
- it neglects country specific shocks that affect the public debt drivers and does not use them to produce simulations; instead, it applies arbitrary selection of shocks that might not be supported by empirical facts at all;
- it produces single point forecast instead of giving distribution of possible forecasting outcomes.

Consequently, these shortcomings could reflect in poor forecasting power of conventional debt analysis, as it is illustrated in case of Serbia, based on five IMF country reports, where DSA forecast of the debt-to-GDP (gross government debt) underestimates actual values for more than 8% on average.

Table 1: Comparison of DSA baseline projections and actual values of debt-to-GDP for Serbia

Reporting year	2008	2009	2010	2011	2012	Projections of debt-to-GDP in %
February 2008	33.2	31.4	29.6	28.2		
May 2009		34.8	37.8	36.3	34.2	
April 2010		36.4	36.0	36.5	35.0	
July 2010			39.1	41.1	40.6	
October 2011			44.5	44.1	44.5	
Actual Values	33.39	38.06	46.48	50.02	63.65	
Forecast errors						Average
2006	-0.19	-6.66	-16.88	-21.82		-11.39
2007		-3.26	-8.68	-13.72	-29.45	-8.55
2008		-1.66	-10.48	-13.52	-28.65	-8.55
2010			-7.38	-8.92	-23.05	-8.15
2011			-1.98	-5.92	-19.15	-3.95
Average	-0.19	-3.86	-9.08	-12.78	-25.08	-8.12

Source: IMF country reports for Serbia and IMF World Outlook database

3. STOCHASTIC APPROACH TO PUBLIC DEBT SUSTAINABILITY ANALYSIS

Application of stochastic approach to public debt sustainability as a specific issue of cost-risk analysis of public debt emerged around 2003, triggered by the one of the shortcomings of traditional fiscal sustainability analysis which often does not take into account the effects of uncertainty (Burnside, 2004). In regard to the existing literature, stochastic approach to debt sustainability is mainly based on numerical approach and uses the common risk management tools (stochastic simulations, scenario analysis, stress testing); it is primarily subjected to stress testing and sensitivity analysis of public debt dynamics under the different scenarios of government economic policy or possible exogenous shocks. Ferruci and Penalver (2003) and Garcia and Rigobon (2004) works became the basis for the most persistent line in further research as they introduced stochastic modeling to the conventional Debt Sustainability Assessment framework. Related work in this field also includes Debrun, Celasun and Ostry (2006), Penalver and Thwaites (2005), Tanner and Samake (2006), Di Bella (2008), Gray et al. (2008), Giovanni and Gardner (2008) and Kawakami and Romeu (2011).

3.1. Methodology

Starting point of the methodology is debt accumulation equation which operates with real variables, under additional assumption that real interest rate on domestic and

foreign debt is the same. Thus, debt accumulation equation in relative terms could be simply rewritten as:

$$d_t = (1 + r_t - g_t)d_{t-1} + pb_t, \quad (3.1)$$

where d_t is ratio of real ⁴ public debt to real GDP and pb_t is real primary deficit to real GDP, while r_t and g_t now represent real interest rate and real growth of GDP. In addition, as the left and right side of this equation in practice would never be equal due to debt-deficit adjustments, equation 3.1 could be further extended with new term which represents public debt skeletons, or simply said debt shocks, denoted as s_t .

$$d_t = (1 + r_t - g_t)d_{t-1} + pb_t + s_t. \quad (3.2)$$

It has to be emphasized that within the stochastic framework all variables in equation 3.2 apart from public debt are considered to be stochastic by nature and therefore they represent the possible sources of riskiness of public debt unexpected changes.

We considered to approaches in stochastic modeling of risk variables, one based on Vector Autoregression (VAR) estimation and one based on univariate autoregression (AR) estimation.

3.1.1. VAR approach

In this work we extended out previous research (Zdravkovic, Bradic-Martinovic, 2012) based on Garcia and Rigobon (2004) with approach of Debrun, Celasun and Ostry (2006). Inflation rate π_t and real exchange rate depreciation e_t are added as the additional risk factors out of equation 3.2. By taking into the consideration that all of these risk variables are most probably correlated to certain degree, we could assume that they follow multinomial normal distribution with conditional mean $\boldsymbol{\mu}_t$ and conditional variance-covariance matrix $\boldsymbol{\Sigma}_t$

$$\{r_t, g_t, e_t, \pi_t, pb_t, s_t\} \sim N(\boldsymbol{\mu}_t, \boldsymbol{\Sigma}_t).$$

Under the assumption of joint distribution, dynamic of these variables could be modeled by the standard reduced-form VAR models. In this case, VAR model in vector terms is given as:

$$\mathbf{x}_t = \mathbf{c} + \sum_{i=1}^p \mathbf{A}_i \mathbf{x}_{t-i} + \mathbf{v}_t, \quad \mathbf{x}_t = \{r_t, g_t, e_t, \pi_t, pb_t, s_t\} \quad (3.3)$$

⁴ Terms real debt and primary balance here denote inflation-free value of debt and primary balance.

$$\mathbf{v}_t \sim N(\mathbf{0}, \boldsymbol{\Sigma}_v),$$

where $\{\mathbf{A}_i\}$ are matrices of lag coefficients up to p lags and $\boldsymbol{\Sigma}_v$ is variance-covariance matrix of reduced-form residuals. However, as the reduced-form residuals are linear combination of structural shocks, they are not suitable to perform impulse response analysis of innovations in risk variables dynamic which requires structural VAR models. Of course, the main problem with structural VAR models is identification of the model. As we do not impose some specific theory about the contemporaneous relations structure, we use recursive ordering approach by arbitrary proposed exogeneity of variables and set simple AB specification of structural VAR model:

$$\mathbf{A}\mathbf{v}_t = \mathbf{B}\mathbf{u}_t, \quad (3.4)$$

where \mathbf{A} is the matrix defining contemporaneous relations, \mathbf{u}_t represent structural shocks and \mathbf{B} is the matrix of structural form parameters.

Structural model is identified with orthogonalization of reduced-form residuals to obtain matrix \mathbf{B} by Cholesky decomposition (Sims, 1981), $\boldsymbol{\Sigma}_v = \mathbf{B}\mathbf{B}'$, while matrix \mathbf{A} is assumed to be identity matrix. As matrix \mathbf{B} is upper triangular matrix, the last variable will be the most exogenous and thus its innovation will have contemporaneous effects on all variables, while innovation in the first variable will affect only itself.

After the estimation, model's parameters can be used for deterministic projection of mutual path of all risk variables using the last known values of risk variables. In addition, using the variance-covariance matrix of estimated residuals it is possible to produce Monte Carlo simulations in order to obtain full stochastic forecast of these variables with simulated distribution of their probabilities. Forecasted values of relevant variables are plugged in debt accumulation equation in order to produce forecast of possible public debt paths.

Thus, methodology described could be summarized in the following steps.

- Based on historical data, parameters of reduced-form VAR(2) model⁵ are estimated

$$\mathbf{x}_t = \mathbf{c} + \sum_{i=1}^p \mathbf{A}_i \mathbf{x}_{t-i} + \mathbf{v}_t, \quad \mathbf{x}_t = \{r_t, g_t, e_t, \pi_t, pb_t, s_t\};$$

- Matrix \mathbf{B} , which represents mathematically how combination of **all** (structural) shocks of risk variables \mathbf{u}_t affects particular values of risk variables, is estimated;
- Based on estimated coefficients from historical data, values of risk variables are forecasted k periods ahead, which is actually baseline (and deterministic) forecast

$$\mathbf{x}_{t+k} = \mathbf{c} + \sum_{i=1}^p \mathbf{A}_i \mathbf{x}_{t+k-i}, \quad \mathbf{x}_t = \{r_t, g_t, e_t, \pi_t, pb_t, s_t\}; \quad (3.5)$$

⁵ Order of lag is restricted to 2 due to the limited number of observations in data sample and large number of parameters for estimation

- Based on estimated values of matrix B, simulations of reduced-form shocks (linear combination of structural shocks) are generated by running the simulations of structural shocks randomized from standardized normal distribution,

$$\tilde{\mathbf{v}}_{t+k} = \mathbf{B}\tilde{\mathbf{u}}_{t+k}, \quad \tilde{\mathbf{u}}_t \sim N(0,1); \quad (3.6)$$

- Simulations of risk variables are produced by adding the simulated reduced-form shocks $\tilde{\mathbf{v}}_{t+k}$ to deterministic projections of \mathbf{x}_{t+k} ;
- Simulated forecasts of risk variables are plugged into debt accumulation equation to simulate debt-to-GDP ratio paths.

3.1.2. AR(1) approach

Our AR(1) approach to stochastic modeling is loosely related to Bergstrom et al. (2002) work, which is primarily concerned with Cost at Risk modeling of public debt. Their model consists of two building blocks, macroeconomic model based on AR(1) modeling of risk variables and strategies simulation part.

Methodology of AR(1) simulations is described by the following steps.

- It is assumed that each risk factor follows a univariate AR(1) process of the form:

$$x_t = \alpha + \rho x_{t-1} + \varepsilon_t, \quad \varepsilon_t \sim IIDN(0, \sigma^2) \quad (3.7)$$
- Based on historical data, the parameters of AR(1) process are estimated for each of the risk factors and estimate processes, as well as the error terms, using ordinary least squares or maximum likelihood estimator.
- Mean of each series $\bar{x} = \alpha / (1 - \rho)$ and the (unconditional) variance of the error terms, $\sigma^2 = Var(\varepsilon_t)$ are calculated
- Different paths for x_t are simulated using the following dynamics implied by the AR(1) process:

$$\Delta \tilde{x}_{t+\Delta t} = (1 - \rho)(\bar{x} - x_t) \Delta t + \sigma \sqrt{\Delta t} * \tilde{e}_{t+\Delta t} \quad (3.8)$$
 where Δt is the time step in the simulation, while $\tilde{e}_{t+\Delta t}$ is a random variable drawn from the standard normal distribution.
- Finally, we plugged simulations of risk variables into debt accumulation equation in order to produce stochastic simulations of debt paths.

3.2. Data

In regard to the political and economic changes that Serbia has passed during the recent decades, consistent series of monthly data do not exist for longer periods; therefore implementation of proposed methodology requires use of data with higher frequency for the empirical estimation of the model. We use the annualized monthly data to provide sufficient data set regarding the possible large number of parameters to be

estimated by VAR model. This limits scope of data to period January 2008 – September 2012, for which exists consistent monthly data series of public debt and primary balance in nominal values. It is also important to emphasize that public debt in this analysis comprise only the debt of central government.

Additional problem to analysis is lack of monthly data on GDP, which is measured only on quarterly basis. In order to end up with approximated monthly data on GDP, we use methodology of Zaman and Markovic (2011) based on quarterly real GDP values weighted by weights obtained from index of industrial production, which is usually highly correlated with GDP dynamic. We used data on chain-linked values of GDP (in 2005 relative prices) as real GDP measure, as it is usual in statistical offices. Further, in order to obtain real values of public debt and primary balances, we used CPI base index as denominator. Data for public debt, primary balance and GDP are annualized as the rolling sum of monthly data for previous twelve months.

As the Serbian public debt portfolio is composed from loans and securities which very differ in maturities and currencies, we have to use some approximations of interest rates and exchange rate depreciation to meet the parsimonious data requirements of the model. Hence, we use the data on weighted average interest rate on government debt instruments which are provided by National Bank of Serbia as an approximation of aggregate interest rate. Real interest rate is obtained as a difference between nominal interest rates and inflation rates.

Aggregate exchange rate is approximated with EUR/RSD exchange rate, in regard to currency structure of debt portfolio were euro-indexed debt dominates, as well as strong correlation between EUR/RSD and exchange rates of other instruments indexed in foreign currency (mostly USD and CHF). Real depreciation is calculated as a difference between nominal depreciation and inflation rate. Debt shocks are calculated based on equation 3.2, as a difference between right and left side of the equation.

3.3. Results

At first, we estimated VAR model for the period January 2008 – September 2012. The estimation of the VAR parameters is of little interest and not shown here, instead the matrix B is presented in order to give insight how structural shocks in one risk variable influence other variables (positively or negatively).

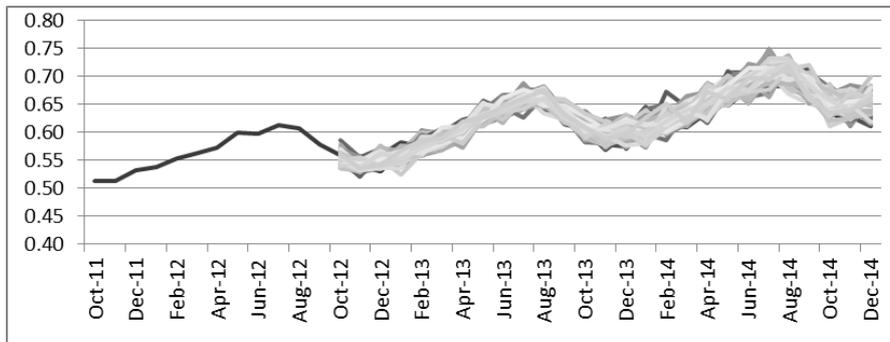
Table 2: Matrix B of estimated VAR model

	Real interest rate	Real GDP growth	Primary deficit	Debt shocks	Real exchange rate dep.	Inflation rate
Real interest rate	0.0074	-0.0013	-0.0019	-0.0015	0.0021	-0.0118
Real GDP growth		0.0037	-0.0012	0.0013	0	-0.0002
Primary deficit			0.0025	-0.0017	0.0004	-0.0001
Debt shocks				0.0119	0.0092	0.0038
Real exchange rate dep.					0.031	-0.0045
Inflation rate						0.0098

Source: author's calculations

Following chart present the dispersion of simulated debt paths over forecasting time (October 2012 – December 2014), based on 1000 simulations:

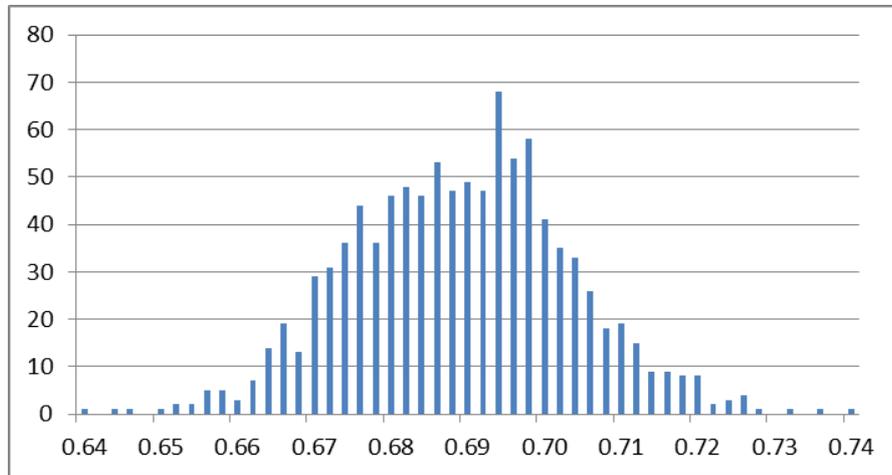
Figure 2: Simulated debt-to-GDP paths, VAR approach



Source: author's calculations

This chart demonstrates important advantage of stochastic approach in regard to conventional approach; instead of single point forecast of debt-to-GDP ratio over time, stochastic approach provides a range of possible debt-to-GDP ratios with assigned probabilities of their realization at any point in time. Following chart gives the range of possible values of debt-to-GDP ratio in June 2014 with probability distribution of their realization:

Figure 3: Probability distribution of forecasted debt-to-GDP ratio in June 2014

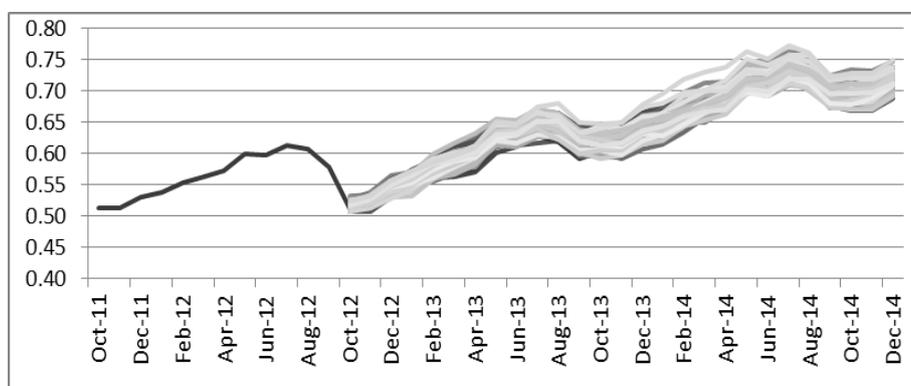


Source: author's calculations

In addition, at any point in time it is possible to calculate probability that debt-to-GDP will exceed some threshold value. For example, if threshold value of debt-to-GDP ratio is set to 70%, by dividing number of simulations exceeding 70% with total number of simulations we end up with probability of 12.4% that debt-to-GDP will exceed 70%. This calculation could be done also in reverse manner - it is possible to determine critical value of debt-to-GDP that will be not exceeded for given probability, e.g. for probability level of 95%, critical value is 70.73%. It means that there is 95% chance that debt-to-GDP will not exceed value of 70.73%.

We also apply AR(1) approach as a benchmark and run separate regression to estimate parameters of the AR(1) process for real interest rate, GDP real growth and primary deficit. Following chart present the dispersion of simulated debt paths over forecasting time (October 2012 – December 2014), based on 1000 simulations:

Figure 4 Simulated debt-to-GDP paths, AR(1) approach



Source: author's calculations

Eventually, we compare four different types of projection: two obtained by conventional debt sustainability analysis (IMF recent projection and official projection of Serbian Government)⁶ and two obtained by stochastic approach to debt sustainability analysis that we applied in this paper:

Table 3: Comparison of debt-to-GDP forecast

	2013	2014
VAR	61.27%	66.02%
AR(1)	61.43%	69.86%
IMF	64.68%	66.53%
Serbian Government	60.60%	53.30%

Source: author's calculations, IMF World Outlook Database, Strategy of Serbian Public Debt Management (2012)

Annual projections of debt-to-GDP for VAR and AR(1) approach are obtained by averaging simulations for given year. Our projections of debt-to-GDP ratio in two years ahead based on VAR approach gives the similar forecast relative to those given by IMF, while projections based on AR(1) approach seem to overestimate debt-to-GDP ratio with increase of forecast horizon. Yet, our forecasts strongly suggest that projection of Serbian government of debt-to-GDP ratio is too low and consequently misleading.

⁶ IMF projection is related to level of gross government debt, thus it is not directly comparable to our projections which are related to debt of central government. However, historical data shows that central government debt participates with more than 95% in gross debt. Also, projection of Serbian Government is approximation of central government debt obtained by reducing gross government debt for debt of lower level of government.

4. CONCLUSIONS

There were several advances in recent years toward the improvements of the key shortcomings of conventional debt sustainability analysis, mainly lack of stochastic tools in application and lack of country specific calibration of shocks. In this work we analyze stochastic approach to debt sustainability assessment. Two approaches are proposed, first one based on mutual modelling of risk variables using the VAR estimation and second one based on separate estimation of autoregression process for each risk variable entering the debt accumulation equation.

We apply stochastic approach to Serbian monthly data, run simulations of debt-to-GDP ratio and compare the results with IMF and Serbian Government mid-term projections. Our projections of debt-to-GDP ratio in two years ahead based on VAR approach gives the similar forecast relative to those given by IMF, while projection based on AR(1) approach seems to overestimate debt-to-GDP ratio with increase of forecast horizon. Yet, our forecasts strongly suggest that projection of Serbian government of debt-to-GDP ratio is too low and consequently misleading in making policy decisions. Unfortunately, due to data unavailability for the longer period of time, it is not possible to conduct serious out-of-sample analysis.

Use of such parsimonious model for debt sustainability analysis like the one proposed in this research has its obvious advantages: lower data requirements (in sense of number of variables entering the model), ease of application, endogenous forecasting and capturing of country specific factors. Furthermore, we point important advantage of stochastic approach in regard to conventional approach; instead of single point forecast of debt-to-GDP ratio over time, stochastic approach provides a range of possible debt-to-GDP ratios with assigned probabilities of their realization at any point in time. In addition, application of stochastic approach allows calculating probability that debt-to-GDP will exceed some threshold value.

REFERENCES

- Debrun, X., Celasun O. and Ostry, J. (2006). Primary surplus behavior and risks to fiscal sustainability in emerging market countries: a "fan-chart" approach, *IMF Working Papers 06/67*
- Di Bella, G. (2008). A stochastic framework for public debt sustainability analysis. *IMF Working Paper Series*
- European Central Bank. (2012). Analysing government debt sustainability in the euro area. *Monthly Bulletin April 2012*
- Ferrucci, G. and Penalver, A. (2003). Assessing sovereign debt under uncertainty. *Financial Stability Review. 15*, 151-59, Bank of England.
- Gapen et al. (2008). Measuring and analyzing sovereign risk with contingent claims. *IMF Staff Papers 55*
- Garcia, M. and Rigobon R. (2004). A risk management approach to emerging market's sovereign debt sustainability with an application to Brazilian data, *NBER Working Papers Series*
- Giovanni, J. and Gardner, E. (2008). A simple stochastic approach to debt sustainability applied to Lebanon. *IMF Working Paper Series*

- Hostland, D. and Karam, P. (2006). Assessing debt sustainability in emerging market economies using stochastic simulation methods. *IMF Working Papers Series*
- International Monetary Fund. Country reports for Serbia
- Kawakami, K. and Romeu, R. (2011). Identifying fiscal policy transmission in stochastic debt forecasts, *IMF Working Paper Series*
- Penalver A. and Thwaites, G. (2005). *Fiscal rules for debt sustainability in emerging markets: the impact of volatility and default risk*. Bank of England Working Paper no. 307
- Sims, C. (1980). Macroeconomics and reality, *Econometrica* 48,1–48.
- Tanner E. and Samake, I. (2006). Probabilistic sustainability of public debt: a vector autoregression approach for Brazil, Mexico, and Turkey. *IMF Working Paper* WP/06/295
- Wyplosz, C. (2011). Debt sustainability assessment: mission impossible. *Review of Economics and Institutions*, Università di Perugia, Dipartimento Economia, Finanza e Statistica, vol. 2(3).
- Zdravkovic, A. and Bradic-Martinovc, A. (2012). Public debt sustainability in Western Balkan countries. *European integration process in Western Balkan countries*. University of Coimbra.

PART X

ROUND TABLE
“ABSORPTION
EXPERIENCE OF
SLOVENIA AND SEE
COUNTRIES”



This Round Table is a part of a Project (529847-LLP-2012-HR-AJM-RE) that has been funded with support from the European Commission. This publication reflects the views only of the author, and the Commission cannot be held responsible for any use which may be made of the information contained therein.

Alen Host

University of Rijeka, Faculty of Economics, Rijeka, Croatia

Vladimira Ivandić

Zagreb, Croatia

ABSORPTION CAPACITIES FOR EU FUNDS

ABSTRACT

Joining the European Union opens considerable funding opportunities which include substantially higher EU budget allocation. Since Croatia is joining the EU six months before the end of current financial perspective (2007-2013 period) it will benefit from an allocation in amount of EUR 800.2 million. Out of this amount EUR 449.4 million is envisaged from the structural funds and Cohesion fund while in the new financial perspective (2014-2020) EUR 1.6 billion will be available for Croatia. Compare to level of pre-accession assistance it presents substantial increase. An adequate absorption capacity and financial management system of EU funds is needed in order to obtain full utilisation of the allocated post-accession assistance. Economic theory suggested that absorption capacity is seen as a set of limits to an effective use of aid flows and that, among other elements, depends on disbursement constraint. It is particular evident when it is case of EU funds. Experience with implementation of EU funds in other countries, especially Central and Eastern European (CEE) has shown that the absorption capacity to generate real impact through the EU financial resources depends on the efficiency of the state administration, municipalities as well as other stakeholders (private sector, NGOs etc.). This is conditioned by the availability to implement a complex policy-making process of programming, management, implementation, monitoring and evaluation of EU funds.

Key words: *aid, financial assistance absorption capacity, pre-accession programs, structural funds, Central and Eastern European Countries*

JEL classification: *O1*

INTRODUCTION

Croatia is due to become 28th Member State of European Union (EU) on July 1, 2013. Integration in EU, as theory suggested, would bring quite substantial economic benefits in long run. The EU Member State (MS) as a part of EU market is in position to take advantages from the integration process in order to achieve faster economic growth and social welfare for the citizens. An additional benefit from the EU membership is an allocation of financial assistance – mainly through the structural funds (SF) and Cohesion Fund (CF)) from the budget for EU members. European financial assistance

is allocated on a grant basis, but it is not a pure transfer of funds. In order to use available funds Member State (MS) country is obliged to follow rules and procedures according to requirements¹.

Croatia through the pre-accession process benefited from all pre-accession programmes (PHARE, ISPA, SAPARD and IPA). One of the main purposes of the pre-accession programmes is to prepare country to be able to use assistance from the SF and CF. In the pre-accession phase through the Instrument of Pre-Accession (IPA) 2007-2013 Croatia got allocated more than EUR 1 billion. EU membership would bring another EUR 8-12 billion over the 2014-2020 period. Capturing those funds will depend on the absorption capacity of the SF and CF, especially ensuring that on-going IPA projects procurement, execution and payment processes after the date of Croatia's accession to the EU will not be stopped or delayed as well as new projects selection and implementation. For the absorption capacity according to the experiences from the New Member Countries (NMCs) is very important to retain in the system human resources of sensitive posts (like Heads of Operation Structures, National Authorising Officer etc.) and competent operational staff from pre-accession programs bodies who gained experience and aware of the requirements and complexity of EU funded programmes implementation and monitoring.

The aim of the analysis is to indicate the current management system of the pre-accession programs in Croatia in the light of the absorption capacity and describe actions and decisions in achieving rational outcomes for management and control system (MCS) set-up for absorption of EU structural funds and Cohesion fund assistance (often referred as EU cohesion policy) in Croatia. Therefore, paper firstly presents theoretical overview with some recent literature on the absorption problem of aid and in particular EU funds. Second part contents short explanation of the EU pre-accession and post-accession financial assistance. Third part is devoted to the experience of Central and Eastern European Countries in implementation of EU funds. Forth part explores absorption capacity in the light of the implementation of pre-accession programmes in Croatia. Last part of the paper is conclusion.

1. THEORETICAL OVERVIEW

The absorption capacity concept applied to the financial assistance (aid) is not a new concept in the economic literature. Namely, it is a rather old concept used for a more than half a century in the aid literature.

The absorptive capacity is seen as set of constrains that diminish returns to aid in the developing countries. Developing countries have low levels of human capital and limited physical infrastructure so returns from foreign aid decline as the flow of aid increases. The idea of absorption capacity of aid originally dates back to Millikan and Rostow (1957). They recommended that aid should be allocated according to the absorption capacity (once taken into account domestic saving). They were followed by

¹ Laid down in the Council Regulation (EC) No. 1083/2006

Rosenstein-Rodan (1961) who presented the most comprehensive use of the absorption capacity concept to measure the capital needs of the developing countries. Most of the main works on development economics fifty years ago referred to the absorption capacity as of limitation of aid and investment (Chenery, Strout, 1966). The revival of the analysis of absorption capacity started in 2004 and it was generated by the perspective of increasing aid flows (the so-called “scaling up”) as a means to achieve the Millennium Development Goals, MDGs (Bourguignon, Sundberg, 2006). A strong interest on the issues of absorptive capacity had emerged because of MDGs and proposal to significantly increase aid volume to the developing countries. The absorption capacity was a kind of warning about the risk of waste whereas fifty years ago it was rather a criterion used to mobilize more aid (Guillaumont, Guillaumont 2006). Hansen and Tarp (2000) concluded that it is almost an article of faith among development economists that developing countries suffer from absorption capacity constraints. All that authors, starting with Bhagwati (1967) marked what is usually called **“second strand “of the literature on aid**. They usually state that developing countries are limited in terms of the amount of foreign assistance they can productively utilise. The issues of aid importance together with the idea of a “big push” were dominant in development economics but also accepted within the international financial institutions (World Bank and others) as a mechanism that could move a country out of an underdevelopment trap. Critics of a large aid increase argued that aid is likely to be useless, wasted or even harmful, and consequently not leading to a big push and a subsequent escape from poverty.

The another strand – so called **“first strand” of the aid literature** is related to the international trade theory where the welfare effects of foreign aid have been examined, in particular, if aid can be “donor-enriching and recipient immiserizing” - the so-called Transfer Paradox.

Svensson concluded (2006) that it is obvious that the notion of absorption capacity of aid has been used with several different meanings, which are sometimes contradictory. The use of the absorption capacity concept in development economics is still ambiguous, as it was in the past. Guillaumont and Guillaumont (2006) pointed out that aid reflects a genuine effectiveness concern in case of increasing aid flows, but also a possible pretext to limit or postpone an increase of aid volume. They consider absorption capacity as the set of limits to an effective use of aid inflows under four main aspects:

- 1) Disbursement constraints, which lead to under utilisation of assistance;
- 2) Macroeconomic troubles, including loss of competitiveness and macroeconomic volatility;
- 3) Decrease of aid returns;
- 4) Institutions weakening induced by aid dependency.

A classical notion of absorption capacity is in line with third meaning (decrease of aid returns) where absorption capacity presents a drop of the marginal return of aid beyond a certain amount. Dalgaard et al. (2004) state that an important piece of the debate about aid-growth relationships was based upon different regression analysis that test a marginal returns of aid. The estimation in growth regressions referring to absorption capacity constraints were run by many authors of which Burnside and Dollar (1997) and Collier and Dollar (2002) mostly influenced further research on aid.

Results were strongly differed as decreasing of returns of aid may be because of any other factor (Beynon, 2003). However decreasing returns do not exclude increasing returns below some aid level (consistently with the big push theory). The turning points are likely to differ among recipient countries depending on their own characteristics. The second meaning refers to possible macroeconomic troubles associated with large aid inflows that include a loss of competitiveness, through real currency appreciation (“Dutch disease approach”).

The lag between commitments and disbursements has been considered for many years but it has not led to many studies (Guillaumont, Guillaumont, 2006). Namely, more attention was paid to the analyses of the donor-specific factors that cause delay in disbursements. The rate of under-utilisation of financial assistance in some cases was dramatically high. The reasons behind may lie in the features of the receiving countries, such as low administrative capacities or non-fulfilment of the conditions attached to disbursement etc.

The literature on the theory of European integration does not offer a unique definition of the absorption capacity of the EU financial assistance. The absorption capacity stands for the degree to which a country is able to effectively and efficiently spend the financial resources from the Structural funds to make a contribution to economic and social cohesion (Boeckhout et al., 2002). The absorption capacity also means a capability of state (or region, unit) to use allocated EU funds on efficient way (European Commission, 2004). The majority of definitions state that absorption capacity represents ability to utilise the allocated EU financial assistance (funds and programs). If a country is able fully to use all allocated financial assistance in an effective and efficient way it means that the absorption problem does not exist. Absorption problem is defined as the case when any recipient country fails to achieve full allocation of the EU funds or “100 percent of its target value programmed *a priori*” (Ederveen et al., 2006). The reason is mainly because the administrative capability of a country to deliver and implement the given operational program is not perfect (Bradley et al. (2003). This approach is strictly input-oriented, ignoring the original idea behind regional policy with the goal of economic convergence.

Herve and Holzmann (1998) provide an output-oriented definition. Any deviation from the potentially highest growth path can be conceived as an effect of absorption problem. Following the classification in Herve and Holzmann one can distinguish several reasons why the actual increase in (physical and human) capital could be considerably smaller than what would be expected under an optimal use of transfer like the waste of transfer, rent-seeking activities, diversion of funds to consumption etc. They argue that for the EU structural funds absorption problems are of empirical relevance and that their scope may be high. They pointed out that absorption problems are likely to increase also with the amount of transfer.

Some authors (like Horvat (2005) and Mrak and Tilev (2008) distinguish several characteristics of the absorption capacity of the EU funds according to different groups of factors. Horvat (2004) pointed out that the absorption capacity of EU funds depends on two groups of factors so called supply and demand side factors. The supply side factors are those that are in connection to the process of programming and managing of

EU funds. They are essentially at the national level. The demand side factors of the absorption capacity are those oriented to the recipients of EU financial assistance. The absorption capacity of the supply side could have three different aspects: macroeconomic, financial and administrative (Horvat, 2004).

From the review of the academic literature it is obvious that there is an absence of a conceptual framework to comprehensively assess the issue of absorption problems related the EU assistance. The existing literature on the EU financial assistance suffers of the lack of an in-dept analysis of the factors of the absorption capacity of EU funds, as well as examination of the EU funds implementation process. As Milio (2007) concluded the vast majority of authors have been more concerned with the policy-making process and the final economic impact of the resources to the economic and social structure of the country than to the issues of absorption capacity of EU funds.

2. EU financial assistance

The EU financial assistance could be broadly divided into two types: pre-accession and post-accession that are run by different sets of rules mandated by the EU regulations (Europa Media, 2010). The actual disbursements of those funds are determined by the type of implementation system in place and could vary between the countries. EU assistance builds on the principle of complementarity, meaning that EU support must match member states' resources in pursuing shared goals. More specifically, for the EU fund allocations to be accessible, adequate means of counterpart financing must be made available. Strict EU procurement and administrative procedures during the implementation of programs cause delays in the launch of operations and influence on the absorption of EU funds.

2.1. Pre-accession programs

Pre-accession programs are designed to prepare candidate countries to adopt the EU laws and policies in order to achieve full economic integration and social cohesion. They could be implemented in the several frameworks – like for instance as Decentralised Management System (DIS) in which ex ante checks by the EC Delegation exist or Extended DIS (so-called EDIS). Pre-accession programs present an essential part of the accession process with the main purpose to support the negotiation process and enable candidate countries for the membership in the EU. In the pre-accession period EU financial assistance is received from the several financial instruments so called PHARE, ISPA, SAPARD and IPA programs. PHARE (*Poland and Hungary Aid for Reconstruction of the Economy*) was created in 1989 to assist Poland and Hungary, but later on it was extended to cover all other candidate countries. ISPA (Instrument for Structural Policies for Pre-accession) and SAPARD (Special Pre-accession Assistance for Agriculture and Rural Development) were introduced within the framework of Agenda 2000 which set strategic and financial directions of the EU in the period of 2000-2006. All three instruments were intended to support candidate countries in adoption of the *acquis*, institutional building and preparation for the future participation in the EU's structural and cohesion policy. IPA (Instrument for Pre-Accession Assistance) was introduced in 2007 for the programming period until 2013 and it replaced all three pre-accession programs. IPA brings together for the first time

in a single framework EU financial assistance to candidate countries while having the main objective to help the beneficiary country to implement the reforms needed to fulfil the EU requirements. Institutional framework under IPA is similar to the institutional framework in the Cohesion/Structural funds so IPA presents for the candidate and potential candidate countries some kind of 'training field' for membership. The sound management of IPA under decentralised manner gives assurance that the country will be ready to manage and implement EU funds. IPA is structured into five components of which potential candidate countries could benefit of two components only, while the candidate countries have access to all five IPA components. Also, the financial assistance given through IPA is similar to that given through the structural funds, namely European Regional Development Fund (ERDF) and the European Social Fund (ESF).

2.2. Structural Funds

The EU **funds** are allocated to the Member countries and designed to play a crucial role in improving their social and economic cohesion within the European Union (Europa Media, 2010). Structural Funds² are focused on regions with a low per capita income, and regions with a level of GDP per capital below 75 per cent of the EU average (Kandžija, Cvečić, 2011). Looking from a strictly financial terms the EU structural funds represent a system of side-payments from the governments of richer EU countries to those of less-developed EU countries (Marks et al. 1996). From the relative modest beginnings, the EU structural policy has grown to become the EU's second most important spending policy after the Common Agricultural Policy. The EU spends about one third of its budget on supporting cohesion by assisting member states and their regions in efforts to promote catching-up. The policy has a distributive dimension as the significant net transfers are headed to the poorer member states with the aim primarily to enhance efficiency and growth. The main goal of the structural funds and Cohesion Fund is to support the main determinants of catching-up. In the current financial perspective (2007-2013) structural funds and Cohesion Fund represents 38% of the EU budget.

2.3. Common characteristics of EU financial assistance

EU financial assistance is allocated to projects within the framework of a program, subject to specific conditions regarding the nature of expenditure eligible for a grant. The EU financial assistance is project-related and could be used only to cover the specific purposes in accordance to financial contract. There is probability that some projects will not go through for different reasons, therefore in reality net transfers are going to be smaller than the appropriations. The programming, the management of programmes and the ability to monitor operations and verify their execution are parts of the demanding requirements by the European Commission posed to the beneficiary country. This means that the states should have an ability to establish convincing programs, involving local and regional authorities as well as social and economic

² Structural funds are the European Regional Development Fund (ERDF) and the European Social Fund (ESF).

partners, plus to create environment for potential beneficiaries (mostly local and regional authorities) to apply and submit applicable projects.

The operations of the EU financial assistance are governed in accordance with operating principles and need to be complemented to national investments, multi-annual programming, partnership, proportionality of interventions, shared management between the Member State and the Commission. In principle it is prescribed that the Operational Programs are designed by the Member States/regions to allocate the funds to the economic and social development while for instance the subsidies to individual firms or to the poor people are not allowed. The management of EU financial assistance is carried out by national and regional authorities and not by the European Commission.

The co-financing element required by any EU funding mechanism differs across the assisted areas – however, generally one quarter is at least expected per each program. EU-funded operations are co-financed to a large extent by beneficiary country.

EU financial assistance is taking place within the multi-level policy networks that involve a various actors from the EU to the national and sub-national authorities, as well as social and economic partners, NGOs etc. Such co-operation implies multiple horizontal and vertical interactions between actors across different layers of decision-making process. Even the legal provision (Council Regulation) of the structural funds requires the creation of a effective association of all relevant bodies in member states, explicitly stating the need for the participation of ‘regional and local authorities and ‘economic and social partners’ on the other (European Commission, 2004).

For the policy model of the EU structural funds Lang (2003) states that it is more elaborate and demanding than of the most domestic regional policies. It requires the co-operation of several actors and demands more efforts than domestic regional policies in terms of the time and resources of the participants involved in implementation.’ As the regional policy in a national state is usually implemented within a uniform framework of national and sub-national relations, the EU structural policy are divergent in its nature and involve wide range of scope within different territorial actors.

Brusis (2002) pointed out a challenge of EU accession states as they have been subjected to essential changes in order to employed and empowered sub-national actors and regional administration while seeking to join the EU. In some cases states spent some time in order to restore the partnership arrangements as a necessary precondition for a successful implementation of the EU structural policy.

3. EU FUNDS IN EASTERN AND CENTRAL EUROPE

The capacity of Member States and their regions to absorb allocated financial assistance in a productive way is an issue more often investigated and questioned. The major challenge issue of the EU funds derives from the inability of the country or lack of absorption capacity to utilise that financial assistance in order to obtain the most beneficial outcomes.

It is evident that experience with so-called ‘cohesion countries’³ has showed that the implementation of the EU structural funds can be a powerful driver for the institutional and policy change as it promotes adoption of rules and principles while involving the stakeholders in the decision-making process and multi-level co-operation. The ability to generate real impact through the EU financial resources depends on the efficiency of the public administration, municipalities as well as other stakeholders (private sector, NGOs, etc.). This is conditioned by the availability of AC to implement a complex policy-making process of programming, management, implementation, monitoring and evaluation. The institutional and administrative capacity relates to ability of public structures to identify and solve implementation problems and allow governments to elaborate and implement programmes with better performance.

The ten Central and Eastern European (CEE) countries join the European Union in two stages: on May 1, 2004, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia; on January 1, 2007, Bulgaria and Romania. In the 2007-2013 the 10 CEE countries have access to EUR 172.6 billion of EU funds, i.e. from the ERDF, CF and ESF⁴. On the annual basis this amount is 2.7% of the annual GDP of the region (according to 2010 Eurostat data).

All CEE countries experienced difficulties in absorbing the allocated funds. They had problems to demonstrate that sound financial management structure of the EU funds is in place and operate effectively.

The CEE Countries had to confront higher challenges of compared to previous enlargements. In some countries like for instance Bulgaria the pre-accession programs were not manage successfully as the administrative capacity was weak and beyond that there have been serious allegations of irregularities as well suspicions of fraud and conflicts of interest in the award of contracts (European Parliament, 2011). Bulgaria was not able to reap the full benefits of financial assistance because of critical weaknesses in administrative capacity at local, regional and central level. Public administration suffers from a high turnover of staff, unattractive salaries that create opportunities for corruption (European Commission, 2011).

Kalman (2002) pointed out also inadequate institutional framework and issues in connection to the area of human capacity development. Especially, as one of the most relevant issues she emphasised importance of an adequate number of people in administering EU funds. If there is a shortage staff the whole process could be delayed and it could pose a problem in contracting. Besides quantity of staff involved in the process the quality (trained and experienced) staff is even more needed. The lack of specific knowledge of programming process could slow down the disbursements and result with the low absorption.

³ Those are Ireland, Portugal, Spain and Greece.

⁴ European Regional Development Fund (ERDF) aims to promote economic and social cohesion by addressing main regional imbalances and participating in the development and conversion of regions. Cohesion Fund (CF) has a purpose to co-fund actions in the field of environment and transport infrastructure. European Social Fund (ESF) has been set up to reduce differences in prosperity and living standards across EU Member States and regions.

The experience in CEE countries shows that the institutional structure for implementing EU funds is primarily determined by the Member States according to national practice. Many CEE countries, especially during the first few years of membership (for the period 2004-2006) to implement SF through a centralised system, which is a “mix” of characteristic of “differentiated” and “integrated” administrative framework (European Parliament, 2011)⁵. Experiences in CEE showed that centralised mixed system has advantages from the efficiency point of views, but that lack a regional dimension and that is “far from the applicants”. In some countries even “heavy” procedures were introduced that posed disproportionately high application costs to the applicants.

There are few common factors that are needed in order to have absorption capacity ready for the SF and CF. Besides the legal framework that could allow for multi-annual budget programming with a view to provide national co-financing for regional policy funds assistance, designation of bodies/authorities responsible for the preparation and implementation of structural funds and the Cohesion Fund is of essential importance. Legal requirement with regard to segregation of duties, in particular between payment and authorizing functions need to be set up, as well as financial control and independent internal audit structures. The administrative capacity needs to be developed in accordance to the organisational development strategies with the training plans for developing management capacity, project management, public procurement, evaluation capacity and financial management. Recruiting and retaining high quality staff is also substantially important and obtaining for them a level of remuneration competitive with the private sector in order to be able to recruit skilled and stable staff. The way how partnership is organised in the preparation, financing, monitoring and evaluation of assistance is also crucial. The partnership structures need to be coherent, independent and consist of the representatives from civil society and socio-economic partners. Furthermore, effective partnership exclusively of the preparation of the programming documents and the active role with of regional/local authorities (municipalities) need to be tackle with special care. Lastly, project pipeline need to be develop in parallel to the programming process taking into account eligibility of future expenditures, readiness of feasibility studies, environmental impact assessments and other preparatory work.

Looking at the results in the absorption of EU funds in the CEE countries it is evident that most of them had difficulties in implementing SF and CF. Namely, especially during the first four years of implementation of SF beneficiaries signed contracts totalling nearly EUR 110.2 billion. This amount is about half of the available budget for the financial perspective. Considering the region’s population, this equates to EUR 1,079 in contracted grants per capita (KPMG, 2011). After four years of implementation of EU funds the ten CEE countries have contracted all together 53% of their budget allocated for the 7-year programming period. The best contracting results

⁵ Integrated/differentiated management of the SF depends to the extend to which the SF are managed through existing national administrative, economic and financial systems or whether administrative, economic and financial systems are set up specifically for the structural funds.

were in Baltic countries as they had the highest contracting rates (between 60-76%) while the lowest contracting rate was in Bulgaria (37%).

4. ABSORPTION CAPACITY AND EU PRE-ACCESSION PROGRAMS IN CROATIA

Croatia as a candidate country (accession country) is confronted with the challenge to ensure high absorption of the allocated EU assistance currently derived from the pre-accession programs. The EU financial assistance in the pre-accession phase amounts approximately EUR 1 billion (while with the EU membership is expected to secure another EUR 8-12 billion over the 2014-20 period)⁶.

Absorption capacity started to develop with the first EU assistance program that had been provided to Croatia⁷, but actual progress was made after receiving the status of candidate country (June 2004) when PHARE program was approved (in 2005). PHARE was complimented by the Instrument for Structural Policies for Pre-Accession (ISPA) and the special accession program for rural development (SAPARD). The purpose of the pre-accession assistance in Croatia, as well as for other candidate countries was to support the adoption and implementation of the *acquis communautaire* and to help strengthening the administrative capacity in preparation for managing the larger amounts of EU funding available once it becomes a Member State. From 2007 these three instruments were replaced by the Instrument for Pre-Accession (IPA), which provides funding of approximately EUR 150 million per annum (totalling EUR 1,071 million for the 2007-2013 period).

Decentralised management system⁸ of EU financial assistance was established firstly for the several CARDS projects in 2004. Later on it was introduced for PHARE program with institutional set up consisting of several bodies mostly from the public administration. System of internal rules and procedure with defined responsibilities for all actors in the system was also developed. Manuals of procedures were adopted for each body with the clear description of all processes and procedures including audit trails. All those were preconditions for the accreditation to be granted to the national system. The accredited decentralised system with ex-ante controls represents a basis for the implementation of allocated funds with ex-ante control (performed from the EC Delegation). The system was developed taking into account a longer perspective namely that functioning without the ex-ante control and later on to be upgraded for the structural funds.

⁶ The ultimate financial outcome depends on the conclusion of the overall EU budget talks for the next financial perspective, 2014-20.

⁷ The assistance was initially provided through the Community Assistance for Reconstruction, Development and Stabilization (CARDS) program.

⁸ Decentralized Implementation System (DIS) means system in which responsibilities and management of the EU funds/projects are transferred to the beneficiary country. DIS was established firstly for the several CARDS projects in 2004.

Table 1: EU pre-accession programmes in Croatia from 2001. to 2012. (in million €)

CARDS	2001.: 60 mil
	2002.: 59 mil
	2003.: 62 mil
	2004.: 81 mil
	Total: 262 mil
PHARE	2005.: 87 mil
	2006.: 80 mil
	Total: 167 mil
ISPA	2005.: 25 mil
	2006.: 35 mil
	Total: 60 mil
SAPARD	2005.: 25 mil
IPA	2007.: 141 mil
	2008.: 146 mil
	2009.: 151 mil
	2010.: 154 mil
	2011.: 157 mil
	2012.: 159 mil
	2013.: 95 mil (forecast)
	Total: 1003 mil

Source: Ministry of Finance, 2012

Contracting rates, the most common measures of the absorption capacity, significantly exceed 90% for pre-accession programs PHARE and IPA (most of the components). The different situation was with SAPARD and later on IPARD (fifth component of IPA) that was accredited later than expected and where the absorption is still at the low level (low contracting rates). It is evident (table 1) that in some IPA components, besides IPARD, results are relatively modest, but the contracting deadline is still not due.

Table 2: EU pre-accession programs in Croatia – budget (in EUR million) by programs and contracting rates and payment rates in percentage (as of March 2011)

Programs in Croatia	Budget (in million EUR)	Contracting rates (in %)	Payment rates (in %)*
CARDS	260	97 %	92 %
PHARE	147	86 %	78 %
ISPA	59	96 %	63 %
SAPARD	25	62 %	48 %
IPA I 2007	45	90 %	57 %
IPA I 2008	42	27 %	20 %
IPA I 2009	42	11 %	11 %
IPA II 2007-09	8	64 %	36 %
IPA III 2007-09 (of which)	143	29 %	7 %
- OP transport	54	20 %	4 %
- OP environment	54	25 %	2 %
- OP regional competitiveness	35	48 %	20 %
IPA IV 2007-09 – OP human resources development	38	71 %	9 %
IPA V 2007-09 (IPARD) – Measure 101 and 103	51	12 %	0 %

* Excluding advanced payments of 30% for Components III, IV and V.

Source: European Court of Auditors, 2011

Good results of absorption of pre-accession funds should be interpreted with cautious (Court of Auditors, 2011). One of the main concerns of the absorption presents insufficiently strong capacities, especially at the local level. Potential beneficiaries of future post-accession funds (structural funds) even do not possess sufficient knowledge of EU funding opportunities and procedures. There is also a need to develop a higher level of intervention and clear definition of inter-institutional co-operation and decision-making responsibilities (MHW Consortium, 2009). Experience of other countries, especially new member states (NMSs) from CEE such as Estonia and Slovenia would be of great benefit in order to avoid mistakes that they had in creating the optimal system of implementation of EU funds. Moreover, lessons learned from the countries that previously joined EU would ensure that the process of developing the

required absorption capacity is not left until it is too late for such bodies (regional and local levels) to participate effectively.

Financial package for Croatia's during first six months of accession to the EU which is for the period Jul 1-December 31, 2013 is EUR 800.16 million (table 3) which is equivalent of the total IPA funds allocated in the last seven years.

Table 3: Approved allocation to Croatia for the period July 1-December 31, 2013 (in EUR million)

Approved allocation to Croatia for the period July 1-December 31, 2013 (in EUR million)	
Participation in EU initiatives and programs	47.4
STRUCTURAL AND COHESION FUNDS	449.4
Cohesion fund	149.8
Structural funds	299.6
AGRICULTURE AND RURAL DEVELOPMENT	20.4
CIVIL SOCIETY, FREEDOM, SAFETY AND JUSTICE	73.3
Schengen facility	40
Transition facility	29
Other EU measures, initiatives and programs in this area	4.3
Administration	22
Cash Flow Facility*	75
TOTAL	687.5
SUBTOTAL**	800.16

* Amount made available to Croatia to mitigate the impact of the full application immediately after accession of the *acquis* governing the contributions made by Member states to the EU budget

** Amount include direct payment in agriculture, support to rural development (IPARD) and support to wine sector.

Source: Ministry of Finance, 2012.

5. CONCLUSION

The analysis of absorption capacity of the EU funds is relatively new field of research. The literature on the theory of the European integration does not offer a unique definition of the absorption capacity of the EU financial assistance. The most common definition of absorption capacity of EU funds is related to the capability of a country to effectively and efficiently spend the allocated EU financial resources. An academic literature also indicates the absence of a conceptual framework to comprehensively assess the issue of absorption problems related the EU assistance and could be concluded that the existing literature on the EU financial assistance suffers of the lack of an in-dept analysis of the implementation process.

The experience in CEE countries shows that the institutional structure for implementing EU funds is primarily determined by the Member States according to national practice. Many CEE countries, especially during the first few years of EU membership implemented SF through a centralised system. The experience from CEE countries are important for Croatia in order to determine factors that could affect the

absorption of EU funds and identify the causes that could hold back Croatia from obtaining the funds needed to develop effectively.

Once Croatia becomes a Member State of EU, it will start implementing the EU SF and CF. Croatia is preparing for the implementation of SF and CF, as IPA is to a large degree follows the principles of funds which finance the EU cohesion policy. Nonetheless, the pre-accession system currently in place does not comply with the rules and requirements of the EU structural funds and Cohesion fund. The activities to strengthened system of the implementation of EU financial assistance needs additional efforts at all levels in Croatia in order to prepare the overall system for the functioning of the structural funds. The EU funding that will greatly increase (almost tenfold) and capturing the post-accession assistance would present a great challenge and depend on the Croatia's absorption capacity to effectively disburse and use allocated future funds.

REFERENCES

- Beynon, J. (2003), "Poverty Efficient Aid Allocations - Collier/Dollar Revisited", Economic and Statistics Analysis Unit, *Working Paper*, No. 2, Overseas Development Institute, London.
- Bhagwati, N.J. (1967) „The Tying of Aid“ in J.N. Bhagwati, R.S. Eckaus (Eds.) „Foreign Aid“, Penguin, Harmondsworth (1967)
- Boeckhout, S., Boot, L., Hollanders, M., Reincke, K-J., de Vet, J.M. (2002), Key indicators for Candidate Countries to Effectively Manage the Structural Funds – Principal Report, Rotterdam: NEI.
- Bourguignon, F., Sundberg, M. (2006), "Absorptive Capacity and Achieving the MDGs", *Research Paper* No. 2006/47, Helsinki: United Nations University, World Institute for Development Economic Research.
- Bradley, J.; Morgenroth, E.; Untiedt, G. (2003), "Macro-regional evaluation of the Structural Funds using the HERMIN modelling framework", Paper for presentation at the 43rd Congress of the European Regional Science Association 27 Aug 2003 - 31 Aug 2003 (<http://www.sre.wu-wien.ac.at/ersa/ersaconfs/ersa03/cdrom/papers/313.pdf>).
- Brusis, M. (2002), *Between EU Requirements, Competitive Politics, and National Traditions: Re-creating Regions in the Accession Countries of Central and Eastern Europe*, Governance, Vol. 15, Issue 4, pp. 531-559
- Burnside, A.C., Dollar, D.(1997), "Aid, Policies and Growth", *World Bank Policy Research Working Paper* No. 569252, Washington, June 1997.
- Chenery, H.B., Strout, A.M. (1966), "Foreign Assistance and Economic Development", *American Economic Review*, Vol. LVI, No. 4, Part 1, pp. 679-733.
- Collier, P. Dollar, D. (2002), "Aid Allocation and Poverty Reduction", *European Economic Review*, Vol.46, No.8, pp. 1475-1500.
- Dalgaard, C-J., Hansen, H., Tarp, F. (2004), "On the Empirics of Foreign Aid and Growth", *The Economic Journal*, 114, June, pp. 191-216.
- Ederveen, S., de Groot, H.L.F., Nahuis, R. (2006), "Fertile Soil for Structural Funds;" *Kyklos*, Vol. 59, No.1, February 2006, pp. 17-42.
- Europa Media Non-Profit Ltd. (2010). *Quick guide to EU Funds*. 3rd edition, Budapest, Europa Media Non-Profit Ltd.
- European Commission (2004), *From Pre-Accession to Accession*", *Interim Evaluation of PHARE Support Allocated in 1999-2002 and Implemented Until November 2003*, DG Enlargement, Evaluation Unit, Brussels.

- European Commission(2011), Monitoring Report for Bulgaria 2011. <http://ec.europa.eu/dgs/bulgaria>
- European Parliament (2011), *Report on Absorption of Structural and Cohesion Funds: Lessons Learnt for the Future Cohesion Policy of the EU*, Committee on Regional Development.
- European Court of Auditors (2011), Has EU Assistance Improved Croatia's Capacity to Manage Post-accession Funding?, *Special Report No. 14*, pages: 49.
- Guillaumont, P., Guillaumont, S. (2006), "Big Push Versus Absorptive Capacity: How to Reconcile the Two Approaches", CERDI. *Etudes et Documents*, E.2006.14, October 2006.
- Hansen, H. and F. Tarp (2000), "Aid Effectiveness Disputed." *Journal of International Development* 12(3): 375–98.
- Herve, Y. and Holzmann, R. (1998), *Fiscal Transfers and Economic Convergence in the EU-An Analysis of Absorption Problems and Evaluation of The Literature*. Baden-Baden: NOMOS.
- Horvat, A., (2004), *Absorption Problems in the EU Structural Funds*, NARG, Ljubljana
- Horvat, A. (2005). "Why Nobody Care About Absorption? Some Aspects Regarding Administrative Absorption Capacity for the EU Structural Funds in Czech Republic, Estonia, Hungary, Slovakia and Slovenia Before Accession, *WIFO Working Papers*, No. 258, Vienna, August 2005.
- Kálmán, J. (2002), "Possible Structural Funds Absorption Problems. The Political Economy View with Application to the Hungarian Regional Development Institutions and Financial System". *Regionalization for Development and Accession to the European Union: A Comparative Perspective*, pp. 31-63.
- Kandžija, V., Cvečić, I. (2011), *Ekonomika i politika Europske Unije*, Rijeka: Ekonomski fakultet sveučilišta u Rijeci.
- KPMG (2011), "EU Funds in Central and Eastern Europe", Progress Report, Budapest, Hungary.
- Lang, J. (2003), *Policy Implementation in a Multi-level system, Linking EU and National Governance*, Oxford University Press, USA.
- Marks, G., Hooghe, L., Blank, K. (1996), European Integration from the 1980s: State-Centric v. Multi-level Governance, *Journal of Common Market Studies*, Vol. 34, Issues 3, Pp. 341-378.
- MHW Consortium Croatia (2009), "Review of PHARE Assistance to Preparation for Structural Funds in Croatia", Ad Hoc Interim Evaluation of the EU Pre Accession Assistance, Zagreb, February, 2009.
- Millikan, M.F., Rostow, W.W. (1958), „Foreign Aid: Next Phase“, *Foreign Affairs*, Vol. 36, No. 3, pp. 418-436
- Milio, S. (2007), Can Administrative Capacity Explain Differences in Regional Performances? Evidence from Structural Funds Implementation in Southern Italy, *Regional Studies*, Vol. 41, No. 4, pp. 429-442
- Ministry of Finance (2012), "Report on the Implementation of Pre-accession Programs" (Izveštaj o korištenju prepristupnih programa), Ministarstvo financija, Zagreb.
- Mrak, M., Tilev, D. (2008). *Absorption for EU Pre-Accession Funds: Concept and Implication for Kosovo*, Forum 2015, Priština, March 2008.
- Rosenstein-Rodan, P.N. (1961). "International Aid for Underdeveloped Countries", *The Review of Economics and Statistics*, Vol. 43, No. 2, pp. 107-138.
- Svensson, J. (2006). "Absorption Capacity and Disbursement Constraints", U: *Financing Development: What are the Challenges in Expanding Aid Flows?*, Proceedings of the 3rd AFD-EUDN Conference, 2005., pp.73-99.

Tomislav Kandžija

Country of Primorsko-goranska, Rijeka, Croatia

Marko Tomljanović

University of Rijeka, Faculty of Economics, Rijeka, Croatia

CONVERGENCE INSTRUMENTS OF WESTERN BALKAN COUNTRIES

ABSTRACT

The fundamental objective of the EU regional policy is to reduce differences in development between regions in Europe. EU is directing structural funds to the regions which need help, and in that way EU helps to raise the level of employment and living standards. Financing is based on 4 main principles of regional policy. For the candidate countries are intended the pre-accession instrument- IPA. Candidate countries have problems in using that intended resources due to inefficient public administration.

New member countries allocate the majority of resources from the ESF, ERDF and the Cohesion Fund, with special emphasis on growth, employment and European territorial cooperation. These objectives also form the basis of the financial perspective 2014. - 2020. During that financial perspective the total amount for regional policy in EU budget will be near to 32%.

Key words: EU, ERDF, ESF, Cohesion fund, regional policy, convergence

JEL classification: O1

1. INTRODUCTION

Recent trends in the European Union, marked by several rounds of enlargement, have led to regional disparities and the growing gap between developed and underdeveloped regions and counties. To reduce these regional disparities it is necessary to introduce the concept of regional policies and instruments of implementation.

The preamble of the Treaty establishing the European Community (also known as the Treaty of Rome) called for the strengthening of the economy in Europe and ensures the harmonious development by reducing the differences existing between the various regions, and concern for the less developed regions.

Implementation of regional policy objectives is achieved through 4 main instruments: ERDF, ESF and Cohesion fund. Pre-accession instrument IPA is available for candidate countries of the Western Balkan.

The basic objective of this paper is to show the level of exploitation of the Structural Funds and pre-accession programs in new member countries, candidate countries and potential candidate countries from Western Balkan.

2. REGIONAL POLICY OF THE EUROPEAN UNION

Regional policy is an instrument of encouraging adaptation to new developments and common policies, and includes financial support for projects of restructuring the problematic areas. Reducing regional disparities is an essential condition for every economic and political progress of the EU. Comparing the development of different regions, usually as a criteria is taken into account the value of GDP per capita, unemployment rate, etc. One of the most important objectives of the European Union is to achieve economic and social cohesion.

As general objectives, along with the already mentioned economic and social cohesion, can be defined also:

- The representation of awareness of regional issues in other public policies;
- Coordination of regional policies in the countries;
- Providing financial instruments to encourage the development of less developed areas.

The most important elements that negatively affect the achievement of these goals are: High concentration of economic activities and population in the central metropolitan areas; significant regional differences in the level of GDP and employment; Limited availability of certain services in the regions and cities; Socio-economic problems in remote and isolated areas.

Regional policy is based on five main principles:

1. Concentrations: available resources are concentrate on regions whose GDP per capita does not exceed 75% of the EU average;
2. Co-financing: Member States of the structural funds must supplement national funds and loans from the European Investment Bank;
3. Programming: The Commission tries to focus national policy priorities with conditioned program of regional development;
4. Partnership: all stages of policy implementation should be carried out in cooperation with national authorities, regional and local authorities and the relevant economic and social partners.
5. Subsidiarity – deciding down to the level closest to the citizen.

For quality establishment and implementation of regional policy, member states should establish a proper legal framework that assumes budgeting and financing for regional development. For the realisation of this condition it is necessary the functioning of the institutions in the member states that manage financial resources of funds. Regional policy requires a high level of harmonization with other common policies such as social and market competition policy.

When development of different regions is compared, usually as criteria is taken in consideration the value of GDP per capita, unemployment rate, etc. Indicators of development are observed at the level of the statistical regions NUT, which are comparable in population across the EU.

Table 1: Categories of NUTS regions according to population

LEVEL	MINIMUM POPULATION	MAXIMUM POPULATION
NUTS I	3 000 000	7 000 000
NUTS II	800 000	3 000 000
NUTS III	150 000	800 000

Source: Bajo, A., Alibegović, J. 2008.

According to the classification given in Table 1. EU territory is divided into 92 regions NUTS I, 269 NUTS II regions and 1 293 NUTS III regions.

Regional policy can be observed from two viewpoints. Redistributive regional policy aims to reduce the developmental differences with a key role of the state. An active policy aims to encourage economic growth and competitiveness by recognizing endogenous development and solving the causes of unequal development. Here is the key role of regional actors.

The financing of regional policy is conducted with three funds: European Regional Development Fund; European Social Fund; Cohesion Fund.

Structural Funds finance multi-annual programs which make development strategy prepared in cooperation of regions, Member States and the European Commission. Regional policy is a major user of the EU budget funds. That share reached, from initial value of the 11,5% (1984.) to a value of 32% in the financial initiative 2014th - 2020. Increasing regional disparities are reflected in the fact that 10% of the population live in the richest regions, which include 19% of EU27 GDP, while the poorest 10% includes 1,5% of GDP.

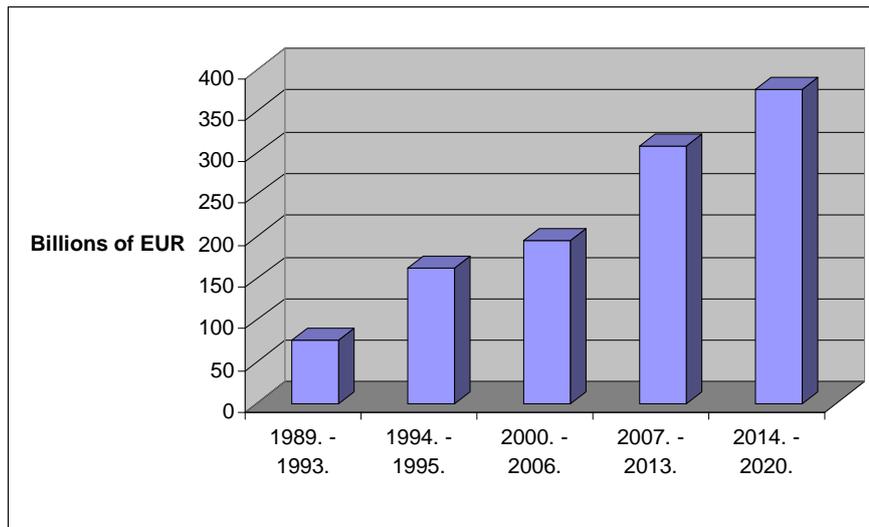
Regional policy key goal is reducing regional disparities within the EU countries based on different rates of unemployment and the different heights of the GDP. Achieving economic and social cohesion is a precondition for economic and social growth.

3. COHESION POLICY WITHIN THE FINANCIAL PERSPECTIVE 2014 – 2020

Cohesion and regional policy have been defined with the aim of reducing economic and social disparities between the Member States by helping regional development. Cohesion policy has contributed to prosperity in the EU. It has to become, considering the economic crisis, a driving force for economic development and competitiveness.

Cohesion policy has in the past 10 years directly helped the opening of more than one million jobs. From cohesion funds was also co-financed the construction of more than 2000 kilometres of highways and 4,000 kilometres of railway lines. Cohesion fund also helped to establish around 800 000 small and medium-sized enterprises.

Figure 1: Budget resources for cohesion policy in the previous budget period



Source: European Commission, DG Budget

Data from Figure 1 shows the constant increase in funds for cohesion policy from the year 1989. to 2014.

According to the European Commission's proposal for the next seven-year budget period, for cohesion policy is intended up to 376 billion Euros. For direct support of the development and competitiveness of all European regions are aimed the remaining 336 billion Euros. Total amount for cohesion policy will be aimed at slightly more than 32% of the European budget.

European Commission has proposed a number of important changes in the design and implementation of cohesion policy: Focusing on the priorities of smart, sustainable and inclusive growth in Europe 2020; Rewarding success; Support for integrated programming process; Focus on results - monitoring to achieve agreed objectives; Strengthening territorial cohesion; Simplification of execution.

Table 2: Structure of the cohesion policy in the period of 2007 - 2013

2007. – 2013.	
Operative goals	ERDF and ESF
Convergence	
Abandonment of convergence	
	Cohesion fund
Regional Competitiveness and Employment	ERDF i ESF
European territorial cooperation	ERDF

Source: European Commission, DG Budget

Table 3: Cohesion policy structure for the period from 2014 to 2020

2014. – 2020.		
Ultimate goals	Categories of regions	Fund
Investment in growth and jobs	Less developed regions	ERDF and ESF
	Transition regions	
		Cohesion fund
	Developed regions	ERDF and ESF
European territorial cooperation		ERDF

Source: European Commission, DG Budget

Unlike the previous budget period, within the perspective of the 2014th - 2020., number of targets is reduced and the focus is put entirely on growth and employment, and European territorial cooperation.

According to the proposal of the European Commission, 162,6 billion Euros, (48,3% of the total), is intended for regions with GDP per capita below 75% of the European average. This category includes all three Croatian statistical regions.

For the more developed regions, whose GDP is above 90% of the European average, is planned 53,1 billion Euros (15,7%). The European Commission has introduced a category for transition regions, whose GDP is between 75 and 90% of the European average and for them it provided 39 billion Euros (11,6%) of the funds for cohesion policy. For territorial cooperation is intended 11.7 billion Euros (3.48%), and for the Cohesion Fund 68,7 billion Euros (20,4%) of which 10 billion is reserved for the transport network. Amount of approximately one billion Euros is planned for remote areas and regions with low population density (Northern region).

Table 4: Qualification for less developed regions within the financial perspective 2007 – 2013 and 2014 – 2020

2007. – 2013.	2014. – 2020.
NUTS 2 regions with GDP per capita less than 75% of the EU average	No changes
Transitional support for regions that would remain eligible for the convergence objective that the threshold of remains 75% of the average GDP in the 15 EU member states	Separate category for transition regions
Cohesion fund: member States whose GNI per capita is less than 90% of the average GNI for the 27 Member States	No changes
Transitional support to member states that would remain eligible for the Cohesion Fund to the threshold remained at 90% of the average GDP in 15 EU member states, not 25	Transitional support to member states that would remain eligible for funding from the Cohesion Fund, the 2013th year, but their GNI per capita exceeds 90% of the average GDP in the 27 EU Member States

Source: European Commission, DG Budget

Table 5: Qualification for transition regions within the financial perspective 2007–2013 and 2014 – 2020

2007. – 2013.	2014. – 2020.
Transitional Support NUTS 2 regions that would remain eligible for the convergence objective threshold remained at 75% of the average GDP in the 15 EU member states, not 25 (abandoning convergence)	NUTS 2 regions whose GDP per capita is between 75% and 90% of the average GDP in the 27 EU member states, with special treatment of regions that are eligible under the Convergence objective in the period 2007th – 2013th
Transitional Support NUTS 2 regions in the period of 2000. - 2006. were covered by the first, but their GDP has exceeded 75% of the average GDP in the 15 EU Member States	

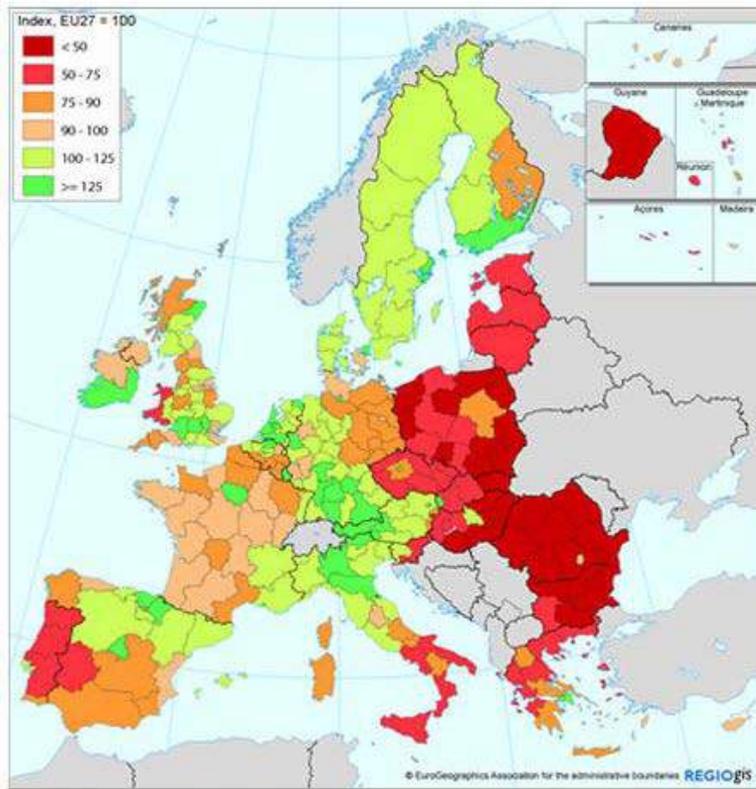
Source: European Commission, DG Budget

Table 6: Qualifications for developed regions in the financial perspective 2007 – 2013 and 2014 - 2020

2007. – 2013.	2014. – 2020.
All regions that are not covered by the Convergence or transitional support abandonment.	NUTS 2 regions with a GDP per capita higher than 90% of GDP in the 27 EU member states, with special treatment of regions that are eligible under the Convergence objective in the period 2007. - 2013.
Transitional Support NUTS 2 regions in the period of 2000. - 2006. years were covered by the first, but their GDP has exceeded 75% of the average GDP in the 15 EU member states.	

Source: European Commission, DG Budget

Image 1: Geographic prevalence of developed and less developed regions and transition to the EU



Source: European Commission, DG Budget

4. EUROPEAN COHESION POLICY INSTRUMENTS

The most important instruments of cohesion policy in the financial perspective 2014th – 2020th are European Regional Development Fund (ERDF), European Social Fund (ESF) and the Cohesion Fund.

ERDF aims to strengthen economic, social and territorial cohesion by removing imbalances between regions. The Fund supports local and regional development focusing on the following areas:

- Research, development and innovation;
- Improving access to information and communications technology;
- Climate change and the transition to a low-carbon;
- Business support to small and medium-sized enterprises;
- General economic interest services;
- Telecommunications, energy and transportation infrastructure;
- Increasing institutional capacity and efficient public administration;
- Health, education and social infrastructure;
- Sustainable urban development.

In more developed regions and those in transition, for example, at least 80% of ERDF resources at national level must be allocated for energy efficiency and renewable energy, innovation, and to support small and medium enterprises.

In less developed regions investment priorities are wider, reflecting higher demand for development. They must allocate at least 50% of ERDF resources for energy efficiency and renewable energy, innovation and to support small and medium enterprises.

The focus on sustainable urban development has also enhanced and it should be achieved by investing at least 5% of ERDF resources. For innovative activities in the field of sustainable urban development from the ERDF is allocated 0.2% of the annual budget. 50% of the funds intended for the most remote and rarely populated regions must be allocated to activities that contribute to the modernization and diversification of the economies of the region with special emphasis on research and innovation, information and communication technology, and competitiveness of small and medium enterprises.

European Social Fund is the main EU financial instrument for investing in human resources. ESF increases the employment opportunities for citizens, promote better education and it improves the situation of people at poverty risk.

Fund is focused on four thematic objectives: Employment and support labour mobility; Promoting social inclusion and combating poverty; Investment in education, skills and lifelong learning; Increasing institutional capacity and efficiency of public administration. At least 20% of the ESF must be allocated for promoting social inclusion and combating poverty. Programs must also concentrate funding on a limited number of priority investments to determine the details of each thematic goal.

Cohesion Fund (Cohesion Fund, CF) is financing projects which improve the environment and develop transport infrastructure within the trans-European transport networks. Cohesion Fund is open for Greece, Portugal and Spain, and after 2004. for new member states.

Interventions that can be financed from the Cohesion Fund are: Trans-European transport network (Trans-European Transport Networks); Transport infrastructure (outside the TEN-T) contributing to environmentally sustainable urban and public transport, inter-operability across the EU transport networks and encouraging inter-modal transport systems; Environmental infrastructure in order to adopt EU standards for environmental protection; Effective use of energy and renewable energy sources.

Funds for the European territorial cooperation, within the framework of the financial perspective 2014th – 2020th can be allocated in the following way: 73,24% for cross-border cooperation; 20,78% for transnational cooperation; 5,98% for inter-regional cooperation.

Financial perspective 2014. – 2020. is focused on 11 thematic areas.

These thematic areas are:

1. Strengthening research, technological development and innovation;
2. Increasing access, use and quality of information and communication technologies;
3. Increase the competitiveness of small and medium-sized enterprises, agriculture and fisheries sectors;
4. Supporting transition to a low carbon economy in all sectors;
5. Adaptation to climate change, prevention and risk management;
6. Environmental protection and promoting resource efficiency;
7. Promoting sustainable transport;
8. Promotion of employment and labour mobility;
9. Promoting social inclusion and combating poverty;
10. Investment in education, skills and lifelong learning;
11. Strengthening institutional capacity and efficient public administration.

5. ALLOCATION OF EUROPEAN FUNDS IN WESTERN BALKAN COUNTRIES

IPA is the main instrument for pre-accession assistance to candidate countries and potential candidates. IPA covers the period of 2007. - 2013. and it replaced previous assistance programs ISPA, PHARE and SAPARD. IPA was established in 2007th by Council Regulation no.1085/2006. The financial value of the seven-year period is 11.468 billion euros. Allocation of funds to the beneficiary countries is contained in the multi-annual indicative financial framework adopted for a three year period. The main objective of the IPA is to help the candidate countries and potential candidate countries in the harmonization and implementation of the *acquis communautaire* and to prepare them for the use of structural funds.

Most of the funds are intended for Turkey, Croatia and Bosnia.

Table 7. Indicative amount of IPA funds allocated for the period 2011- 2013

COUNTRY	AMOUNT PLANNED (in mil €)
Croatia	430
Iceland	28
Macedonia	304,76
Turkey	2586,9
Albania	257,73
BIH	314,22
Montenegro	91,28
Serbia	587
Program for multiple users	520,97
Cross – border cooperation	214,28
Total	5538,75

Source: Delegation of the European Union in the Republic of Croatia, 2012.

Mentioned funds should act as a catalyst to encourage reforms in the potential member countries and to support the countries on the path to European integration. EU aid will have a direct impact on the daily lives of citizens by contributing to improvement of the rule of law, governance, social conditions and economic prosperity in a situation of global economic crisis which affected all the regions of Europe.

These countries have right to use the IPA funds until they become members of the EU.

5.1. Allocation of IPA funds in Croatia

The European Commission has earmarked for Croatia the amount of 910,2 million Euros in the period until 2012.

Table 8: IPA financial allocations for Croatia in period of 2007. - 2012. (amounts in millions of Euros)

IPA components	2007.	2008.	2009.	2010.	2011.	2012.
Transition Assistance and Institution Building	49,6	45,4	45,6	39,5	39,9	40,9
Cross – border cooperation	9,7	14,7	15,9	16,2	16,5	16,9
Regional development	45	47,6	49,7	56,8	58,2	59,3
Human Resources Development	11,4	12,7	14,2	15,7	16	16
Rural development	25,5	25,6	25,8	26	26,5	27,3
Total	141.2	146	151,2	154,2	157,1	160,4

Sources: Operational Programme for Regional Competitiveness

The funds allocated to Croatia through the IPA program are growing from year to year, and for the year of 2012, the planned amount was up to 160,4 million of Euros. The funds are directed primarily toward the transition assistance and institution building and regional development.

Table 9: Implementation of IPA funds in Croatia

IPA component	Budget (mil of €)	% contracted	% granted
IPA I. – 2007.	45	90%	50%
IPA I. – 2008.	42	27%	20%
IPA I. – 2009.	42	11%	11%
IPA II. – 2007. – 2009.	8	64%	36%
IPA III – 2008. – 2009.	143	29%	7%
III a - Transport	54	20%	4%
III b – Environmental protection	54	25%	2%
III c – Regional competitiveness	35	48%	20%
IPA IV – 2007. – 2009.	38	71%	9%
IPA V. – 2007. – 2009.	51	12%	0%
UKUPNO	512	35%	13%

Source: ECA, 2011.

The biggest problem in the Croatian pre-accession period is inadequate public administration at all levels - from the lowest operational level, which is characterized by lack of skills and knowledge, as well as lack of motivation and poor mobility of employees, up to the highest political levels, where there are individuals without the necessary management competence and knowledge. These difficulties resulted in contracting only slightly more than one third of the total funds available through the five IPA components.

Croatia is still facing with a regional underdevelopment, centralization and the key issue - unprepared and insufficiently competitive economy and especially the sector of small and medium enterprises. IPA funds should help the sector of small and medium enterprises to adapt and to strengthen their competitiveness, but only under the condition of good ability to use potential funds.

5.2. Allocation of IPA funds in Serbia

IPA funds granted to the Republic of Serbia for the period of 2007. - 2013. is shown in Table 10.

Table 10: IPA funds granted to the Republic of Serbia for the period of 2007 - 2013

Component	2007.	2008.	2009.	2010.	2011.	2012.	2013.
Transition Assistance and Institution Building	181.4	179,4	182,5	186,2	190,5	190	203,1
Cross – border cooperation	8,2	11,4	12,2	11,7	11,3	12,1	11,6
Total	189,6	190,9	194,7	197,9	201,8	202,1	214,7

Source: European Commission, 2012.

During the budget period from 2007. to 2013. in Serbia were granted funding related to the use of IPA components I and II, transition assistance, institution building and cross-border cooperation. Total absorption of IPA funds in Serbia is over 95%, which ranks Serbia among states with the highest rate of utilization of IPA funds.

5.3. Allocation of IPA funds in Bosnia and Herzegovina

Signing the Stabilization and Association Agreement (SAA) is an important strategic step for Bosnia and Herzegovina on its path to EU membership. During a transitional period of six years, Bosnia and Herzegovina will improve its legislation towards the most important rules of the EU internal market

Table 11: The financial assistance to Bosnia and Herzegovina from IPA in period from 2007 to 2010

Year	Program	Available	granted	% contracted
2007. – 2010.	Component I. Transition Assistance and Institution Building	295.279.276	165.695.785	56,11%
2007. – 2010.	Component II. Cross – border cooperation	10.319.302	4.766.385	46,19%

Source: Delegation of the European Union in the BiH, 2012

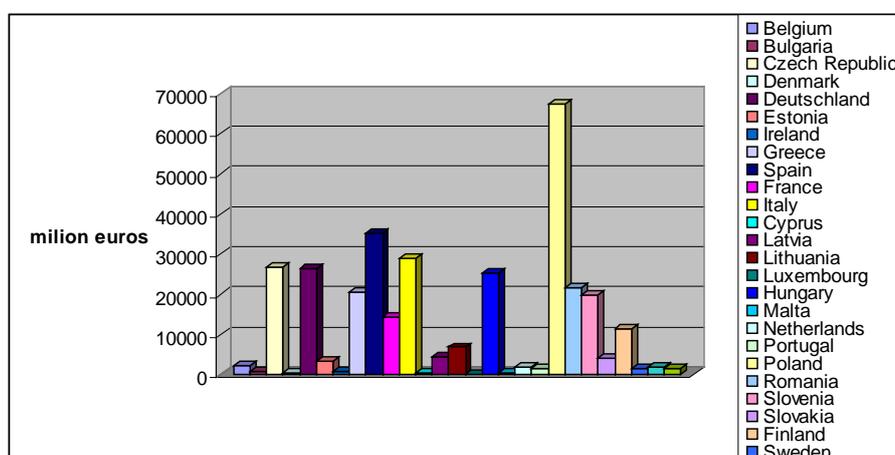
During the period from 2007. to 2009. for Bosnia and Herzegovina has been allocated the amount of about 266 million Euros through IPA funds, and for the period from 2010. to 2013. about 434.1 million Euros. The total value of the current financial assistance within the first two components of IPA funds has shown that Bosnia and Herzegovina still has plenty to work on the development of its own institutional capacity.

Until now, Bosnia and Herzegovina has used about 50% of the approved budget, which shows a clear focus on the further process of strengthening their own capacity and further development of the institutional framework. These indicators provide a course of action for the development of Bosnia and Herzegovina.

5.4. Allocation of Bulgaria from the EU structural funds

During the observed budgetary period the biggest resources were allocated in Poland (67 billion Euros). During the study period, Bulgaria allocated 6.8 billion Euros. (Figure 3.)

Figure 3: Allocation of EU cohesion funding



Source: European Commission, Directorate-General for Regional Policy

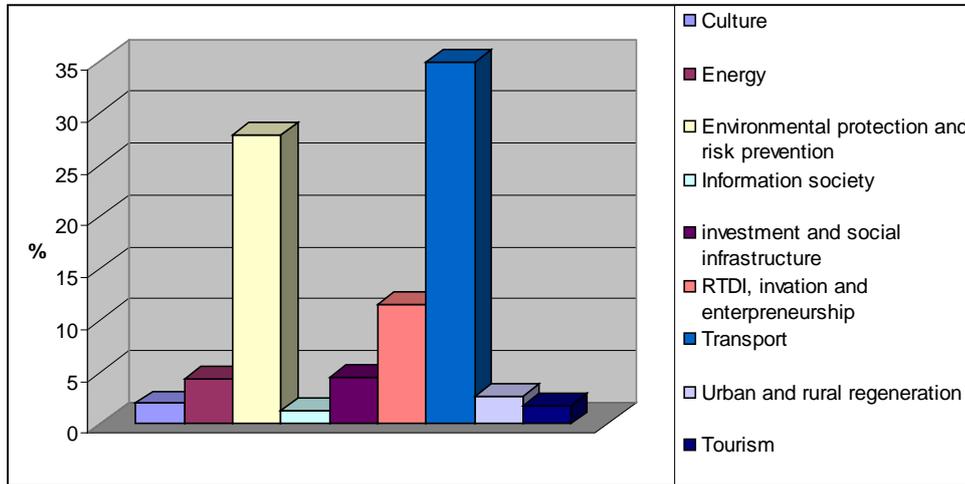
Bulgaria allocated majority of resources from ERDF.

Table 12: Allocated resources in Bulgaria from certain funds

Fund	Total
ERDF	3 205 132 218
ESF	1 185 459 863
Cohesion fund	2 283 036 163

Source: European Commission, Directorate-General for Regional Policy

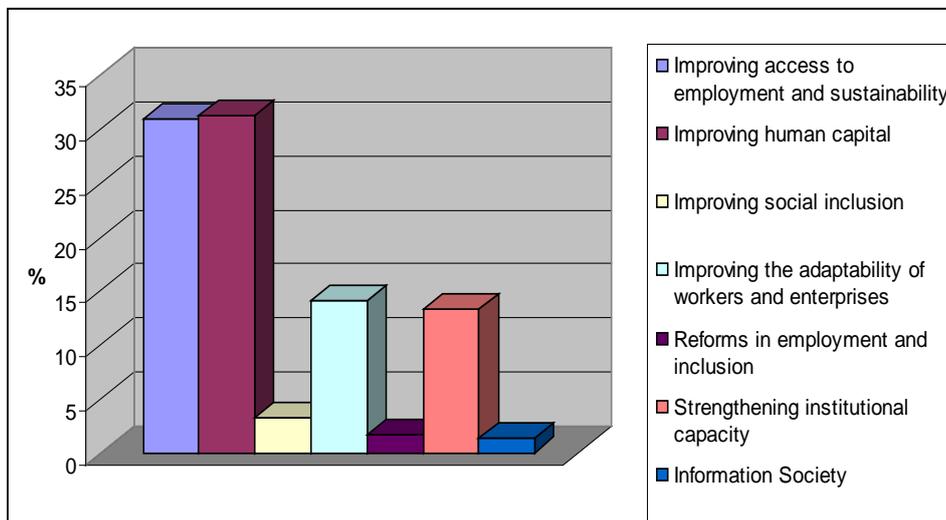
Figure 4: Areas of Bulgaria allocation from the ERDF and the Cohesion Fund



Source: European Commission, Directorate-General for Regional Policy

Observing the direction of funds from the ERDF and the Cohesion Fund, it is evident that Bulgaria is focused on the areas of transportation, environmental protection and risk prevention and RTDI, innovation and entrepreneurship.

Figure 5: Areas of Bulgaria allocation from the ESF



Source: European Commission, Directorate-General for Regional Policy

During the study period, Bulgaria's budget from ESF was focused in the areas of improving access to employment and inclusion, environmental protection and risk

prevention, increasing the adaptability of workers and enterprises and strengthening institutional capacity.

5.5. Allocation of Romania from the EU structural funds

In the period from 2007. to 2013., Romania allocated 21,5 billion Euros from the EU structural funds. (Table 13.)

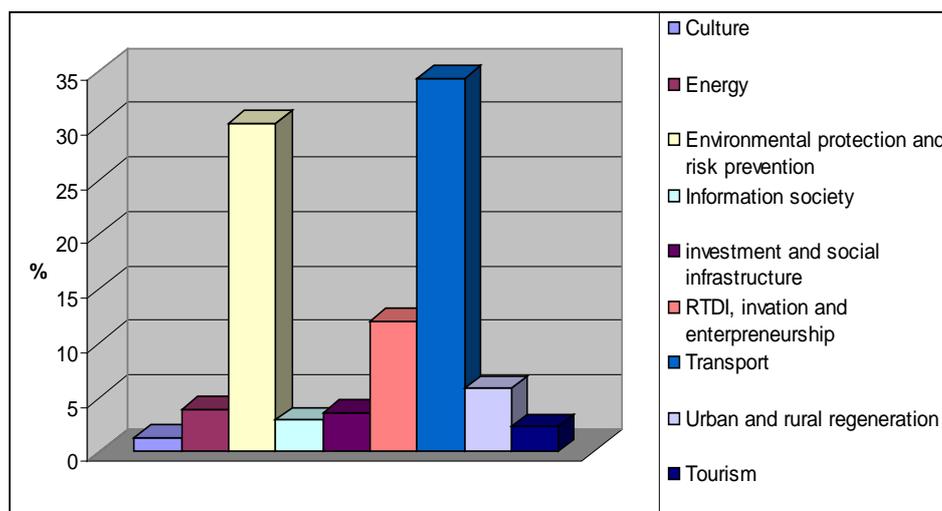
Table 13: Allocated resources in Romania from certain funds

Fund	Total
ERDF	7 739 813 871
ESF	3 684 147 618
Cohesion fund	6 552 423 028

Source: European Commission, Directorate-General for Regional Policy

Romania allocated majority of resources from ERDF.

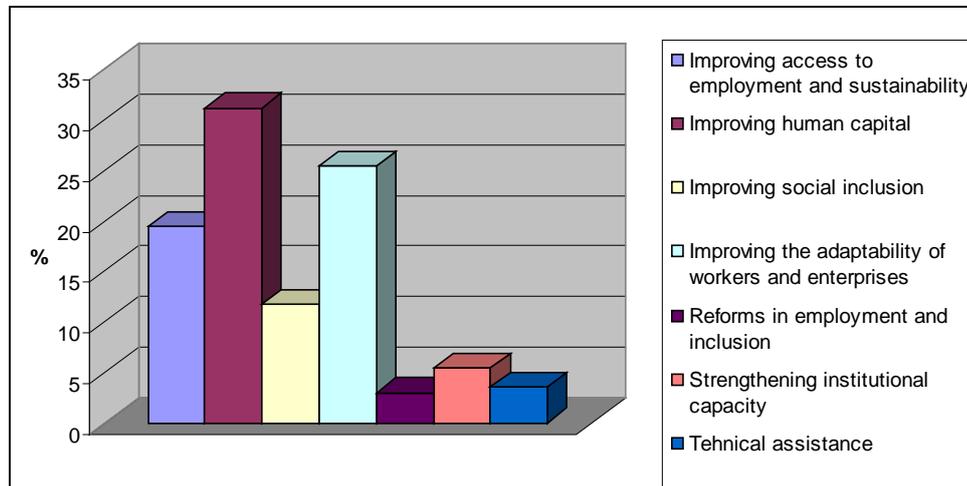
Figure 6: Areas of Romania allocation from the ERDF and Cohesion fund



Source: European Commission, Directorate-General for Regional Policy

Majority of resources in Romania were allocated for environmental protection and risk prevention, transportation and RTDI, innovation and entrepreneurship.

Figure 7: Areas of Romania allocation from the ESF



Source: European Commission, Directorate-General for Regional Policy

In the observed period, Romania's ESF resources are largely allocated to the areas of improving human resources, improving adaptability of workers and enterprises and the improvement of access to employment and sustainability.

5.6. Allocation of Slovenia from the EU structural funds

During the study period, Slovenia allocated 4,1. billion Euros from EU structural funds. (Table 14.)

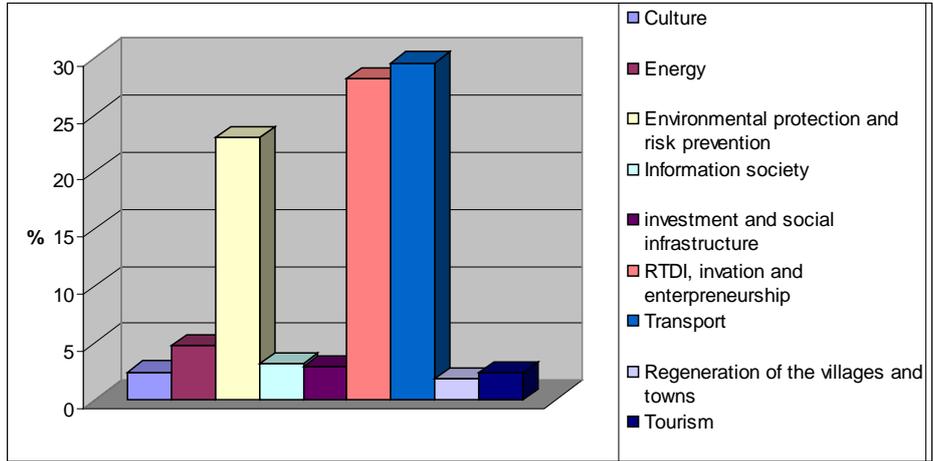
Table 14: Allocated resources in Slovenia from certain funds

Fund	Total
ERDF	1 933 779 408
ESF	755 699 370
Cohesion fund	1 411 569 858

Source: European Commission, Directorate-General for Regional Policy

Slovenia allocated majority of resources from ERDF.

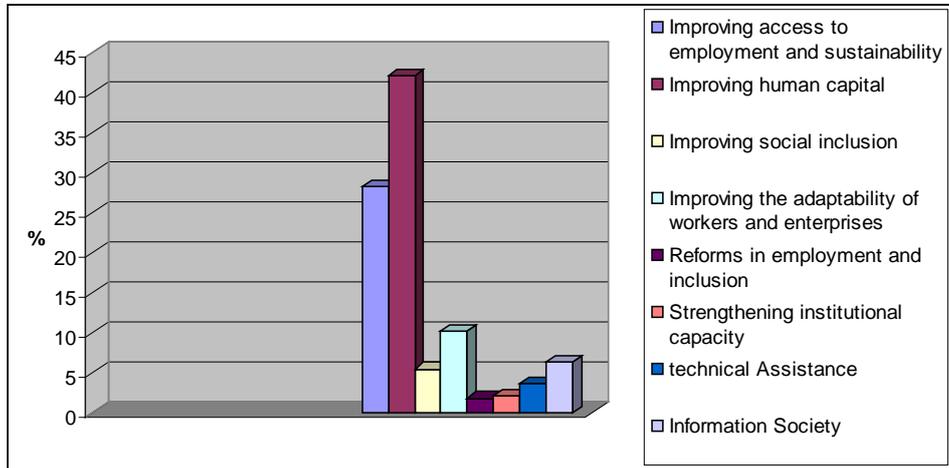
Figure 8: Areas of Slovenia allocation from the ERDF and the Cohesion Fund



Source: European Commission, Directorate-General for Regional Policy

Most of the funds from the ERDF and Cohesion Fund Slovenia allocated to RTDI-areas, innovation and entrepreneurship, transportation and environmental protection and risk prevention.

Figure 9: Areas of allocation of Slovenia from the ESF



Source: European Commission, Directorate-General for Regional Policy

Most funds allocated from the ESF, Slovenia has focused in the areas of sustainability and improving access to employment, improving human resources and increasing the adaptability of workers and enterprises.

6. CONCLUSION

Regional policy is an instrument of encouraging adaptation to new development and common policies, and includes financial support for projects of restructuring the problematic areas. Reducing regional disparities is an essential condition for every economic and political progress of the EU.

Financing of regional policy is conducted with three funds: European Regional Development Fund; European Social Fund; Cohesion Fund.

IPA is the main instrument for pre-accession assistance for candidate countries and potential candidates. IPA covers the period of 2007. - 2013. and it replaced previous assistance programs ISPA, PHARE and SAPARD.

The main objective of IPA is to help the candidate countries and potential candidate countries in the harmonization and implementation of the *acquis communautaire* and to prepare them for the use of structural funds.

REFERENCES

- Bajo, A., Alibegović, J. 2008. „Javne financije lokalnih i regionalnih vlasti“, Školska knjiga, Zagreb
- Belić, M. 2008. „EU fondovi – vodič kroz europske fondove 2008. – 2013.“, Novum, Zagreb.
- Bošnjak, S. 2009. „Kohezijska politika EU i instrumenti njena razvoja“, ekonomski fakultet Osijek, Osijek.
- Bridge, B. 2008. “European regional policy – boosting economic development”, Irish Times, Eight edition
- Dudek, C. 2008. „Coordinating regional policy in the EU“, department of political science, Hooystra University, Hempsted, NY.
- Europska Komisija, 2007. „Cohesian policy 2007. – 2013.“, komentari i tekstovi za javnost, Luxemburg.
Eurostat Regional Yearbook 2009., Eurostat, Europska Komisija
- Growing regions, growing Europe – 5th progress report on Economic and Social Cohesion, European Commission, Luxemburg, 2008.
<http://www.imo.hr/europa/publikacije/knjige/eurocd/3/eu3-8-1.html>
- Investing in Europe's future, 2010. „Fifth report on economic, social and territorial cohesion“, European Commission, Bruxelles, Belgium.
- Jae – Hong, C. 2007. „Implementation of a new 7-year regional EU policy“, E-Kiet, Industrial economic information.
- Kandžija, V., Cvečić, I. 2008. „Makrosustav Europske Unije“, Ekonomski Fakultet Sveučilišta u Rijeci, Rijeka.
- Moussis, N. 2009. „Access to European Union – Low, Economics, Policies“, European study service, Rixensort, Belgium.
- Omondi, R., Lo Pipero C., Napini, F. 2005. „A Guide to European Union Funding for NGOs- Accessing Europe's largest donor“, ECAS, Bruxelles, Belgium.
- Prokopova, D. 2006. „Focus on EU funds – Programmes, tools and government institutions“, seeeurope.net.

- Regional Policy – Inforegio, 2010. Results of the negotiations of Cohesion Policy strategies and programmes 2007. – 2013. in Bulgaria,
(dostupno na http://ec.europa.eu/regional-policy/sources/docgener/informat/info_en.htm).
- Regional Policy – Inforegio, 2010. Results of the negotiations of Cohesion Policy strategies and programmes 2007. – 2013. in Slovenia,
dostupno na http://ec.europa.eu/regional-policy/sources/docgener/informat/info_en.htm).
- Regional Policy – Inforegio, 2010. Results of the negotiations of Cohesion Policy strategies and programmes 2007. – 2013. in Estonia,
(dostupno na http://ec.europa.eu/regional-policy/sources/docgener/informat/info_en.htm).
- Regional Policy – Inforegio, 2010. Results of the negotiations of Cohesion Policy strategies and programmes 2007. – 2013. in Slovakia,
(dostupno na http://ec.europa.eu/regional-policy/sources/docgener/informat/info_en.htm).
- Regional Policy – Inforegio, 2010. Results of the negotiations of Cohesion Policy strategies and programmes 2007. – 2013. in Cyprus,
(dostupno na http://ec.europa.eu/regional-policy/sources/docgener/informat/info_en.htm).
- Regional Policy – Inforegio, 2010. Results of the negotiations of Cohesion Policy strategies and programmes 2007. – 2013. in Hungary,
(dostupno na http://ec.europa.eu/regional-policy/sources/docgener/informat/info_en.htm).
- Regional Policy – Inforegio, 2010. Results of the negotiations of Cohesion Policy strategies and programmes 2007. – 2013. in Czech Republic,
(dostupno na http://ec.europa.eu/regional-policy/sources/docgener/informat/info_en.htm).
- Regional Policy – Inforegio, 2010. Results of the negotiations of Cohesion Policy strategies and programmes 2007. – 2013. in Estonia,
(dostupno na http://ec.europa.eu/regional-policy/sources/docgener/informat/info_en.htm).
- Škabić – Kersan, I. 2005. „Koliko je Hrvatska spremna iskoristiti sredstva regionalne politike EU? – Primjer Istre“, Zaklada Friedrich Ebert, Zagreb.

Margarita Shivergueva
Nouvelle Université Bulgare, Sofia, Bulgaria

L'EXPÉRIENCE BULGARE : LA DIFFICILE ABSORPTION DES FONDS COMMUNAUTAIRES

RESUME

L'élargissement de l'Union européenne à dix nouveaux pays en 2004 a engendré une réforme importante de la politique de cohésion de l'UE. La Commission a voulu pour l'occasion simplifier les procédures et concentrer les aides sur les régions les plus pauvres (celles dont le PIB/tête est inférieur à 75% de la moyenne de l'UE). La ventilation des fonds pour chaque État Membre obéit à des variables qui sont la taille du pays, l'importance des disparités régionales ou encore les priorités nationales

Etat membre depuis 2007, la Bulgarie poursuit une transition rapide, accélérée par l'adhésion mais aujourd'hui freinée par la crise. Elle progresse dans la reprise de l'acquis malgré les difficultés économique et structurels.

Mots-clés: récession, la dette, la Grèce et de l'Europe du Sud

JEL Classification : 01

1. INTRODUCTION

La période de préadhésion était censée, fournir aux acteurs des différents niveaux administratifs le cadre qui leur apprendrait à décider ensemble ce qui valait le mieux pour tous, les aiderait à transformer la culture et les mentalités et à introduire un mode de gouvernance plus inclusif. L'UE entendait encourager l'articulation par le bas des identités et des intérêts communs.

l'UE a joué un rôle majeur dans la formulation de la politique régionale bulgare. La politique régionale de l'UE a permis une comparaison des approches, des instruments et des priorités du développement régionale.

.L'ouverture et la fermeture du chapitre 21, "Politique régionale et coordination des instruments structurels », furent un jalon important sur la route de la Bulgarie vers l'UE et un avant-goût des bénéfices escompter de l'adhésion. Ce chapitre ne contenait qu'un nombre réduit d'exigences concrètes de l'UE. Il recommandait vivement la Bulgarie de crée le cadre juridique «approprié» la mise en oeuvre des fonds structurels, de développer au niveau national la capacité de programmation et d'administration pour

l'intervention structurelle et de renforcer les dispositions relatives à la gestion financière et budgétaire. Il attendait également de la Bulgarie qu'elle applique le principe de partenariat et qu'elle définisse explicitement les missions de tous les organes et institutions impliqués dans l'élaboration et la réalisation des projets structurels et de cohésion (Commission, 2003a).

Les instruments structurels de l'UE ne se bornent pas à un soutien financier mais concernent également la répartition des pouvoirs et des compétences dans le domaine de la politique régionale. Le principe du partenariat exige une coordination verticale renforcée des différents niveaux territoriaux et une plus grande participation des autorités infra - étatiques à toutes les phases des projets de développement régional. Pour Hooghe (1996a, p. 89), le partenariat n'est pas seulement un principe politique mais encore un ensemble de structures organisationnelles censées [faciliter] la collaboration entre les différents niveaux administratifs créés durant le processus d'élaboration et de mise en oeuvre de la politique régionale de l'UE. De même, le principe de la programmation pluri annuelle des mesures de développement régional impose aux acteurs issus des différents niveaux territoriaux de se rencontrer et de débattre ensemble des objectifs et des moyens de les réaliser.

Le document intitulé "Elargissement de l'Union européenne : guide des négociations chapitre par chapitre (Commission, 2003a) précisait que la Bulgarie devait établir, en accord avec la Commission, une classification NUTS (Nomenclature des unités territoriales statistiques) provisoire pour la mise en oeuvre des fonds structurels. A des fins statistiques, le niveau NUTS II était le plus approprié pour évaluer les inégalités socio-économiques et élaborer les projets destinés à être financés par les fonds structurels. L'on supposait que la perspective de dotations significatives de l'UE au niveau NUTS II encouragerait la Bulgarie réorganiser sa division administrative et territoriale en créant l'échelon administratif régional correspondant.

En Bulgarie on peut clairement distinguer trois séries d'impulsions de l'Union européenne pendant les années 2004-2005 :

1. La nécessité de s'adapter au système d'allocation financière de l'UE en remaniant l'organisation administrative et territoriale pour qu'elle concorde avec la classification NUTS ;
2. L'obligation de mener une politique nationale de développement régional car l'argent de l'UE n'est versé qu'en complément de projets nationaux existants et doit être programmé pour plusieurs années ;
3. La participation des acteurs infranationaux · la programmation de la politique régionale qui est une condition préalable pour percevoir des fonds de l'UE et une composante obligée de la bonne gouvernance.

En 1999, la toute première loi jamais adoptée en Bulgarie sur le développement régional fut dans le cadre d'un « paquet » législatif qui a Régionalisation et politique régionale en Bulgarie 95 restauré les 28 entités intermédiaires de 1959 et les a

dénommés oblasti (départements). L'oblast équivalait à une unité territoriale de niveau NUTS III ou les services de l'Etat étaient déconcentrés mais OÙ aucun organe n'était directement élu. Les gouverneurs de département étaient nommés par le Conseil des ministres et leurs activités coordonnées par le ministre du Développement régional et des travaux publics. Les services administratifs du département, dont le personnel était composé de fonctionnaires, dépendaient entièrement des transferts du budget de l'Etat car, contrairement aux municipalités, ils ne disposaient d'aucun bien ou source de revenus propres. Etant donné leur taille réduite, les 28 départements n'ont pas été compatibles avec les objectifs de la politique régionale et du financement structurel de l'UE. Dans le but de planifier et d'organiser la politique de développement régional, six régions de planification (rajoni za planirane), qui regroupaient plusieurs départements, ont été créées au niveau NUTS II.

2. LA SITUATION ÉCONOMIQUE EN BULGARIE APRÈS L'ADHÉSION

En Bulgarie, après 2007, la situation macroéconomique se caractérise avec une stabilité financière. Pendant la récession qui a touché le pays en 2009, le PIB aurait chuté de 5,5 % (4,9 % précédemment), contraction comparable à la moyenne régionale. 2010 reste cependant comme une année de croissance zéro en moyenne (+ 0,2 %). 2011 est bien, elle, l'année de la reprise avec une croissance de 1,2 %, selon les prévisions 2012 pose les bases d'une croissance tirée par les exportations.

Selon la Banque centrale Bulgare (les exportations progressent de 33 % sur l'année 2010 après avoir chuté de 23 % en 2009. Les importations augmentent elles de 13 % alors qu'elles avaient baissé de plus de 33 % en 2009. La progression des exportations se poursuit début 2011 et pendant le 2012. Elle pourrait, sur l'ensemble de l'année, permettre une reprise plus forte de l'économie en même temps qu'un nouveau rééquilibrage de la balance courante.

Selon la Banque centrale (BNB Annual Report, 2011, pp 16-26), en 2011, le déficit commercial (FAB/FAB) a été ramené à 2,4 Md EUR (6,7 % PIB estimé) et le déficit courant ne représente plus que 0,8 % du PIB (plus de 23 % en 2008, 9,9 % en 2009). La reprise s'accompagne néanmoins d'un regain inflationniste. Selon l'Institut des statistiques, l'inflation moyenne sur 2011 est de 3 % (contre 2,5 % en 2010 et 7 % en 2009). 4,4 % annuels sont prévus en 2012. La hausse est essentiellement due à l'augmentation des prix des loisirs, ainsi que de ceux du transport et des produits alimentaires.

Les positions bulgares en matière de politique économique, après 2010 se précisent, vers le débat sur la « gouvernance économique européenne ».

En 2010, le déficit budgétaire s'élève (base de trésorerie) à 2,8 Md BGN (3,9 % du PIB). Le déficit 2011 est à 2,5 % du PIB.

En matière budgétaire, le Programme de convergence bulgare envisage une réduction progressive du déficit budgétaire à 1,5 % du PIB en 2012, 1 % en 2013, 0,5 % en 2014.

La dette de l'Etat atteint 5,2 Md EUR (13,6 % du PIB) fin février 2012 (Economic Review, Issue 2/2012, Bulgarian National Bank, pp.6-12), (Les garanties de l'Etat atteignent 617,3 M EUR (1,6 % du PIB). Par ailleurs, au débat européen sur la gouvernance économique correspond en miroir un débat intérieur sur la surveillance budgétaire nationale.

Un projet de « Pacte de stabilité financière » (Fiscal Board » est soumis au Parlement au printemps 2011.

Ce pacte prévoit notamment le plafonnement des dépenses de l'Etat à 37 % du PIB, la limitation du déficit budgétaire à 3 % et de la dette publique à 40 % du PIB et la soumission de toute modification de la fiscalité directe à un débat public et à une majorité qualifiée de 160 votes (deux tiers des députés).

D'autre part, le débat sur la directive introduisant une base commune consolidée pour l'IS est un enjeu stratégique majeur pour la Bulgarie, dont l'économie dépend fortement des flux d'IDE. Or, selon la dernière Assessment letter pour la Banque mondiale du FMI (début mars 2012), si la position extérieure du pays continue de s'améliorer, la crise a profondément tari les flux de capitaux (certes, notamment, dans le secteur des biens non échangeables). Selon la Banque centrale, les flux d'IDE ont enregistré en 2011 une nouvelle et forte chute de 58,6 % à 1,4 Md EUR (3,8 % du PIB) – chiffres inférieurs aux prévisions officielles (1,5 Md EUR et 4,1 % du PIB selon le Programme national de réformes 2011).

La demande intérieure reste encore freinée par les bilans des ménages et des entreprises. Le contexte inflationniste impacte les ménages au moins par deux canaux, carburants et produits alimentaires.

Les salaires (52 % du revenu total) et les retraites (30,6 %) demeurent les principales sources de revenu. Par ailleurs, le taux de chômage progresse de 3,3 points au quatrième trimestre 2011, à 11,2 %. Le taux d'emploi diminue de 2,2 points atteignant 59 % de la population en âge de travailler (3,4 millions de personnes fin décembre 2011). Le chômage chez les jeunes de 15 à 24 ans demeure élevé, s'établissant à 26,5 %. Le taux de chômage de longue durée augmente de 2,5 points, à 5,9 %.

Il faut néanmoins remarquer que le salaire moyen mensuel brut enregistre une progression quasi-continue sur l'année 2011, atteignant 342 EUR au quatrième trimestre (+ 4,9 % d'un trimestre à l'autre,+ 10 % sur un an).

En outre, selon Eurostat, la consommation finale des ménages contribuerait à nouveau à la croissance en 2013. Elle progresserait de 2,2 % puis 3,8 % en 2012 (après avoir chuté de 7,6 % en 2009 et baissé de 1,2 % en 2010). Enfin, dans leurs récentes hypothèses macroéconomiques (2012-2014) soutenant le Programme de convergence comme le Programme national de réforme, les autorités anticipent une réduction progressive du taux de chômage.

Le taux de chômage moyen est estimé à 10 % en 2011, le taux d'emploi progressant de 0,2 % fin 2011. En 2012-2014, le ministère des Finances prévoit « une accélération de

la productivité combinée à une croissance modérée du taux d'emploi, le taux de chômage étant projeté à 8,9 % en 2014 », (<http://www.minfin.bg/en/statistics/1>).

Entrée dans l'Union européenne (UE) en 2007, la Bulgarie peut pour la première fois bénéficier des fonds communautaires au titre de la politique de cohésion. Après la transition du pays d'une économie centralisée vers une économie de marché, les politiques nationales dans de nombreux secteurs étaient toujours inexistantes. Toutefois, le processus de négociation a permis de combler cette lacune.

Fin juillet 2008, la Commission a suspendu le versement des fonds de préadhésion restants et menace la Bulgarie de la priver des aides structurelles en raison de la piètre gestion des autorités nationales et de la corruption endémique. Cette décision montre que, malgré l'assouplissement de la conditionnalité l'UE peut encore exercer des pressions sur la Bulgarie. Le risque de voir les bénéfices prévisibles de l'appartenance à l'UE échapper à son pays incitera-t-il le gouvernement bulgare à renforcer les niveaux infra-étatiques et à réellement s'engager dans un partenariat avec tous les acteurs ou le difficile exercice du contrôle financier et la faiblesse des capacités administratives à tous les niveaux conduiront-ils à recentraliser la planification, la programmation et la gestion des fonds à l'échelon régional ?

Le dialogue entre la Commission et les autorités bulgares a débouché sur un cadre de référence stratégique national (CRSN pour la Bulgarie, qui a identifié les priorités clés devant bénéficier du soutien financier de la politique de cohésion pour la période de programmation 2007-2013

La cohérence entre les priorités communautaires et les besoins réels du pays a été respectée, par exemple, dans les secteurs du transport et de l'environnement. Une part considérable des Fonds a également été allouée au développement des ressources humaines et de la capacité administrative du pays.

Les objectifs centraux du CRSN sont de garantir une croissance économique forte et durable, stimuler la compétitivité de l'économie, développer le capital humain, garantir un niveau supérieur d'emplois et de revenus, et faciliter une meilleure intégration sociale.

La Bulgarie a transposé les priorités stratégiques définies dans le CRSN dans sept programmes opérationnels:

- capacité administrative,
- compétitivité,
- environnement,
- développement des ressources humaines,
- développement régional,
- transport et
- assistance technique.

De plus, la Bulgarie participe à deux programmes de coopération transfrontalière, à un programme de coopération transnationale ainsi qu'à la coopération interrégionale entre tous les États membres.

Tableau 1: Les fonds structurels européens: absorption en Bulgarie

<i>Programme Opérationnel</i>	<i>Budget total (en M €)</i>	<i>Part UE (en M €)</i>	<i>% PO du budget total</i>	<i>Budget engagé (en M €)</i>	<i>% Engagé dans part UE</i>	<i>Budget dépensé (en M €)</i>	<i>% Dépensé dans part UE</i>
Transport	2003.5	1624.5	24	198.4	12.2	35.8	2.2
Environnement	1800.8	1466.4	22	319.6	21.8	39.7	2.7
Dévtpt régional	1601.3	1361.1	21	404.3	29.7	26.4	1.9
Ressources humaines	1213.9	1031.8	15	216.5	21.0	33.8	3.3
Compétitivité	1162.2	987.9	15	327.5	33.2	3.9	0.4
Capacité administrative	180.8	153.7	2	60.9	39.6	32.2	20.9
Aide technique	56.8	48.3	1	10.9	22.6	2.4	4.9
TOTAL	8019.2	6673.6	100	1538.2	23.0	174.2	2.6

Source : eufunds.bg

La Bulgarie, comme d'autres États membres, a reçu une aide financière et technique considérable de l'Union européenne au cours de la période de préadhésion et remplit les conditions requises pour bénéficier d'un niveau élevé de soutien financier durant la période s'étendant jusqu'en 2013 (6,674 milliards d'EUR au titre des seuls Fonds structurels).

Alors que la mise en œuvre des Fonds structurels n'en est encore qu'à un stade initial en Bulgarie, les montants reçus au cours de la période de préadhésion (au titre des programmes PHARE, ISPA et SAPARD, notamment) ont déjà été engagés. Outre les retards administratifs communs à de nombreux États membres, la Commission a eu connaissance de certaines insuffisances dans les systèmes de contrôle utilisés en Bulgarie et de plusieurs cas de fraude et d'irrégularités.

Les autorités bulgares ont conscience de ces problèmes et ont engagé des mesures afin d'y remédier, notamment en nommant un vice-premier ministre (2008-2009) chargé de superviser la gestion des fonds communautaires dans le pays. Étant donné la responsabilité que lui confère le traité en ce qui concerne l'exécution du budget et la protection des intérêts financiers de l'UE, la Commission a décidé de rendre compte des problèmes de mise en œuvre que rencontre la Bulgarie au Parlement européen et au Conseil, qui constituent l'autorité budgétaire de l'UE.

La nomination, en mars 2010 de nouveau cabinet, d'un ministre chargé des fonds européens, a permis de relancer les réformes indispensables à accélérer le lancement d'appels d'offres et optimiser la gestion des programmes tout en assurant une meilleure

coordination interministérielle du suivi des projets après l'identification des « goulots d'étranglement » et des insuffisances des capacités administratives dans les secteurs prioritaires : routier, eau, ferroviaire et compétitivité.

Dès 2010, avec le lancement de grands projets routiers, le démarrage de l'instrument JEREMIE et l'engagement des institutions financières internationales, l'effort porte ses fruits et le taux d'absorption se redresse.

Mi 2011, plus de 13 % des fonds ont fait l'objet de paiements certifiés et près de 47 % ont été engagés. De nombreux appels d'offres sont en cours pour le réseau autoroutier, le ferroviaire, l'usine de traitement des déchets de la capitale, la phase 2 du métro de Sofia et les transports urbains intégrés.

Cela augure favorablement d'une nouvelle progression de la consommation avant la fin 2012 dans le sens des objectifs ambitieux fixés par le ministre en charge des fonds européens d'atteindre un taux d'absorption de 35 à 40 % fin 2012 et de 55 % en 2013.

Le débat sur les prochaines perspectives financières 2014 – 2020 est lancé, dans lequel la Bulgarie souhaite que soient maintenus le niveau des fonds de cohésion et un équilibre dans leur répartition entre la poursuite du développement des infrastructures (autoroutes, notamment) et le financement des objectifs Europe 2020 en matière d'environnement et d'innovation.

3. FACE AUX PROBLÈMES - Réduire les disparités régionales

Les disparités régionales en Bulgarie atteignent des niveaux relativement faibles en comparaison avec les autres États membres de l'UE. Parmi les six régions composant le pays, la plus en retard en termes d'activité économique et de qualité des infrastructures est celle du Nord-Ouest. Celle du Sud-Ouest est la plus avancée car c'est là que se trouve la capitale, Sofia, où se concentrent l'activité économique du pays, les écoles et les universités, ainsi que l'administration gouvernementale. Si l'on excluait Sofia de cette région, les disparités interrégionales seraient relativement faibles. Afin d'assurer un développement territorial plus équilibré, le CRSN pour 2007-2013 vise à encourager le développement urbain intégré, des améliorations en matière de capital humain et d'infrastructures de base dans les zones les moins peuplées, la création et la modernisation des systèmes de transport, les actions de formation, le développement du tourisme, le développement économique local et la préservation du patrimoine naturel et culturel.

La Bulgarie s'est engagée à investir plus de la moitié de l'aide allouée au titre des Fonds structurels dans les priorités directement liées à son programme national de réforme en reconnaissance de l'importance du rôle que la politique de cohésion joue dans la réalisation des objectifs du programme de Lisbonne. Par conséquent, les aspects fondamentaux du programme national de réforme reflètent les objectifs du CRSN et les éléments associés de croissance et d'emploi, en particulier l'esprit d'entreprise, la recherche, le développement et l'innovation (RDI), le développement durable, l'éducation et la formation. L'impact escompté de ces investissements des Fonds est une croissance du PIB de 51 % de la moyenne de l'UE d'ici à 2013, une augmentation

du taux d'emploi de 55,8 % (en 2005) à 64 %, ainsi qu'une augmentation des dépenses dans la R & D de 0,4 % à 1,15 % du PIB d'ici à 2013.

Améliorer l'infrastructure de base des transports et, par la même, l'accessibilité de l'ensemble de la Bulgarie est une des principales priorités nationales en raison de l'important déficit dans ce secteur.

La contribution communautaire dans ce domaine s'élève à près de 2 milliards d'euros, ce qui représente 30 % de l'enveloppe financière. Les négociations ont eu, entre autres, pour résultat clé la mise en avant de projets prioritaires dans le cadre des réseaux transeuropéens de transport (RTE-T). Par exemple, les investissements de la politique de cohésion devraient financer la construction de 248 km d'autoroutes RTE-T.

Plus de 2 100 km de routes et 780 km de voies ferrées seront également modernisés avec l'aide des Fonds. Une attention particulière sera également portée aux investissements immatériels en matière d'infrastructures de transport, comme les systèmes de logistique et d'information de gestion, les nouveaux règlements opérationnels et les questions de maintenance. La Bulgarie s'est également engagée à présenter un nouveau plan directeur des transports nationaux.

La stratégie nationale de cohésion bulgare reconnaît l'importance cruciale de l'investissement dans la recherche et l'innovation en tant que secteur clé pour le développement durable à long terme du pays.

Quelque 850 millions d'euros (près de 13 % de la contribution communautaire) seront alloués à cette priorité. Les Fonds devraient générer 110 projets de coopération entre organismes de recherche et entreprises, qui devraient aboutir à la création de quelque 300 emplois dans ce secteur.

Encourager l'esprit d'entreprise dans les PME, soutenir les jeunes sociétés et les pôles d'entreprises et introduire un mode de gestion moderne et de production durable sont d'importantes priorités pour le développement de l'économie bulgare, pour lesquelles plus de 320 millions d'euros (près de 5 % de la contribution communautaire) ont été réservés. Le pays s'est aussi résolument engagé à recourir aux instruments d'ingénierie financière par l'intermédiaire de l'initiative JEREMIE, qui bénéficie d'une allocation de près de 200 millions d'euros. Ces fonds devraient soutenir au moins 1 100 projets, ce qui devrait générer quelque 570 millions d'euros d'investissements supplémentaires.

Créer une infrastructure moderne des technologies de l'information et de la communication (TIC) est une autre priorité stratégique.

Quelque 89 millions d'euros des Fonds structurels seront investis dans des réseaux à large bande modernes et des services en ligne à destination des entreprises et des citoyens, ce qui permettra à 9 % supplémentaires de la population de bénéficier d'un accès à large bande moderne.

La mondialisation et les changements structurels impliquent que les entreprises et leur main-d'oeuvre soient capables de s'adapter rapidement et avec succès aux

changements. Le développement économique rapide que la Bulgarie a connu ces dernières années renforce cette pression.

Conscientes du caractère dynamique du marché de l'emploi et de ses besoins changeants, les parties prenantes aux négociations ont convenu d'affecter 201 millions d'euros à l'amélioration de la capacité d'adaptation des travailleurs à travers des investissements dans les formations de reconversion, la formation continue et sur le lieu de travail ainsi que dans diverses mesures visant à encourager les citoyens à travailler plus longtemps. Le montant alloué aux mesures de renforcement de la capacité d'adaptation de la main-d'œuvre représente environ 20 % du total des fonds disponibles affectés au développement des ressources humaines pour la période de programmation.

Les négociations ont mis en évidence l'importance du développement des ressources humaines pour le pays, et ont débouché sur une allocation de 371,4 millions d'euros au titre de tous les Fonds de convergence disponibles, à investir dans le capital humain.

Les besoins de différents groupes ont été analysés et abordés: les travailleurs, les chômeurs, les employeurs, les femmes, les jeunes, les chômeurs de longue durée, les groupes défavorisés, etc., bénéficieront du programme opérationnel pour le développement des ressources humaines.

Les activités envisagées ont pour objectif de réduire encore plus le taux de chômage, d'augmenter l'activité et l'emploi sur le marché du travail et d'améliorer la productivité grâce à une main-d'œuvre mieux qualifiée. Le processus de négociation a également souligné l'importance de la formation pour le développement du capital humain et la nécessité d'introduire des réformes considérables dans le secteur de l'enseignement en relation avec le processus de Lisbonne.

3.1. Évolution démographique et marchés du travail

La Bulgarie est un des États de l'Union dont le développement économique est le plus vulnérable à une évolution démographique défavorable. La population n'a cessé de décroître au cours des dernières décennies, et le phénomène est particulièrement évident aujourd'hui. Les négociations ont identifié des moyens d'inclure toutes les couches de la société dans le marché de l'emploi et de stimuler le secteur de l'enseignement et le secteur social grâce à un budget de plus de 374 millions d'euros alloués à cet effet. Des actions spécifiques se concentreront sur la promotion d'un marché de l'emploi favorisant l'inclusion, répondant aux besoins des femmes, des personnes handicapées et des personnes issues de groupes minoritaires.

Des mesures d'inclusion sociale sont prévues pour la communauté rom et pour les personnes ayant des besoins spécifiques. L'égalité des sexes est également encouragée comme un principe horizontal applicable dans tous les domaines.

3.2. Relever les défis du développement durable

Le processus de négociation a permis d'identifier les priorités clés de financement communautaire en matière d'infrastructures environnementales en ce qui concerne la collecte et le traitement des eaux usées et des déchets, les mesures de prévention des catastrophes naturelles (inondations) et les réseaux de distribution d'énergie et de gaz durables.

En tout, les Fonds investiront 2,8 milliards d'euros (soit 42 % de leurs allocations totales) dans des mesures relatives aux secteurs de l'environnement, de la prévention des risques et de l'énergie, qui aideront la Bulgarie à faire face à ses obligations liées à l'acquis en matière d'environnement. Quelque 1,8 million de personnes supplémentaires bénéficieront de projets dans le domaine des eaux usées.

Une part de ce montant s'élevant à 808 millions d'euros (12 %) servira directement à relever les défis du changement climatique, tandis que 243 millions d'euros (3,6 %) seront consacrés à des projets relatifs aux énergies renouvelables et à l'efficacité énergétique.

3.3. Renforcer la gouvernance et le partenariat

En collaboration avec l'Association nationale des communes, le gouvernement bulgare a pris des initiatives pour renforcer la capacité des autorités régionales et locales. Une stratégie de décentralisation mise en place pour la période 2006-2015 et le plan d'action qui l'accompagne devraient renforcer la gouvernance territoriale. Cette stratégie établit des lignes directrices pour la redistribution des responsabilités et la répartition des ressources financières aux niveaux central, régional et municipal, qui devraient mener à une distribution plus efficace de services publics de meilleure qualité aux citoyens.

Une administration de l'État efficace et responsable est un facteur fondamental de la croissance socioéconomique. La réforme de l'administration (loi sur la fonction publique) et la formation d'un nouveau ministère de l'administration de l'État et de la réforme administrative ont pour objectif d'aborder ces problèmes et de moderniser l'administration bulgare. Les initiatives de réforme administrative nationale concernent tous les niveaux de l'administration de l'État: administrations aux niveaux central, local et des circonscriptions, organes judiciaires et législatifs. Le nouveau cadre réglementaire pour la politique de cohésion a permis d'inclure des actions pour améliorer l'efficacité de leur administration. D'importants montants alloués à l'assistance technique seront dépensés dans le développement des capacités des autorités responsables de la gestion de l'aide des Fonds structurels ainsi que des municipalités, qui sont des bénéficiaires majeurs des projets des Fonds structurels.

Ces actions se concentreront sur le renforcement des capacités institutionnelles de l'administration publique et du secteur public, l'introduction des principes de bonne gouvernance dans les secteurs de l'administration et de la justice, la modernisation de la gestion des ressources humaines au sein des structures administratives, judiciaires et civiles, l'amélioration des qualifications et compétences des fonctionnaires et des

magistrats, l'amélioration de la qualité des services administratifs et le développement de l'administration en ligne.

L'initiative JASPERS aidera les autorités bulgares à préparer les projets importants dont la mise en oeuvre sera financée par les Fonds.

Les déterminants de la capacité d'absorption

Au final, les déterminants majeurs peuvent être identifiés:

- Le développement de la capacité administrative. Un développement efficace, continu et durable de la capacité administrative repose sur une fonction publique stable et une bonne gestion des ressources humaines. Une fonction publique stable, compétente et indépendante est essentielle à l'élaboration d'une approche pragmatique de la mise en oeuvre du financement européen, ce qui implique que le jugement professionnel doit prévaloir sur les règles et les procédures complexes lorsqu'il s'agit de prendre les décisions qui aboutiront aux meilleurs résultats. Une capacité administrative ad hoc est la clé d'une intégration réussie et, par conséquent, d'une bonne gestion des Fonds structurels et de cohésion. Si des conditions sont posées de façon cohérente (faire dépendre l'octroi de fonds d'une réelle amélioration de la capacité administrative), les Fonds structurels et de cohésion seront probablement plus efficaces.
- Transparence et responsabilité. Il faut mettre en place une culture, dans laquelle la société civile, y compris les organisations non gouvernementales et le secteur privé, demande des comptes aux gouvernements. L'aide de l'UE prévoit un soutien au développement de la société civile.
- Gestion et contrôle. Une distinction des fonctions et bonnes structures, des procédures et des responsabilités claires, ainsi que des contrôles efficaces, sont la pierre angulaire d'une mise en oeuvre correcte de l'aide. Les activités et résultats relatifs aux projets ne constituent, en soi, pas un indicateur de réussite. L'aboutissement d'un projet devrait plutôt être évalué en fonction des changements observés dans les performances ou le comportement de groupes cibles, d'institutions ou de systèmes mis en place par les projets. Par ailleurs, il convient d'assurer la pérennité et, idéalement, le développement de ces changements une fois l'aide extérieure arrivée à son terme. Pour ce faire, le contrôle des résultats doit se poursuivre pendant une certaine durée après la fin de la mise en oeuvre du projet. En ce qui concerne les exigences en matière de présentation de rapports, il convient de garder un juste milieu entre la qualité et la quantité.
- Le montant des fonds alloués, en tenant compte de la répartition régionale et sectorielle.
- La structure de gouvernance au niveau du programme et du projet (expérience passée, capacité des autorités locales, centrales et régionales de préparer plans et programmes à temps et de pouvoir fournir la documentation demandée).

- La situation publique et privée au niveau du cofinancement (capacité à cofinancer les projets, planifier et garantir ces contributions sur une base pluriannuelle).

Quelles mesures la Bulgarie doit-elle prendre de toute urgence pour revenir sur la bonne voie?

Les fonds alloués par l'UE à la Bulgarie sont l'expression concrète de la solidarité de l'Union envers les citoyens bulgares. L'UE encourage la Bulgarie à agir d'urgence pour assurer la mise en œuvre des fonds, qui sont destinés à favoriser la cohésion sociale, à améliorer le développement régional et à renforcer la stabilité et les performances économiques globales du pays.

L'UE recommande à la Bulgarie de prendre les mesures suivantes: sa capacité administrative à gérer les fonds de l'UE doit être renforcée en assurant la stabilité du personnel, en le formant et en le dotant des compétences techniques nécessaires. Les conflits d'intérêt potentiels doivent être évités lors des nominations à des postes d'encadrement; les conflits d'intérêt dans la gestion des fonds doivent être exclus; le contrôle et la transparence des procédures de marchés publics doivent être améliorés; des contrôles et audits sur place doivent être réalisés périodiquement pour l'ensemble des programmes de financement; les cas d'irrégularités et de fraude doivent être signalés à la Commission sans délai et sur la base de critères clairement établis; des actions destinées à prévenir les violations de la confidentialité doivent être mises en œuvre et des mesures défensives, correctives ou disciplinaires doivent être prises rapidement lorsqu'il y a lieu; la coordination entre les ministères, entre les différentes parties prenantes et entre les autorités centrales, régionales et locales doit être améliorée.

4. CONCLUSION

Les critiques émises par L'UE et par la société bulgare au sujet de la faible absorption des fonds européens, s'appliquent tout autant aux fonds structurels qu'aux fonds de cohésion. La Bulgarie devra donc renforcer les capacités de son administration en formant les personnels concernés. Elle devra éviter les conflits d'intérêt qui empêchent les nominations à des postes d'encadrement ainsi qu'une gestion d'ensemble des fonds. Elle devra améliorer la transparence des procédures publiques d'achat, et procéder à des audits et à des contrôles sur le terrain. Elle a donc fort à faire et doit agir de toute urgence pour remédier à ces déficiences.

L'enjeu est de taille si l'on veut que les citoyens bulgares commencent à sentir les effets bénéfiques des investissements réalisés au travers des différents programmes. On ne saurait trop insister sur l'impact des fonds européens qui permettraient de combattre la récession économique dans l'État membre le plus pauvre de l'Union.

Détermination et volonté politique sont désormais les mots d'ordre – d'autant qu'il faut trois à quatre ans pour préparer un projet et que les autorités bulgares viennent de s'atteler aux programmes prévus sur la période 2014-2020..

Lors d'une récente interview, le ministre en charge des crédits européens annonçait pour fin mai-début juin 2011 des changements visant à faire tomber les barrières bureaucratiques. Il préconisait une simplification des procédures de candidature à un programme et une harmonisation des règlements existants. Autre mesure annoncée : une publication plus rapide des informations relatives aux financements afin de donner un coup de pouce aux entreprises, aux organisations non gouvernementales (ONG) et aux municipalités.

RÉFÉRENCES

Bailey D. & De Propis L. (2002), † The 1988 Reform of the European Structural Funds: Entitlement or Empowerment?‡ Journal of European Public Policy, Vol. 9, n- 3, pp. 408-428.

Borzel T.A. (2001), † Europeanization and Territorial Institutional Change ‡, in M. Green Cowles, J. Caporaso & T. Risse, eds., Europeanization and Domestic Change: Transforming Europe, Ithaca and London: Cornell University Press, pp. 137-158.

BNB Annual Report • 2011, Bulgarian National Bank, Sofia.

CMRB (Conseil des ministres de la République de Bulgarie) (1999), Nacionalen Plan za regionalno razvitie za perioda 2000-2006 (Plan national de développement régionale pour la période 2000-2006), PMS n- 208, DV br. 106, 03.12.

CMRB (2005), National Strategy for Regional Development 2005-2015; www.mrrb.government.bg.

Commission (2003a), Enlargement of the European Union: Guide to Negotiations Chapter by Chapter, Brussels: DG Enlargement; [http:// ec.europa.eu/enlargement/archives/enlargement_process/future_prospects/negotiations/eu10_bulgaria_romania/chapters/index_en.htm](http://ec.europa.eu/enlargement/archives/enlargement_process/future_prospects/negotiations/eu10_bulgaria_romania/chapters/index_en.htm)

Commission (2003b), Regular Report on Bulgaria's Progress towards Accession, Brussels: The European Commission.

Commission (2004), A New Partnership for Cohesion: Convergence, Competitiveness, Cooperation. Third Report on Economic and Social Cohesion, Luxembourg: Office for Official Publications of the European Communities.

Convergence Programme (2012-2015). Republic of Bulgaria. Ministry of Finance. April 2012, Sofia, Bulgaria

Economic Review, Issue 2/2012, Bulgarian National Bank, Sofia.2012

Government Debt Monthly Bulletin September 2012, <http://www.minfin.bg/en/statistics/1>

Hooghe L. (1996a), † Building a Europe with the Regions: The Changing Role of the European Commission ‡, in L. Hooghe, ed., Cohesion Policy and European Integration: Building Multi-level Governance, Oxford: Clarendon Press, pp. 89-128.

Kohler-Koch B. & Eising R. (1999), The Transformation of Governance in the European Union, London: Routledge.

Larsson T. (2000), The Internal Enlargement of the European Union and the Surplus of the Intermediate Level of Governance †, Eipascope, 2, pp. 18-26..

Marinov V. & Garnizov V. (2006), Assessment of Municipal and District Capacities for Participation in EU Structural and Cohesion Funds Absorption, Sofia: UNDP.

Stoyanov Y. (2003), † Regional Policy in Bulgaria in the Context of EU Regional Policy †, Public Administration – Publication of the Bulgarian Institute for Public Administration and European Integration, 3, pp. 57-69.

THE BULGARIAN ECONOMY IN 2007. Annual report.<http://www.minfin.bg/document/9064:1>

Jamila Jaganjac

University,, Vitez,, Vitez, Bosnia and Herzegovina

USE OF PRE-ACCESSION FUNDS AND EXPERIENCES IN IMPLEMENTATION OF WB COUNTRIES

ABSTRACT

The management of use of pre-accession EU funds in Bosnia and Herzegovina is centralized, which includes funds management, in terms of contracting and monitoring the implementation. It is performed by the EU Delegation. Directorate for European Integration (DEI) is the European integration coordinator at the state level (i.e. horizontal coordination) and between state institutions and entities (i.e. vertical coordination). Among other things, DEI coordinates financial assistance of the European Union, and the director is also the National Coordinator for IPA and pre-accession aid.

Among the financial instruments of the EU, Bosnia and Herzegovina has used the CARDS (Community Assistance for Reconstruction, Development and Stabilization) in the period from 2000 to 2006. Program CARDS was replaced by IPA 1 Funds, which is being implemented in the period since 2007 by 2013. IPA 2 project is planned to be realized in the period from 2014 to 2020. Efficiency of CARDS program can point to the experience that eventually spilled over to the IPA project. Bosnia and Herzegovina is a potential candidate as the country which has access to the first two IPA components: transition assistance and institutional development and cross-border cooperation. For these two components Bosnia and Herzegovina has been provided by 660 million euro in the period from 2007 to 2013.

In order to determine the effectiveness of the financial management and the degree of implementation of pre-accession aid, it is necessary to perform secondary research, using the evaluation of the European Commission on the implementation of instruments CARDS and IPA in Bosnia and Herzegovina. There are number of aspects that are related to the absorption of funds, which include: preparation, implementation of projects, consumption of resources, as well as aspects of achieving defined goals and accomplished results.

It is necessary to identify whether in the process of realization of EU projects in Bosnia and Herzegovina there was adequate absorptive capacity and, if not, the possible reasons why: the lack of people, time, or lack of knowledge on how to use technical assistance projects. In addition to access to relevant publications, it is necessary to form questionnaires at a later stage, to enable participation of: Directorate for European Integration, Ministry of Foreign Trade and Economic Relations. Research findings can be useful for forthcoming IPA2. The main findings of the research are

focused on three elements: to give overview of existing pre-accession system related to the process of introducing decentralized implementation system in Bosnia and Herzegovina, as the goal towards candidate status and full membership of the European Union; retrospective of what is made in that process and how it fits to planned revised model of pre-accession instrument IPA, i.e. a new instrument IPA II. All three components will be presented as separate papers.

Key words: pre-accession funds, IPA

JEL classification: O1

1. INTRODUCTION

CARDS assistance was centralized, led by the European Commission, since there was lack of national administrative capacity and because of frequent staff turnover. Most of the CARDS program was designed by the Commission with limited involvement of users and external stakeholders in certain situations. As it is presented in Ad hoc evaluation final report, administrative control within the Delegation contributed to fast procurement but user ownership was reduced. Keeping the whole process of procurement under the authority of the local Delegation enabled fast contracting and implementation and efficient delivery of outputs.

The lack of real involvement of the national authorities in the procurement process meant it was fast but contributed to lower than expected impact (Enlargement Directorate, 2008:3). Such a development is not sustainable, because it points to the dependence of the state on others in project management. The establishment and strengthening of state level institutions was in line with the EC's strategic documents and in most cases addressed the needs of beneficiaries at the time of programming. Limited, or non-existent, counterpart administrative capacity, a large number of active donors and poor donor co-ordination by the state meant that programming was necessarily donor driven (Enlargement Directorate, 2008:4).

Ad hoc evaluation also notes that European Integration Assistance to DEI was partly successful, because high staff turnover, where none of the staff trained for CARDS was involved in IPA 2007, what could be of benefit in contest of knowledge sharing and improving lessons learned. In 2007 CARDS was replaced by a new financial instrument - Instrument for Pre-Accession Assistance (IPA). IPA I funds are going to be completed by the end of 2013. and replaced by IPA II (for the period from 2014-2020).

2. EXISTING PRE-ACCESSION SYSTEM

At present, Bosnia and Herzegovina is receiving financial support from the EU via the Instrument of Pre-Accession Assistance (IPA) in order to adjust system to the standards and policies of the EU. The financing strategy consists of two components: Component

I, Transitional Assistance and Institutional Building; Component II, Cross Border Cooperation between candidates and potential candidates, as well as between candidates and EU member states.

1. IPA components in use:

1.1. Component I, Transitional Assistance and Institutional Building
(users: BH Institutions)

1.2. Component II, Cross Border Cooperation
(users: public institutions and other organizations of the public interest at all levels, local governmental organizations, professional associations, the universities)

Authority and responsibility over the following processes belong to the European Commission and the Delegation of the European Union:

1. Tendering for the selection of the best bidder;
2. Signing a contract with the selected best bidder;
3. Establishment of the project management board;
4. Drafting and adoption of the initial work plan for the implementation of project activities;
5. Implementation and use of IPA funds approved under the Project Agreement transferring the funds to the account or implementers selected best bidder;
7. Monitoring and process monitoring of project implementation;
8. Reporting on the activities implemented and the results achieved;
9. Financial audit and control of money spent;
10. Evaluation of project results achieved and the project purpose.

In the case of the centralized system implementation (CIS), by completion of the tender procedure chosen supplier that will continue to implement the project signs a contract with the Delegation of the European Union. In a decentralized system using IPA funds, authority and responsibility of the above processes is transferred from the European Commission or the European Union Delegation to the institutions of the state.

The Directorate for European Integration has the role of chief coordinator of the European integration process at the state level (horizontal coordination) and between the state institutions and entities (vertical coordination). Among other things, DEI coordinates financial assistance of the European Union and the DEI Director is also the National Coordinator for IPA (the Instrument for Pre-accession Assistance). The Directorate produces a variety of information, analyses, reports and strategic documents necessary for the integration process. DEI has a significant role in promoting and informing the public as to what the integration process signifies and entails.

There are plans to implement the gradual transfer or decentralization of competencies and IPA management from the EU institutions to the national authorities regarding processes which are now under responsibility and authority of EU Delegation. The strategy for decentralized implementation system in Bosnia and Herzegovina was adopted by the Council of Ministers on June 23rd, 2008.

State that intends to achieve membership in the EU must be capable to use the EU funds, i.e. IPA funds in a decentralized mode of implementation. Also, the state cannot progress in the process of approaching the EU without an established and accredited state system of implementation of EU funds, because the existence of this system is a precondition for opening certain negotiations chapters.

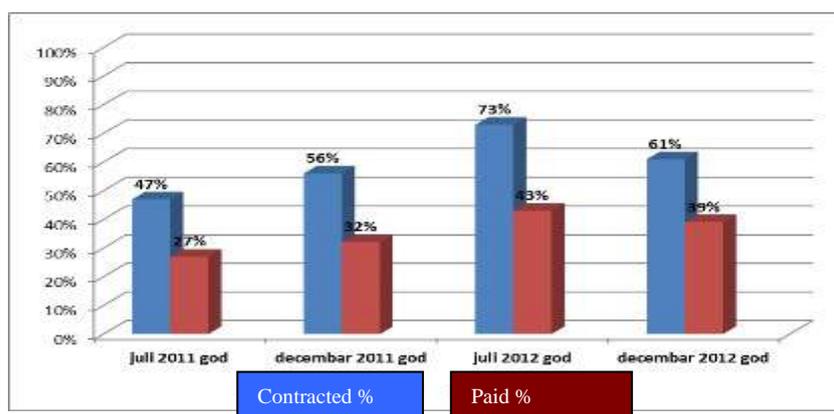
Central Finance and Contracting Unit (CFCU) is formed at Ministry of Finance and Treasury, which should after completed tender procedure sign contract with chosen contractor which would implement project. For the purposes of introduction of DIS Bosnia and Herzegovina has appointed certain persons to perform individual functions in the DIS, including: Accreditation Officer (SAO), which is responsible for the political management of the introduction of the DIS and National authorizing officer (SO), which is responsible for the technical management. These individuals are responsible for reporting on the progress in the establishment of DIS and also after introduction of DIS for reports on the functioning of the DIS-based on which the renewal accreditation for DIS1.

2.1. Monitoring utilization of funds

With the purpose of conducting preparatory activities that would facilitate the process of assigning accreditation for DIS, the European Commission decided to include domestic institutions in the monitoring process, primarily the Department of Monitoring and Evaluation Directorate for European integration, along with the network of still informally appointed project managers.

The above practice, which was launched at the initiative of the European Commission, is carried out under the supervision of Directorate and by now there were six meetings of IPA monitoring committee, a body whose establishment and operation of is one of the requirements of decentralized implementation system.

Figure 1 from IPA allocations 2007-2011



Source: Directorate for European integration (<http://www.dei.gov.ba>)

Bearing in mind that Bosnia and Herzegovina has centralized management system of EU financial assistance, the source of data on the degree of utilization of funds from the IPA I is the EU Delegation in Bosnia and Herzegovina.

After the signing of the Financial Agreement for certain annual IPA allocation, funds become available for tendering and contracting of projects. According to the provisions of the Financial Agreement, the deadline for signing contracts is two years from the date of signing the financing agreement, and the deadline for implementation of the project is two to three years after date of contracting. Using IPA funds depends on the dynamics of conducting tender procedures, dynamics of signing a contract and payment schedule for each project activity for which is solely responsible EU delegation.

It should be emphasized that this dynamics of: conducting tendering, contracting dynamics, and the dynamics of withdrawal payments, after which begins the process of project implementation, largely depends on the type of individual project contracts. For some of them, European legislation prescribes a different procedure. Based on that, the requirements of the process of tender procedures are in some cases more complicated and thus the process of selecting the best bidder takes longer. For example, contract for the execution of builders' works is the most complex and requires a lot of preliminary work, provision of a large number of licenses, approvals, etc. On the other hand, the process of implementation of the tender procedures for contract connected to service support is not as technically demanding.

2.2. Programming funds

Programming IPA for the period 2011-2013. year is based on multiannual indicative sectoral approach. This approach is new compared to the previous programming. So far, the program was project-oriented, and now is sectoral directed. The result of the new approach should be increased efficiency use of funds, because it identifies priorities for the three year. Based on them individual projects were prepared.

Absorption capacity implies possibility of institution to make project proposals in accordance with the priorities from MIPD with prior Strategic Documents in Bosnia and to manage implementation projects on the way provided by DIS.

It is necessary continue to strengthen the capacity for the use of EU funds primarily by establishing units for supporting Project Managers in institutions, and capacity building for all other obligations defined by DIS; the establishment of Internal Control and Audit unit, risk management unit, unit for estimation of working load, etc.

Also, strengthening regional cooperation is crucial for funds withdrawal from IPA II component, where developing project proposals and execution of projects BiH realizes in close cooperation with neighboring and EU member states.

Some changes, which are scheduled for IPA II (2014-2020), examine the process of decentralization and the establishment of DIS, as the subject of separate research. Adoption of the Regulation on the establishment of the IPA II is expected to be in mid

2013. Preparation of IPA II implementing regulation is ongoing, and its finalization is expected in the second half of 2013.

3. CONCLUSION

What is common CARDS and IPA I is centralized management of funds, with the improvements made in the course of implementation of IPA I. Process of decentralization has started and research is needed to determine whether it goes in accordance with the adopted Strategy for implementation of DIS, are established units and appointed persons operational and how it fits to the context of changes that are announced for IPA II.

Proposal for a new Regulation on the establishment of IPA II abolishes distribution on the previous five components, and introduce the policy areas within different interventions will be implemented. Financial assistance may be available in all areas of policy, regardless of whether the country has the status of a candidate or potential candidate.

Policy areas under the new Regulations are divided as follows:

- a) The process of transition towards membership and capacity building (former IPA Component I - Transition Assistance and Institution Building)
- b) Regional Development (formerly IPA Component III - Regional Development)
- c) Employment, Social Policy and Human Resources Development (formerly IPA Component IV - Human Resources Development)
- d) Agriculture and Rural Development (formerly IPA Component V - Agriculture and Rural Development)
- e) Regional and territorial cooperation (former IPA Component II - Cross-border cooperation)

The new proposal for IPA II particularly emphasize that progress in achieving certain objectives is going to be assessed through indicators and, depending on the progress made, the reallocation of financial support programs will be made between programmes as well as between the beneficiary countries.

This means that if the country does not achieve certain pre-defined indicators of progress from the pre-accession agenda, it is possible that the funds initially allocated for that country will partly be assigned to another country that has made progress from the pre-accession agenda. In this way the state is actually encouraged to strengthen absorptive capacity.

The new approach is designed to enable:

1. Increasing influence of financial and technical assistance in achieving reform goals

2. Taking into account the specificities of each of the countries when identifying needs
3. Financial assistance will be available in all areas of policy, regardless of whether the country has the status of a candidate or potential candidate
4. Higher flexibility in allocation, programming and implementation of assistance
5. Simplified programming and implementation including the introduction of multi-annual programming
6. Introduction of sectoral approach
7. Simplified multi-year strategic planning on the principle of two level-one for all beneficiary countries and other based on individual planning for each country

The general objective of IPA II is to assist the beneficiary countries in the implementation of necessary reforms for convergence and EU membership. Specific objectives are formulated in compliance with the Copenhagen criteria and based on the needs of each country beneficiaries according to their individual agendas to accession.

REFERENCES

European Commission, Enlargement Directorate (2008): *Ad-Hoc Evaluation of the CARDS Programme in Bosnia and Herzegovina*, Final Report,

www.dei.gov.ba Directorate for European Integration BH

www.delbih.ec.europa.eu EU Delegation BH

www.ec.europa.eu European Commission

www.parlament.ba Parliamentary assembly BH

www.vpi.ba Foreign Policy Initiative BH (NGO)

www.lgi.osi.hu Local Government and Public Service Reform Initiative

PART XI

WORKSHOP
“ABSORPTION
EXPERIENCE OF
CROATIA AND
WESTERN BALKAN
COUNTRIES”



This Workshop is a part of a Project (529847-LLP-2012-HR-AJM-RE) that has been funded with support from the European Commission. This publication reflects the views only of the author, and the Commission cannot be held responsible for any use which may be made of the information contained therein.

Ivana Maletić

Center for Public and Nonprofit Sector Development „TIM4PIN“, Zagreb, Croatia

Davor Vašiček

University of Rijeka, Faculty of Economics, Rijeka, Croatia

Jelena Kandžija

Cabinet d'avocats, Zagreb, Croatia

CROATIAN EXPERIENCES IN MANAGEMENT AND ABSORPTION OF THE EU PRE-ACCESSION FUNDS

ABSTRACT

Through the Instrument of Pre-accession Assistance (IPA), Croatia is preparing for the implementation of Cohesion policy, as IPA to a large degree follows the principles of structural funds and the Cohesion Fund. IPA as instrument that merges pre-accession programme and structural instruments rules, and as such was a new challenge for all stakeholders, Croatia and European Commission. From comparison of all IPA components it is visible that each component has its specificities with different rules and provisions. This is way experience gained and lessons learnt during implementation of pre-accession funds are of high importance for better preparation for structural and Cohesion funds. Experience gained from implementation of pre-accession programmes shows that timely commencement of project implementation is important for good absorption of funds, which means that project preparation should commence early enough, several years prior to the commencement of financial perspectives.

Due to the aforementioned, we can identify several important areas which need to be set up and prepared as the basis for the use of EU funds, that is, for participation in the European Cohesion Policy:

- 1. Multiannual strategic planning and linking of regional and national priorities with Cohesion Policy priorities,*
- 2. Timely identification (selection) and preparation of projects,*
- 3. Setting-up of a sound financial management system on all levels (local, regional, national) and in all EU funds beneficiaries,*
- 4. Institutional building and administrative capacities for preparation and implementation.*

Keywords: Cohesion policy, IPA, multiannual strategic planning

JEL classification: O1

1. INTRODUCTION

Through the system of various conditions set by the European Union before candidate countries, the more comprehensive framework is created enabling the implementation of the reforms in practice as well as their sustainability. In order to achieve high-quality adjustments, i.e. the convergence, the harmonisation but also the Europeanization in a wider sense¹, it is not sufficient that legal criterion is satisfied but also that all other – political, economic and, above all, administrative criteria are met. The administrative one means ensuring the stability of the institutions and the capacity to take the obligations derived from the quality of being European Union Member State².

Pre-accession assistance programmes³ implemented by candidate countries for their accession into the EU, present the preparation for the management and implementation of forthcoming European Funds once a country becomes an EU member state.

By introduction of pre-accession assistance programmes *the European rules for managing public finance* were also partially introduced. In order for these programmes to start being used, the country, i.e. the institutions involved in their implementation are *obliged to satisfy a whole set of criteria* laid down by EU regulations and financial agreements concluded with the European Commission, regarding the implementation of a particular programme.

Satisfying accreditation criteria is the main condition to be fulfilled for gaining work permit from the European Commission and for managing European Funds. In accordance with the above said, all institutions involved in the implementation of EU pre-accession programmes are obliged to carry out detailed and comprehensive preparations regarding the establishment of control environment, risk management, control activities, monitoring and evaluation system as well as information and communication system. All the above mentioned is defined in the Annex to the European Commission IPA Implementing Regulation⁴(hereinafter: IPA Regulation).

These areas actually constitute parts of the comprehensive concept of the sound financial management, i.e. the basic components of the public internal financial control system defined by the Law on public internal financial control system⁵.

¹Europeanization should not be confused with other concepts, such as convergence, harmonization, integration and policy making. Europeanization is a process, while convergence represents its consequence. Also, Europeanization should not be confused with the harmonisation process, which reduces the diversity of regulations, offering a certain action model. Contrary to harmonisation, Europeanization provides the idea of open diversity. The result of Europeanization may be diversity of regulations, increased competition or its distortions. Cfr.Matei, A., Matei, L.(2009) Globalization and Europeanization – A Projection on a European Model of Public Administration.*Theoretical and Applied Economics*.Vol. 4, No. 4.

²Cfr.Matei, L.(2009) Romanian Public Management Reform – Theoretical and Empirical Studies.*Administration and Public Services*.Vol. 1.,pp.77-78 (European conditionality).

³A unified Instrument for Pre-Accession Assistance (IPA) replacing CARDS, PHARE, ISPA and SAPARD pre-accession programmes was introduced in the financial perspective 2007-2013.

⁴Annex to the Commission Regulation, No. 718/2007 of June 2007 implementing Council Regulation, No. 1085/2006 establishing an instrument for pre-accession assistance (IPA) 1085/2006 establishing an instrument for pre-accession assistance (IPA).

⁵Official Gazette, No.141/2006.

Therefore, during the period of accession to the EU, *internal financial control system is being introduced into the practice of a candidate country through two processes*. One of the processes includes preparation and utilisation of EU pre-accession assistance programmes for which all institutions must have fully established internal financial control system, in accordance with EU requirements. The other one is the negotiation process in the framework of which, in Chapter 32 - Financial Supervision, a candidate country becomes obliged to set up and apply internal financial control system.

2. DIFFICULTIES IN IPA IMPLEMENTATION

Once Croatia becomes a Member State of the European Union, it will start implementing the EU Cohesion policy. Through the Instrument of Pre-accession Assistance (IPA), Croatia is preparing for the implementation of Cohesion policy, as IPA to a large degree follows the principles of structural funds and the Cohesion Fund. This is way experience gained and lessons learnt during implementation of pre-accession funds are of high importance for better preparation for structural and Cohesion funds.

IPA is a new instrument that merges pre-accession programme and structural instruments rules, and as such was a new challenge for all stakeholders, Croatia and European Commission.

2.1. Specifics of IPA

From comparison of all IPA components it is visible that each component has its specificities with different rules and provisions:

- Under IPA Components I and II, the management functions on an annual basis of implementation with strict deadlines for contracting, implementation and disbursement. As an example of foreseeable and manageable process of tendering and contracting of individual projects, excellent results are achieved and 92,22% of IPA I 2007, 94,7% of IPA I 2008 allocation is contracted. However the main weakness is the fact that all projects are defined in advance and there is no flexibility (within given timeframe for contracting) for changing the list of projects. If some of the approved projects gain savings or facing difficulties procedure for adding new projects is subject to changes in Financing Agreement which could take more than six months. This is the main reason why absorption cannot achieve 100% of contracting. Over programming in Component I would contribute better management and 100% contracting.
- Operational Programmes under IPA Components III and IV are multiannual and apply provisions similar to those for structural instruments, such as the n+3 rule (n+2 for member states). As in IPA Component I, when it concerns “small” projects with less demanding process of preparation, the good results are achieved and more than 74% of planned contracts were signed. But for the major projects process of approval is beyond beneficiary control and because of that automatic de-commitment in 2011 was applied.
- IPA Component V is implemented under extended decentralised system (without ex-ante approval of EU Delegation). The accreditation process lasted unexpectedly long. The system set for the implementation of SAPARD supposed to be transposed into the

system for the implementation of IPARD, continuing the implementation under the established procedures taking into account the experience gained. However, there is a huge gap between the moment of the programme's adoption in February 2008 and the accreditation of measures since the EC introduced new requirements in order to integrate in IPARD procedures all the lessons learnt through SAPARD implementation in other countries. Due these facts, the request for conferral of management powers was submitted to EC in November 2008 and the conferral of management powers was granted only in December 2009 (for Measures 101 and 103) and in April 2011 (for Measures 301 and 302). Some measures are still not accredited due to the fact that it is not clearly defined in IPARD programme how to implement those measures (202 and 501) what caused the needs for further modifications of programme.

Taking into consideration that the implementation started only at the beginning of 2010 (as only then all the preconditions for launching of the first Call for applications were met) and taking into account also the fact that it was not possible to start with the implementation of projects earlier and certify/verify them once the accreditation was granted, the n+3 rule in IPARD has been practically reduced to n+1 rule.

The specificity of the IPARD programme which differentiates it from all other IPA Components is in the fact that investment must be fully completed and all expenditures paid by the beneficiary prior to be refunded from IPA funds. Without advance payments, the implementation of contracts under IPARD programme is more prolonged.

2.2. Start of implementation closely linked to process of accreditation and conferral of management decision

Even though the IPA instrument formally became available to Croatia from 1 January 2007, IPA Implementing regulation, No. 718/2007⁶ laying down detailed rules for management and implementation of IPA as designation of structures and authorities and accreditation criteria, was adopted by the European Commission in June 2007. Therefore, the main activities during the 2007 and 2008 were focused on setting up of the management and control system for all IPA components in order to achieve conferral of management powers by the European Commission.

It was a big challenge to meet the accreditation criteria and to prepare the institutions for implementation of the new pre-accession programme according to the rules similar for the implementation of the cohesion and structural funds taking into account specificities of each IPA component. The requests for conferral of management for the IPA Component I, II, III and IV were submitted in April 2008 to the relevant DGs. After the efforts was invested by the all stakeholders, the accreditation criteria for the decentralised management of IPA were fulfilled what was confirmed by the EC auditors and the conferral of management for decentralised management with ex ante controls was granted to the operating structures for all four IPA Components in the last

⁶European Commission, Commission Regulation (EC), No. 718/2007 of 12 June 2007 implementing Council Regulation (EC), No. 1085/2006 establishing an instrument for pre-accession assistance (IPA), <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32007R0718:EN:NOT>.

quarter of 2008. For IPA Component V, the request for conferral of management powers was submitted to EC in November 2008 and the conferral of management powers was granted only in December 2009 (for Measures 101 and 103) and in April 2011 (for Measures 301 and 302). Accordingly, the financing agreements were signed. *It is important to emphasize that implementation of IPA programme could not have started and tender documentation could not have been sent to EU Delegation for ex-ante control before the conferral of management powers by the European Commission was achieved. Contrary to this, EU member states in management of structural instruments can start implementation before compliance assessment is achieved and reimburse funds for implemented projects.*

In January 2010 IPA Implementing regulation, No. 718/2007 was amended with Commission regulation, No. 80/2010⁷ in order to enhance efficiency and effectiveness in the implementation of IPA. Article 34 of IPA Implementing regulation⁸, in paragraph 2, the second subparagraph was replaced by the following: “Launch of calls for proposals or calls for tenders may also be eligible prior to the initial conferral of management and after 1 January 2007, subject to this initial conferral of management being in place within the time limits defined in a reserve clause to be inserted in the operations or calls concerned, and, except for the rural development component, subject to the prior approval of the documents concerned by the Commission. The calls for proposal or calls for tender concerned may be cancelled or modified depending on the decision on conferral of management.”

Only with this revision in 2010 it is allowed to start implementation before the conferral of management powers but Croatia could not have benefited. It should be taken into consideration that Croatia took all efforts to set up the system, successfully perform self-assessment and external audit in order to get conferral of management and start with IPA implementation. Only 10 months after the IPA Implementing regulation was adopted, the requests for conferral of management powers for the IPA Components I-IV were submitted to the EC.

In case of component V accreditation process lasted significantly longer than in other components. There was a huge gap between the moment of the programme’s adoption in February 2008 and the accreditation of measures since the EC introduced new requirements in order to integrate in IPARD procedures all the lessons learnt through SAPARD implementation in other countries. Due to these facts, the request for conferral of management powers was submitted to EC in November 2008 and the conferral of management powers was granted after 13 months (in December 2009 for Measures 101 and 103) and after 29 months (in April 2011 for Measures 301). Implementation could start only after the accreditation was granted and the n+3 rule in IPARD has been practically reduced to n+1 rule which brings Croatia to the position where it was not possible to use allocated funds due to the fact that projects should be

⁷Commission Regulation (EU), No. 80/2010 of 28 January 2010 amending Regulation (EC), No. 718/2007 (IPA Implementing Regulation), Official Journal of the European Union, L25/1, 2010.

⁸EUR-Lex: Access to European Union law: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32007R0718:EN:NOT>.

first selected through the call for applicants procedure, implemented, reimbursed and at the end expenditures could be certified to the Commission/funds absorbed.

2.3. Particularities in implementation of major projects are recognized in EU fund regulation but are not part of IPA regulation

In case of member states, the complexity of approval and implementation of major infrastructure projects is recognised in Article 94 of the Council Regulation, No. 1083/2006 laying down general provisions on the European Regional Development Fund⁹, The European Social Fund¹⁰ and the Cohesion Fund¹¹, which stipulates that automatic de-commitment rule is to be applied to major projects from the date of the Commission Decision¹² by which a specific project is approved. For the major projects financed under IPA there is no provision which would provide additional flexibility with respect to the application of n+3 rule similar to Council Regulation 1083/2006. Tendering procedure could not have started prior to the major project approval. In case of Croatia the process of approval of major project applications took more time than it could have been reasonably expected (major projects were approved during 2009) what had significant impact on start of implementation of major projects and subsequently on the absorption on funds.

Only in 2011 the EUD allowed to initiate the tendering procedure for non-approved major projects under suspension clause.

2.4. Project approval and contracting of major projects require more than two years which Croatia had for implementation

Taking into account all the above, the time which was remaining for the implementation of the IPA interventions has been significantly reduced what has an impact on absorption. This is especially visible in the Operational Programmes within the IPA component III through which major infrastructure projects are financed. Due to the demanding preparation of technical documentation, process of approval by the EC, lengthy and complex tender procedure and time needed for finalization, major projects by its nature are difficult to be contracted within two years period which in the case of Croatia means by the end of 2011 (having in mind that implementation of operational programmes has started only in 2009 after conferral of management). This was the main reason which creates difficulties in 2011 when in all operational programmes under IPA Component III the fulfilment of n+3 rule was depending on expenditures incurred in major infrastructure projects.

The major project approval was followed by a Bilateral Project Agreement (BPA) signed between Croatia and European Commission. Under IPA component IIIa for major project Zagreb Main Station Signalling and Interlocking System BPA was signed in August 2009. Under IPA component IIIb for major projects CWMC Marišćina,

⁹EuropeanCommission: http://ec.europa.eu/regional_policy/thefunds/regional/index_en.cfm.

¹⁰EuropeanCommission: <http://ec.europa.eu/esf/home.jsp?langId=en>.

¹¹European Union:

http://europa.eu/legislation_summaries/regional_policy/provisions_and_instruments/160018_en.htm.

¹²EUR-Lex: Access to European Union law: <http://eur->

[lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52009SC1495:EN:NOT](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52009SC1495:EN:NOT), 6.1., b.

CWMC Kaštijun and WWTP SlavonskiBrod BPA was signed in June 2009, while for WWTP Knin in February 2010¹³.

IPA components IIIa and IIIb are mainly focused on major projects (50% of the allocation 2007-2011 for IPA IIIa is envisaged to finance 2 major projects, and 95% of the allocation 2007-2011 for IPA IIIb is envisaged to finance 5 major projects). Specificities of the major projects are long-lasting process of approval of major project applications (up to 18 months) and procurement procedure due to the need for ex-ante approval of each step. In the best cases the contracting procedure for major projects lasted for 14 months.

The IPA components IIIc and IV are focused on grant schemes and service contracts under which over 74% of planned contracts have been signed and it is evident that the implementation of operational programmes is progressing much better when the process is not affected with procedure of major project approval and contracting.

2.5. System with ex ante control by the EUD – DIS system, important for lessons learnt but time consuming

Implementation under decentralised implementation system (DIS) is very important process of learning. The tendering and contracting procedures are performed by Croatia and the EU Delegation in two levels of controls what results with contracting procedure which is two times longer.

Consequently, n+3 rule under DIS in reality means n+1,5 what brings Croatia in position less favourable than to the EU member states which apply n+2 rule.

2.6. Awareness of over programming was raised only in 2010 which could help absorption in future years

Due to the financial crisis and downward trend in market prices in the process of contracting of major projects significant savings were realized that have impact on the absorption. On the other hand there is no flexibility in IPA implementation in a way that new operations/projects could be introduced without long lasting procedure of ex-ante approval if some of the approved operations/projects gain savings or facing difficulties. This is why without over programming mechanism absorption was in danger.

3. LESSONS LEARNT, CHALLENGES AND RECOMMENDATIONS

Experience gained from implementation of pre-accession programmes shows that timely commencement of project implementation is important for good absorption of funds, which means that project preparation should commence early enough, several years prior to the commencement of financial perspectives. A high level of fund

¹³EuropeanCommission: http://ec.europa.eu/enlargement/ppt/project-in-focus/donor-coordination/meetings_events_conf_coord_aid/19_oct09/22-panel_ii_croatia_19102009.ppt.

utilization does not automatically mean also better growth and development, for this it is rather more important that funds are targeted and used strategically.

In addition to targeted, strategically oriented and highly utilized EU funds, it is important to ensure that funds are used in accordance with sound financial management rules, in order to avoid subsequent loss of funds and the obligation of recovery of funds to the EU budget. In the implementation of the Cohesion Policy, it is necessary to ensure a multiannual and strategic approach, partnership (the objectives should be in the interest of all parties, and exchange of information and joint decision-making and actions: the central state, local and regional self-government units, the civil society, entrepreneurs, social partners...), the principle of additionality (investments which are already financed on the national and local levels should be additionally financed and accelerated, without the invention of new investment areas), systematic control and monitoring and evaluation.

Due to the aforementioned, we can identify several important areas which need to be set up and prepared as the basis for the use of EU funds, that is, for participation in the European Cohesion Policy:

5. Multiannual strategic planning and linking of regional and national priorities with Cohesion Policy priorities
6. Timely identification (selection) and preparation of projects
7. Setting-up of a sound financial management system on all levels (local, regional, national) and in all EU funds beneficiaries
8. Institutional building and administrative capacities for preparation and implementation

3.1. Multiannual strategic planning and linking of regional and national priorities with Cohesion Policy priorities

The objectives of the Cohesion policy include equal and sustainable development of all European regions (NUTS II level – statistical region), and through its implementation in member countries the following investments are financed: transport, environmental protection, power, regional competitiveness (i.e. enhancing business and society infrastructure, strengthening the economy), human resource development aiming to increase employment and employment opportunities of the labour force.

The above mentioned areas, encompassed by the Cohesion policy, are part of the special interest in each country, and accordingly in the Republic of Croatia they have been recognized as development drives from the local to the central level in the country. The coordination of strategic priorities at the local, regional and national level as well as their harmonisation with the objectives of the Cohesion policy presents one of the key challenges.

The process of EU funds planning is based on: programmes and the application of the accrual accounting. Considering that planning is based on programmes, only well placed and defined programmes are financed. The planning process is in the competence of line ministries and is coordinated by the Central State Office for

Development Strategy and Coordination of EU Funds (CODEF)¹⁴ and as of 2012, by the Ministry of Regional Development and EU Funds¹⁵.

The planning covers the proposal and adoption of strategies for particular areas and, in line with the priorities of particular areas, the proposal and preparation of projects to be financed from pre-accession programmes. Objectives and performance indicators are defined on all programme levels, and are monitored in detail during implementation. The preparation of operational programmes in IPA is a significantly simpler process than defining of strategic documents for a seven-year financial perspective and use of EU funds. The objective of pre-accession assistance programmes is to prepare the candidate country for membership in the EU and provide assistance with regard to reforms which must take place during negotiations. The financial and economic effects are not of primary interest because the amount of funds is small in relation to that which Republic of Croatia is expecting from EU funds. Precisely due to the limited scope and small amounts, it was simpler to prepare strategic documents for the use of IPA funds.

The Republic of Croatia will prepare the first seven-year strategic document – National Strategic Reference Framework for the period 2014-2020¹⁶. This is a strategic document drawn up by member countries for each EU financial perspective, which establishes the priorities as regards the use of funds from structural instruments. In addition to this parent programme document, operational programmes are also brought. Operational programmes are programme documents used to identify key measures for the realization of priorities established in the NSRF and the method of their implementation according to particular sectoral areas. Precisely due to this strategic and multiannual approach in the European budget, it was important to enhance the planning process through the introduction of a strategic and multiannual budget framework for all member countries. In the Republic of Croatia, the first steps in this respect were made with the bringing of the 2008 Budget Act¹⁷:

- The obligation of strategic planning and drawing up of a three-year strategy of government programmes was introduced in order for strategic priorities and the objectives of government policy to directly influence the allocation of funds within the budget.
- The multiannual dimension of the budget was ensured with a provision defining that the Croatian Parliament, that is, the representative body (on the local level), in addition to adopting the budget for one budget year, also adopt the projection for the following two years.

The weaknesses of this legal solution are the time framework which is too short (three years) for strategic documents, and the fact that the adoption of the strategy is required

¹⁴Central State Office for Development Strategy and Coordination of EU Funds (CODEF):http://www.vlada.hr/en/adresar_i_linkovi/drzavni_uredi/drzavni_ured_za_upravljanje_drzavnom_i_movinom.

¹⁵The Ministry of Regional Development and EU Funds:<http://www.mrrfeu.hr/default.aspx?id=866>.

¹⁶The Ministry of Regional Development and EU Funds:
http://www.mrrfeu.hr/UserDocsImages/EU%20fondovi/partnerske%20konzultacije/National_Strategic_Reference_Framework_2012_2013_1.pdf.

¹⁷Official Gazette No. 87/2008.

only on the state budget level, whereas local and regional self-government units should only adopt a plan for development programmes. The absence of requirements for the local and regional level relating to the adoption of strategic documents was attempted to be solved with the Regional Development Act¹⁸ from 2009, accentuating that the linkage of local and regional development requirements with central level development priorities is to be ensured through regional development policies¹⁹.

In addition to the aforesaid, the Regional Development Act defines that the Regional Development Strategy of the Republic of Croatia and county development strategies are the planning documents of the regional development policy, and that they are brought in line with the duration period of the Government Programme Strategy. The regional development strategy should establish the objectives and priorities of regional development of the Republic of Croatia, the method for their achievement, and the institutional and planning framework of the regional development policy. The objectives and priorities defined in the Regional Development Strategy should be the basis for the drawing up of the Government Programme Strategy. County development strategies should be in line with and result from the Regional Development Strategy, and vice versa. According to the Regional Development Act, a county development strategy is a document of a local or regional self-government unit, defining the development objectives and priorities of the particular local or regional self-government unit.

The development programme plans which local and regional self-government units are obliged to bring in accordance with the Budget Act must be in line with the county development strategy. The contents of county development strategies, drawing-up methodology and evaluation are defined by The Regulation on mandatory content, elaboration methodology and ex-ante evaluation procedure of county development strategies²⁰. In the process of adoption of development strategies, counties should cooperate with towns and municipalities within their area, and in line with the partnership principle, also with other interested parties such as the civil society, entrepreneurs, social partners, scientific institutions etc.

The concept which the Regional Development Act defines, particularly relating to the linking of strategic objectives and priorities on the local and regional levels to national objectives and priorities has not yet come into effect in practice. The fact that the Regional Development Strategy for the period 2011-2013²¹ was not used as the basis for the bringing of the Government strategy for the same period because it was adopted later, and that The Regional Development Strategy for the period 2012-2014 has not yet been adopted, whereas the government programme strategy has, confirms this point.

As the government programme strategy should cover the regional development strategy, that is, county development strategies, so the National Strategic Reference Framework (NSRF) should be a document resulting from the strategy of government

¹⁸OfficialGazette No. 153/2009.

¹⁹RegionalDevelopmentAct, article 2, paragraph 2.

²⁰OfficialGazette No. 53/2010.

²¹Regional Development Strategy for the period 2011-2013, <http://www.mrrfeu.hr/default.aspx?id=404>.

programmes covering all national (and regional) objectives regardless of the sources of financing (budget, donations, EU funds...). Only in this manner the sustainability of implementation of all strategic documents (national – government strategy, regional – county development strategies and regional development strategies, EU - National Strategic Reference Framework) can be ensured, considering that all priorities are financed from a combination of sources – state budget, local budgets, EU funds.

The objective is to achieve linkage of county development strategies with the three-year Government Programme Strategy²². In addition to this linkage, another level which we should get accustomed to is introduced by the Regional Development Act, specifically the statistical region. The Partnership Council of Statistical Regions is set up in order to define the joint priorities of local and regional self-government units in the area of statistical regions and proposal of projects on that level. The concentration and mutual linkage of counties will be an important precondition for the proposal of large, competitive projects of significance for several counties. *Strategic planning and projects are the keys to the use of European funds and the basis for encouraging development.*

Strategic planning with establishment of objectives and performance indicators is one of the underdeveloped areas in the Republic of Croatia on the national level and in particular on the level of local and regional self-government units. It is of key importance for the use of European funds that strategic documents such as the National Strategic Reference Framework and operational programmes result from strategies brought on state level, as per regions, that priorities are clearly defined with explanations, expected objectives and manners of performance indicators as regards the attainment of the set objectives.

Without strategy-based projects and arguments for their implementation based on results, the EU will not accept the proposed strategic documents and projects and funds will be directed at the financing of projects which primarily fulfil European objectives in Republic of Croatia, such as investment into transport infrastructure on European corridors passing through Croatia and investment in environmental infrastructure in accordance with directives. Thereby the Republic of Croatia should intensify work on strategies for different areas from transport, environmental protection, energy via science, primary education, pre-school education, health care, social welfare to the economy and agriculture.

It is important to decide on what is to be developed in a particular area and which are the main priorities of particular areas. At the same time it is important to focus on a specific, limited number of realistic objectives, rather than bringing lengthy lists and wish lists pointing that it is not clear what we wish to achieve in the following mid-term and long-term periods in the area of a particular region and nationally. It is important to intensify communication with the local/regional level and to establish joint objectives and priorities.

3.2. Timely identification (selection) and preparation of projects

²²GovernmentProgrammeStrategy2013-2015:<http://www.mfin.hr/hr/stratesko-planiranje>.

Experience gained from implementation of pre-accession assistance programmes shows that preparation of larger projects in areas of transport (railways), waste management (waste management centers) and waters (water treatment equipment and water supply networks) lasts as much as several years. Drawing up of technical documentation was continuously delayed, which shows that capacities for designing and drawing up of documentation in accordance with EU standards are rather weak. In addition, the solving of property-legal relations and obtaining required permits last too long, as well as the drawing up of environmental impact studies. Precisely because of the lack of administrative capacities, it is important to connect with design firms, faculties and other institutions, introduce them to the planned areas and investment amounts and include them into preparation.

Therefore it is important to identify projects in high preparation phases and complete them in accordance with EU rules in order for them to be sent to the European Commission for approval during 2012 and 2013 and to commence implementation at the very start of the 2014 – 2020 financial perspective. Without finished projects ready for implementation at the start of 2014 and spending of the first allocations from 2014 – 2020, it is very likely that part of the funds will be lost in accordance with the n+2 rule. It is also important to prepare reserve projects so as to avoid the situation that funds are lost in case some of the planned projects are terminated or postponed for any reason.

Thus, for example, in the railway area in IPA, preparation of 7 projects is planned (in the total value of 65,8 million euro): Novska-DugoSelo, Goljak-Skradnik, Križevci-Koprivnica-national border, Zaprešić-Horvati-Turopolje-DugoSelo, Novska - DugoSelo phase II, Vinkovci-Vukovar, HrvatskiLeskovac-Karlovac. Contracting was planned for 2012 and 2013. The first project, Novska-DugoSelo, in the value of 5,4 million euro was contracted in June 2011 and documentation should be completed in June 2014. For other projects to be contracted during 2012 and 2013, documentation is expected to be completed during 2015 and 2016, which shows that, considering the complexity of railway projects and long preparation periods, even now projects the implementation of which could commence at the start of 2014 in order to avoid initial delays in relation to the start of the perspective which occurred in IPA due to objective circumstances (delay in the bringing of regulations, implementation could not commence before work permits had been obtained) are lacking.

The railway example shows that it is important to establish a list of projects to be prepared from national funds, find ways to accelerate the preparation of documentation and sort out the projects which could be prepared within a shorter deadline simultaneously with the preparation of projects financed from IPA. If some projects had been prepared earlier for financing from loan funds (most often from international financial institutions), local budgets or the national budget and are now in a high preparation phase, they should be redirected for financing from EU funds.

3.3. Establishment of a sound financial management system on all levels (local, regional, national) and in all beneficiaries of EU funds

The adjustment of the financial and budget regulations to the frameworks and practices of the European Union is one of the key reforms and together with the institutional and legislative changes and strengthening of administrative capacities present the basis for high quality integration into the EU Cohesion policy.

The annual allocation from pre-accession programmes is small (cca. 150 million euro) in relation to the allocations expected from European Funds (over 1 billion euro) when we become a member country, and even the use of these smaller amounts in accordance with EU rules proved to be rather demanding for our administration and final beneficiaries.

Satisfying accreditation criteria is the main condition to be fulfilled for gaining work permit from the European Commission and for managing European Funds. In accordance with the above said, all institutions involved in the implementation of EU pre-accession programmes are obliged to carry out detailed and comprehensive preparations regarding the establishment of control environment, risk management, control activities, monitoring and evaluation system as well as information and communication system. All the above mentioned is defined in the IPA Regulation.

These areas actually constitute parts of the comprehensive concept of the sound financial management, i.e. the basic components of the public internal financial control system defined by the Law on public internal financial control system²³.

Through the system of managing pre-accession assistance programmes the Republic of Croatia acquires practical experience on the European Commission requirements in the framework of each particular element of the internal financial control system. This experience has been developed since 2004 when preparations for the utilisation of first pre-accession assistance programmes – PHARE, ISPA and SAPARD took place. At the same time from 2004 in the framework of negotiations the activities on primary and secondary legislations regarding public internal financial control system have commenced (PIFC)²⁴.

At the very beginning of 2004, but also during following few years, it was still not sufficiently recognized that these were all identical processes of financial management through which, on one side the system of EU pre-accession assistance programmes was built, while on the other side the processes have been introduced into the existing system in order to improve the financial management of state (and local) budget and to set „ready environment“ for absorption of future EU funds.

²³Official Gazette, No. 141/2006.

²⁴In September 2004 the Government of the Republic of Croatia adopted the first PIFC Strategy. In the same year the Memorandum of understanding on administrative cooperation between the Ministry of Finance and the EC Directorate General for Budget was concluded.

The reason for a separation and a kind of parallel work on the system of managing EU pre-accession assistance programmes and the system of state budget was the speed at which certain knowledge on and elements of the internal financial control system were supposed to be adopted. Therefore, for example, the accreditation process for PHARE, ISPA and SAPARD programmes took place throughout 2005, and it was already then that all institutions managing the programmes were supposed to have regulated and described work procedures, process maps, audit trails, risk management methodology, irregularity management functioning and irregularity officers appointed, including all other elements of the internal financial control system elaborated and established in details. On the other side, legal and implementing regulations just started to be developed and thought over at the national level. The exact elements of internal financial control system were clarified, i.e. the process of learning on the theoretical framework of internal financial control system was underway.

As of 2008 these two processes have been connected for the purpose of speeding up the overall process of developing financial management system at the level of central state as well as of local (regional) self-government units through 2009 and 2010 so that Croatia, as a member state could include as many institutions as possible into the system of managing EU Funds. In this way Croatia would also ensure the most effective and efficient usage of the funds offered. Only those institutions which have implemented all elements of financial management and control may ensure successful management and implementation of EU Funds. A system established and formed in the above mentioned way is also essential for national funds while strict criteria of sound financial management shall also be laid down in the budget system.

A significant step in the strengthening of the financial management and control system was made with the bringing of the Fiscal Responsibility Act and the Directive on drawing up and delivery of the Statement on Fiscal Responsibility and the Report on Application of the Fiscal Rules. For the first time, managers (heads of budgetary users - ministers, directors, mayors...) are required to give a Statement on Fiscal Responsibility. The Statement on Fiscal Responsibility is an annual statement by which the head of a budgetary or extrabudgetary user of the state budget and local and regional self-government units' budgets and the head of the local and regional self-government unit confirm that they ensured legal, regular and purposeful use of funds in operation, and efficient and effective functioning of the financial management and control system within the framework of funds established in the budget, that is, financial plan.

Local and regional self-government units, budgetary and extrabudgetary users of the state budget and local and regional self-government units defined in the Register of budgetary and extrabudgetary users are obliged to draw up Statements on Fiscal Responsibility.

On the basis of questions from the Fiscal Responsibility Questionnaire²⁵, self-evaluation of processes, procedures and controls per budget areas is carried out, aiming to confirm that the financial management and control system is functioning efficiently

²⁵Ministry of Finance: <http://www.mfin.hr/hr/izjava-o-fiskalnoj-odgovornosti>.

and effectively. The Questionnaire covers questions from the area of budget/financial planning, execution, public procurement, accounting and reporting. It is important to stress that the Questionnaire tests minimal requirements, per budgetary processes, for sound financial management. Tests according to the questions from the Questionnaire are carried out in order to evaluate whether and to which extent the prescribed legislative framework is being acted upon. The Questionnaire is only one of the elements for providing a Statement on Fiscal Responsibility. In providing the Statement, the head takes into account his own acquired knowledge and information, internal and external audit reports, control results and similar.

It is important to continue to develop this system, and it is essential to extend its scope in order to include the less-controlled part outside the budgets, specifically companies owned by the state and/or local and regional self-government units which are also potentially significant final beneficiaries of EU funds.

3.4. Building of institutions and administrative capacities for preparation and implementation

The institutional structure for the first generation of programmes is significantly different from the IPA institutional structure. While only one central contracting body – Central Finance and Contracting Agency (CFCA)²⁶ – was in charge of contracting and implementation of PHARE and ISPA programmes, in IPA a special structure for each operational programme component was developed, a series of new bodies were introduced with different roles, from those of bodies responsible for the operational programme, bodies responsible for the priority/measure, to implementing bodies which carry out contracting, payments and project implementation.

It was also possible to retain the centralized approach as regards IPA, and implement all operational programmes through one unique implementing body – *e.g. Central Finance and Contracting Agency*, and to centralize planning and monitoring through, for example, *Central State Office for Development Strategy and Coordination of EU Funds*. Both solutions have their advantages and shortcomings. One of the main weakness in the implementation of ISPA programme was insufficient specific technical knowledge in the CFCA for monitoring of documentation preparation, evaluation and monitoring of implementation of environmental protection projects (Bikarac Waste Management Center, Karlovac Water Supply and Sewerage) and railway projects (Vinkovci-Tovarnik track). Although these are only three large infrastructural projects, the lack of specific technical knowledge on the level of the CFCA could be felt. Hereafter an overview of positive and negative elements based on which it was decided that a system with several management structures and bodies be built is provided.

²⁶Central Finance and Contracting Agency (CFCA): <http://www.safu.hr/en/about-us>.

Table 1. Setting up the project implementation system

No.	Reasons for establishment of a system with several bodies involved in implementation	Reasons for establishment of a system with a unique implementation body
1.	Wide coverage of different areas covered by IPA (institution building, transport, environment, entrepreneurial sector, human resources development, regional development, agriculture) and the fact that specific national level bodies implementing similar programmes financed from national budget funds traditionally deal with each of these areas.	Easier coordination and standardization of EU programme implementation procedures as per all operational programmes.
2.	A unique line of decision-making and responsibilities for particular areas - for example, a minister responsible for areas of transport/environment/small and medium-sized enterprises on the national level... is also responsible for the use of EU funds.	Simpler development of horizontal knowledge regarding controls and financial management required for work with European Funds in all components. A smaller number of employees is required for horizontal functions, but continued education in national bodies and linkage is required for specific sectoral knowledge.
3.	Availability of specific sectoral knowledge because capacities in the existing national structure have already been built to a large extent.	A simpler process of certification and payment of expenditures.
4.	Simpler linkage of national priorities with EU priorities due to inclusion of structures for EU Funds management into the structures of bodies dealing with these areas on the national level.	Possible introduction of reward measures and conducting a special policy for retaining staff. Considering that the quality of staff and experience are of key importance for the success of implementation, wages and other methods of motivation are of significant importance.
5.	Easier linkage with the budget and ensuring of national co-financing funds through the budget. There is no space for financing two different policies, it is necessary to harmonise national programmes with programmes proposed for financing from the EU.	

Source: Authors

In the same way, it is necessary to consider both the positive and negative aspects of the institutional structure to be built for the use of EU funds in the 2014-2020 perspective. The end of 2013 is still for the most part set by IPA both in the strategic sense – financing of areas, priorities, measures and projects, and in the institutional sense. Having in mind time for implementation it would not be sustainable to completely change the institutional structure at the very end of the perspective. Certain changes still need to take place due to the different roles of particular bodies within IPA in relation to their role in the Funds. Thus for example, regarding the Funds, the final beneficiaries themselves contract projects according to national public procurement procedures, implement projects in line with the rules of sound financial management and request recovery of funds from the managing body. Final beneficiaries are outside the accredited structure. In IPA, bodies which contract and

implement projects are part of the accredited structure and have the role of implementing bodies (Croatian Railways, Croatian Waters, Environmental Protection and Energy Efficiency Fund...).

4. CONCLUSION

As a candidate country for the membership in the European Union the Republic of Croatia is the beneficiary of EU pre-accession programmes (firstly the following programmes: CARDS, PHARE, ISPA and SAPARD, and afterwards the new IPA programme), while when it becomes the member of the EU the Republic of Croatia will have the possibility to use European funds becoming a part of the implementation of European Cohesion policy.

The objectives of the Cohesion policy include equal and sustainable development of all European regions (NUTS II level – statistical region), and through its implementation in member countries the following investments are financed: transport, environmental protection, power, regional competitiveness (i.e. enhancing business and society infrastructure, strengthening the economy), human resource development aiming to increase employment and employment opportunities of the labour force.

The above mentioned areas, encompassed by the Cohesion policy, are part of the special interest in each country, and accordingly in the Republic of Croatia they have been recognized as development drives from the local to the central level in the country.

The coordination of strategic priorities at the local, regional and national level as well as their harmonisation with the objectives of the Cohesion policy presents one of the key challenges.

For this reason primarily, the new Budget Act which entered into force as of 1st January 2009 introduced the strategic planning and a three-year-budget framework. For the first time the Strategy of the Governmental programmes was adopted for the period 2010 – 2012, clearly highlighting strategic priorities related to the budget, objectives were set and manners of measuring the successfulness of accomplishing the objectives were defined. This strategic consideration at the national level in the context of the state budget constitutes the basis for the adoption of strategic documents and connection of national priorities with the objectives of the EU Cohesion policy.

The adjustment of the financial and budget regulations to the frameworks and practices of the European Union is one of the key reforms and together with the institutional and legislative changes and strengthening of administrative capacities present the basis for high quality integration into the EU Cohesion policy.

REFERENCES

Central Finance and Contracting Agency (CFCA): <http://www.safu.hr/en/about-us>.

Central State Office for Development Strategy and Coordination of EU Funds (CODEF):
http://www.vlada.hr/en/adresar_i_linkovi/drzavni_uredi/drzavni_ured_za_upravljanje_drzavnom_imovinom.

Commission Regulation (EU), No. 80/2010 of 28 January 2010 amending Regulation (EC), No. 718/2007 (IPA Implementing Regulation), Official Journal of the European Union, L25/1, 2010.

EUR-Lex: Access to European Union law: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32007R0718:EN:NOT>.

EUR-Lex: Access to European Union law: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52009SC1495:EN:NOT>.

European Commission, Commission Regulation (EC), No. 718/2007 of 12 June 2007 implementing Council Regulation (EC), No. 1085/2006 establishing an instrument for pre-accession assistance (IPA), <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32007R0718:EN:NOT>.

European Commission: http://ec.europa.eu/enlargement/ppt/project-in-focus/donor-coordination/meetings_events_conf_coord_aid/19_oct09/22-panel_ii_croatia_19102009.ppt.

European Commission: <http://ec.europa.eu/esf/home.jsp?langId=en>.

European Commission: http://ec.europa.eu/regional_policy/the_funds/regional/index_en.cfm.

European Union:
http://europa.eu/legislation_summaries/regional_policy/provisions_and_instruments/160018_en.htm.

Government Programme Strategy 2013-2015: <http://www.mfin.hr/hr/stratesko-planiranje>.

Matei & A., Matei, L. (2009) Globalization and Europeanization – A Projection on a European Model of Public Administration. *Theoretical and Applied Economics*. Vol. 4, No. 4.

Matei, L. (2009) Romanian Public Management Reform – Theoretical and Empirical Studies, Administration and Public Services. Vol 1.

Ministry of Finance: <http://www.mfin.hr/hr/izjava-o-fiskalnoj-odgovornosti>.

Ministry of Regional Development and EU Funds: <http://www.mrrfeu.hr/default.aspx?id=866>.

Official Gazette No. 141/2006.

Official Gazette No. 153/2009.

Official Gazette No. 53/2010.

Official Gazette No. 87/2008.

Regional Development Act, article 2, paragraph 2.

Regional Development Strategy for the period 2011-2013, <http://www.mrrfeu.hr/default.aspx?id=404>.

The Ministry of Regional Development and EU Funds:
http://www.mrrfeu.hr/UserDocsImages/EU%20fondovi/partnerske%20konzultacije/National_Strategic_Reference_Framework_2012_2013_1.pdf.

Margarita Shivergueva

Nouvelle Université Bulgare, Jean Monnet Chair, Sofia, Bulgaria

L'ABSORPTION DES FONDS STRUCTURELS ET LA COMPETITIVITE DE L'ECONOMIE BULGARE

RESUME

L'article intitulé « L'absorption des fonds structurels et la compétitivité de l'économie bulgare », analyse la situation actuelle de l'absorption des fonds européens après 2007, les problèmes bureaucratiques et administratives et la pratique actuelle en Bulgarie.

Les fonds structurels européens ont pour mission de contribuer à la réduction des inégalités régionales tout en garantissant la compétitivité européenne. Suite au élargissement de 2007, la programmation 2007-2013 de la politique de cohésion encadre davantage les actions dans les Etats-membres. La Bulgarie décline la politique de cohésion européenne en 5 priorités nationales dont les deux premières, dédiées à l'environnement, risques et énergies ainsi qu'à la modernisation des transports, comptent respectivement pour 46% et 33% des fonds structurels.

L'article traite les problèmes de la compétitivité de l'économie bulgare et des déformations existantes, ainsi que de leur manifestation spécifique dans le contexte de la crise économique et financière mondiale. La compétitivité économique figure parmi les principaux objectifs nationaux dans le contexte de la stratégie Europe 2020 parce que, actuellement, l'économie bulgare affiche un indice de compétitivité mondiale faible. Conformément aux derniers développements dans l'Union concernant une surveillance et une coordination plus intégrées des politiques économiques dans le cadre du semestre européen, les processus et instruments du pacte de stabilité et de croissance et de la stratégie Europe 2020 sont synchronisées dans l'optique d'une plus grande interconnexion entre les politiques budgétaires et structurelles. Dans le cadre d'un pays – membre, la politique économique bulgare est en corrélation avec les grandes lignes d'orientations européens.

L'article porte une attention particulière aux possibilités d'amélioration de l'environnement commercial et la réalisation de la compétitivité à long terme de l'économie bulgare.

Les problèmes de l'économie bulgare et de sa compétitivité demeurent au centre de cet Article. Ils constituent en effet une priorité majeure de la restructuration économique et de la politique économique bulgare faisant suite à la crise, et sont liés aux débats européens. Le programme national de réforme de la République de Bulgarie pour la période 2012-2015 aborde les questions prioritaires en faisant état des besoins immédiats actuels et des défis rencontrés par la petite économie ouverte du pays. Les domaines prioritaires suivants pour la politique économique bulgare ont été identifiés:

- *améliorer les infrastructures et l'environnement commercial pour attirer les investissements,*
- *augmenter la compétitivité des jeunes, et*

- *restaurer la confiance envers les institutions publiques.*
- Les mesures de politique économique visent en priorité à surmonter les obstacles actuels à la croissance économique et se présentent comme suit:*
- *renforcer l'efficacité des dépenses publiques et allouer des fonds publics à des activités qui améliorent le potentiel de croissance de l'économie;*
 - *pourvoir à un secteur financier fonctionnel et efficace comme condition nécessaire au développement durable de l'économie;*
 - *améliorer et rendre plus efficace l'utilisation du potentiel de main-d'oeuvre de l'économie;*
 - *pallier les faiblesses de l'environnement commercial et améliorer l'efficacité administrative;*
 - *augmenter la qualité et l'efficacité des systèmes d'éducation et de formation.*

Mots-clés : *fonds structurels, Bulgarie, compétitivité, Europe 2020*

JEL classification : O1

1. INTRODUCTION

La politique régionale ou la politique de cohésion européenne représente l'instrument économique le plus important qui est en même temps un outils essentiel pour la croissance et la compétitivité et la traduction concrète, ciblée et pratique de la solidarité européenne. En effet, à travers les projets financés à l'aide des fonds européens, qu'ils soient fonds structurels ou de cohésion, la solidarité européenne devient emplois, objectifs économiques, croissance, compétitivité en gros elle dévient partie intégrante du moto : Unité dans la diversité.

Au lendemain du dernier élargissement à la Roumanie et Bulgarie, la politique de cohésion a été à son tour soumise aux réformes, afin d'assurer une utilisation plus efficace, plus complète des fonds structurels. Cette réforme est la plus importante jusqu'au présent étant donné que pour la première fois 12 nouveaux Etats membres participent pleinement à une période de programmation. 12 Etats membres en provenant de l'Europe Centrale et de l'Est avec de niveaux de développement différents, avec des écarts ou des décalage importants qui montent à des pourcentages pas rencontrés avant.

Si l'on ajoute à ces aspects internes à l'Union Européenne, le phénomène de mondialisation qui caractérise le monde d'aujourd'hui, les délocalisations fréquentes dans au-delà de l'Union, on peut facilement voire que le plus grand défis de la nouvelle période de programmation est réussir une réforme de la politique de cohésion efficace et efficiente. Car c'est à travers des fonds finançant des projets qui répondent aux besoins des pays membres, qui aident ces Etats à mettre au profit leur avantages concurrentiels, il sera possible pour toute l'Union de faire fasse aux pressions économiques, sociale et politique mondiales.

Les fonds structurels européens ont pour mission de contribuer à la réduction des inégalités régionales tout en garantissant la compétitivité européenne. Suite au élargissement de 2007, la programmation 2007-2013 de la politique de cohésion encadre davantage les actions dans les Etats-membres. La Bulgarie décline la politique de cohésion européenne en 5 priorités nationales dont les deux premières, dédiées à l'environnement, risques et énergies ainsi qu'à la modernisation des transports, comptent respectivement pour 46% et 33% des fonds structurels.

L'article traite les problèmes de la compétitivité de l'économie bulgare et des déformations existantes, ainsi que de leur manifestation spécifique dans le contexte de la crise économique et financière mondiale. La compétitivité économique figure parmi les principaux objectifs nationaux dans le contexte de la stratégie Europe 2020 parce que, actuellement, l'économie bulgare affiche un indice de compétitivité mondiale faible. Conformément aux derniers développements dans l'Union concernant une surveillance et une coordination plus intégrées des politiques économiques dans le cadre du semestre européen, les processus et instruments du Pacte de stabilité et de croissance et de la Stratégie Europe 2020 sont synchronisées dans l'optique d'une plus grande interconnexion entre les politiques budgétaires et structurelles. Dans le cadre d'un pays – membre, la politique économique bulgare est en corrélation avec les grandes lignes d'orientations européens.

Les problèmes de l'économie bulgare et de sa compétitivité demeurent au centre de cet Article. Ils constituent en effet une priorité majeure de la restructuration économique et de la politique économique bulgare faisant suite à la crise, et sont liés aux débats européens.

Le programme national de réforme de la République de Bulgarie pour la période 2012-2015 aborde les questions prioritaires en faisant état des besoins immédiats actuels et des défis rencontrés par la petite économie ouverte du pays. Les domaines prioritaires suivants pour la politique économique bulgare ont été identifiés:

- améliorer les infrastructures et l'environnement commercial pour attirer les investissements,
- augmenter la compétitivité des jeunes, et
- restaurer la confiance envers les institutions publiques.

2. LE ROLE DE DEUX OBJECTIFS POUR LA CROISSANCE ECONOMIQUE EN BULGARIE

Les deux grandes lignes, la première l'objectif «convergence» qui vise à améliorer les conditions de croissance et les facteurs menant à une réelle convergence pour les États membres et les régions les moins développées, et la deuxième, l'objectif «compétitivité régionale et emploi» vise à renforcer la compétitivité et l'attractivité des régions, ainsi que l'emploi, grâce à une double approche qui vise:

- D'abord, à mettre en place des programmes de développement afin d'aider les régions à anticiper et à favoriser les changements économiques en stimulant l'innovation, la

société de la connaissance, l'esprit d'entreprise, la protection de l'environnement et en améliorant l'accessibilité, et

- Ensuite à augmenter le nombre et la qualité des emplois en adaptant la main-d'oeuvre et en investissant dans les ressources humaines.

La Bulgarie, comme d'autres États membres, a reçu une aide financière et technique considérable de l'Union européenne au cours de la période de préadhésion et remplit les conditions requises pour bénéficier d'un niveau élevé de soutien financier durant la période s'étendant jusqu'en 2013 (6,852 milliards d'EUR au titre des seuls Fonds structurels).

Un peu d'histoire pour expliquer ce déficit d'absorption des fonds structurels européens en Bulgarie en commencement avec les programmes de pré-adhésion.. On peut tout d'abord interroger les conditions posées par la Commission européenne. Les objectifs de Lisbonne correspondent à des objectifs formulés en 2000 pour et par des économies d'Europe occidentale dont on peut interroger la pertinence pour l'économie bulgare. Le seuil de 60% d'objectifs associé à une économie de la connaissance demeure dans une large mesure en porte-à-faux avec les besoins et les réalités bulgares dans une logique de rattrapage. Les programmes de pré-adhésion (ISPA et PHARE, et exclusion ici de SAPARD) permettent de dresser un bilan comparatif. Selon le ministère des finances bulgare, le bilan 2000-2006 du financement ISPA (880 millions d'euros en date de juillet 2010) montrent que 53% des projets ont concerné la gestion, le recyclage des déchets et des eaux usées ainsi que l'adduction en eau, ce qui correspond tout simplement à une reconstruction des réseaux techniques ; 15% ont concerné les infrastructures de transport. Les fonds de pré-adhésion ont constitué des vecteurs d'apprentissage de la machine communautaire en permettant au pays de piloter une enveloppe annuelle.

En juillet 2010, les taux d'exécution (projets payés par rapport aux engagés de l'enveloppe 2006) atteignaient 56% pour ISPA et 76.6% pour PHARE avec la contrainte de tout dépenser d'ici la fin 2010, sans possibilité de report. Mais les déboires de leur gestion soulignent les difficultés rencontrées par la Bulgarie : suspensions des fonds pour suspicion de corruption, retards répétés dans les délais à tenir, scandales dans la passation des marchés.

L'importance des fonds de pré-adhésion pour l'intégration de la Bulgarie dans l'UE dépasse le seul aspect quantitatif lié au poids des transferts financiers pendant la période de programmation 2000 - 2006 – ils représentent environ 2% du PIB national bulgare..

En effet, l'impact le plus important est la *conditionnalité*, c'est-à-dire le fait de conditionner les fonds européens à certains objectifs ou actions nationaux. Ainsi, les fonds de pré-adhésion ont joué tous un rôle essentiel pour « discipliner » les politiques gouvernementales, étant parfois le facteur clé dans la *formulation et la planification stratégique des stratégies nationales pour le développement économique général ou sectoriel*.

Cet aspect est d'autant plus important étant donné la nouvelle qualité de la Bulgarie à partir de 2007 de nouvel Etat membre de l'Union Européenne et donc les réformes et

mesures nécessaires pour être capable d'utiliser pleinement les nouveaux fonds structurels.

L'aide financière de l'Union européenne n'est disponible qu'à partir du moment où il peut être démontré et officiellement reconnu que le pays fait preuve d'une bonne gestion financière. La Bulgarie rencontre de graves difficultés dans la mise en œuvre de plusieurs programmes financés par l'UE et doit encore démontrer que les structures permettant une gestion financière rigoureuse sont en place et fonctionnent efficacement. Ses capacités administratives sont encore faibles et de graves allégations d'irrégularités circulent, alors que des soupçons de fraude et de conflits d'intérêt planent dans le cadre de l'attribution des marchés. Cette situation a conduit à la suspension temporaire du versement de certaines aides pendant la période 2007 - 2009.

Reconnaissant l'ampleur du problème, le gouvernement bulgare a récemment adopté un certain nombre de mesures correctives. Il s'est attelé à la préparation des changements procéduraux et législatifs nécessaires pour gérer efficacement les conflits d'intérêt. Il a procédé à plusieurs nominations à des postes clés de haut niveau, notamment celle d'un vice-premier ministre responsable de la coordination des fonds de l'UE, qui est aussi le chef des services bulgares de coordination antifraude. Un nouveau directeur de la Cour des comptes a été désigné. Ces initiatives vont dans la bonne direction mais doivent toutes être complétées par des mesures correctives structurelles crédibles ainsi que par une réforme fondamentale.

Les fonds alloués par l'UE à la Bulgarie sont l'expression concrète de la solidarité de l'Union envers les citoyens bulgares. ***Pour stimuler l'absorption des Fonds, la Bulgarie doit prendre les mesures suivantes:***

- sa capacité administrative à gérer les fonds de l'UE doit être renforcée en assurant la stabilité du personnel, en le formant et en le dotant des compétences techniques nécessaires. Les conflits d'intérêt potentiels doivent être évités lors des nominations à des postes d'encadrement;
- les conflits d'intérêt dans la gestion des fonds doivent être exclus;
- le contrôle et la transparence des procédures de marchés publics doivent être améliorés;
- des contrôles et audits sur place doivent être réalisés périodiquement pour l'ensemble des programmes de financement;
- les cas d'irrégularités et de fraude doivent être signalés à la Commission sans délai et sur la base de critères clairement établis;
- des actions destinées à prévenir les violations de la confidentialité doivent être mises en œuvre et des mesures défensives, correctives ou disciplinaires doivent être prises rapidement lorsqu'il y a lieu;

- la coordination entre les ministères, entre les différentes parties prenantes et entre les autorités centrales, régionales et locales doit être améliorée.

Les fonds structurels et les fonds de cohésion sont destinés à stimuler le « rattrapage » mais, par leur ampleur, ils peuvent avoir un impact économique important à la condition toutefois qu'ils puissent être rapidement engagés et rapidement absorbés par les acteurs économiques. Or, on se heurte souvent, dans les États en reconstruction, à une difficulté de gestion de ces fonds. On sait qu'ils devraient permettre au PIB bulgare d'augmenter de 9 points s'ils étaient entièrement consommés d'ici 2015, et ainsi de réduire le chômage de 15 %.[8].

Au lieu de cela, le lancement des programmes opérationnels a été difficile dans le pays en l'absence d'expérience et faute surtout de capacités administratives et juridiques adéquates. C'est ainsi que les projets n'ont commencé en Bulgarie que début 2009. Quant aux taux d'engagement, en janvier 2013, il s'élevait à 30 % en Bulgarie ; il s'agit de taux le plus bas dans l'Union des 27.

Tout a déjà été dit sur les irrégularités dans les appels d'offres et certaines pratiques frauduleuses qui viennent de l'insuffisance du contrôle des autorités de gestion. L'amélioration est d'ailleurs le maître - mot employé par la Commission qui reconnaît que des réformes ont été engagées. Ainsi, à partir de 2009, le gouvernement bulgare a remanié le mécanisme de gestion des fonds en profondeur et un projet routier d'envergure a été relancé. Un ministre uniquement chargé des fonds européens a été nommé ainsi qu'une agence ad hoc pour les grands projets d'infrastructure.

La difficile absorption des fonds européens illustre les difficultés de la Bulgarie et rappelle que dans la reconstruction d'un État, tout marche de front : c'est parce que l'État de droit n'est pas achevé et que les rouages administratifs et judiciaires ne sont pas fiables, que les fonds sont mal absorbés et les fonds étant mal absorbés, ils ne produisent pas les efforts attendus. Il convenait pour la Bulgarie de montrer que la situation progressait à la fois parce que les dégagements d'office s'annonçaient et parce qu'il semblait nécessaire d'être plus convaincant au moment où l'on négociait les perspectives financières 2014-2020. Pour cette période, le pays prétend de enveloppes en hausse de près de 25%.

La Bulgarie dispose pour la période 2007 – 2013, de 6,7 Mds € de fonds structurels et de cohésion auxquels s'ajoute 1,3 Md € de contribution nationale. Ce montant inclut 900 millions pour la construction d'autoroutes et 900 millions pour le rail. L'autoroute « Liulin » (A5 – direction Grèce) qui lie la capitale Sofia avec la ville industrielle de Pernik a été mise en exploitation en Mai 2011. Le port de Varna sera doté de terminaux pour céréales, containers, liquides et marchandises dangereuses, ainsi que d'un terminal pour passagers. A Burgas un terminal pour containers est prévu. Les ports du Danube seront également développés. L'achèvement de la construction du deuxième pont de Danube qui liera les villes de Vidin et Calafat est prévu pour le première trimestre 2013 et sa mise en exploitation – pour Juin-Juillet 2013 [8].

Pour le développement régional et agricole 5 milliards d'euros seront disponibles. La modernisation de l'infrastructure des transports et le développement régional

renforceront la compétitivité de l'économie bulgare et son attrait aux yeux des candidats ' investisseurs. A cet effet le gouvernement a élaboré un plan d'action coordonné 2006-2015. L'exécution de ce plan repose en bonne partie sur des partenariats entre secteurs privé et public (PPP). La BEI investira chaque année (jusqu'en 2013) entre 500 et 700 millions Euro en projets d'infrastructure.

Fin 2012, avec 2,8 Mds € de montants payés, la Bulgarie a porté son taux d'absorption des fonds à 29,5 %. L'impact macroéconomique est important : selon le ministère des Finances, les fonds européens avaient contribué à la croissance du PIB à hauteur de 0,29 point en 2011 et leur contribution sera supérieure en 2012. La Bulgarie doit encore progresser en matière d'absorption, mais elle est parvenue ces deux dernières années, à réduire son retard par rapport aux autres Etats membres.

Grâce à une série de mesures prises entre 2010 et 2012 (nomination d'un ministre chargé des fonds UE, mobilisation des fonds sur des projets d'envergure, réaffectations de fonds), les autorités bulgares sont parvenues à redresser l'absorption des fonds de 3 % fin 2009 à 19 % à la fin 2011 pour atteindre 29,5 % actuellement en 2012 [9]. Les fonds structurels et de cohésion ont ainsi permis la réalisation de nombreux projets, notamment d'infrastructures.

Les autorités concentrent désormais leurs efforts sur la date butoir de 2013, au-delà de laquelle la Bulgarie risque de perdre les fonds qui n'ont pas été engagés, et sur les perspectives financières 2014-2020. Le Gouvernement procède en particulier à un engagement accéléré des programmes opérationnels les moins avancés (fin 2012 le programme « Environnement » est, ainsi, sur engagé à 139 %). Selon le ministère des Finances, à l'horizon 2015 (« n+2 »), le décaissement devrait atteindre 98 % de l'enveloppe 2007 – 2013. Cependant, la consommation des fonds restants à décaisser (environnement, compétitivité), sera plus difficile, l'essentiel des grands projets ayant été lancés ou achevés. Les risques de perte d'une partie de l'enveloppe sont, donc, bien réels.

3. LA SITUATION ECONOMIQUE EN BULGARIE PENDANT LES ANNEES 2011-2012

Le 15 avril 2011, la Bulgarie a présenté la version actualisée de son programme de convergence 2011, qui couvre la période 2011-2014, ainsi que son programme national de réforme 2011 et le 13 Avril 2012 les deux Programmes, qui couvrent la période 2012'1015. La crise économique a mis un terme à une période de forte croissance alimentée par un afflux massif d'investissements directs étrangers et par l'expansion du crédit. Après avoir chuté de 7,1 % au total par rapport au niveau le plus élevé qu'elle avait atteint, la croissance du PIB a repris au second trimestre 2011, avec pour résultat final un PIB réel quasiment stable pour l'année 2012 dans son ensemble. La forte reprise des exportations et la reconstitution des stocks ont été les principaux déterminants de la croissance. Alors qu'il était excédentaire avant la crise, le solde budgétaire des administrations publiques s'est transformé en un déficit qui a atteint 3,7 % du PIB en 2010 et 2,3 % du PIB en 2011. Si la production et l'emploi dans les industries à vocation exportatrice ont augmenté, le ralentissement de l'activité dans les

secteurs de la construction, de l'immobilier et du commerce de détail a freiné la reprise au cours de l'année écoulée. C'est l'emploi qui a le plus souffert de la correction de la production, quelque 458 000 postes de travail ayant été perdus par rapport au sommet atteint en 2011. En conséquence, le chômage a augmenté de plusieurs points de pourcentage pour s'établir à 12,4 % fin 2012 ; il n'est pas prévu qu'à moyen terme, l'emploi revienne à son niveau d'avant – crise [17].

La correction du déficit excessif telle qu'envisagée d'ici la fin 2012 contribuera à restaurer la confiance et renforcera la crédibilité de la politique menée par le gouvernement. À moyen terme, il sera important d'atteindre l'objectif d'un faible déficit structurel, à hauteur de 0,6 % du PIB, de manière à garantir que la politique budgétaire soutient le régime monétaire en vigueur. L'assainissement budgétaire est toutefois entravé par des dysfonctionnements du secteur public qui pourraient engendrer une pression considérable sur les dépenses, alors que les recettes budgétaires seront probablement inférieures structurellement à ce qu'elles étaient au cours des années d'expansion qui ont précédé la crise. Il convient donc de procéder à une réforme ambitieuse des finances publiques pour pouvoir mener à bien l'indispensable ajustement budgétaire et contribuer à dégager les moyens financiers nécessaires à la mise en oeuvre des réformes structurelles, y compris le cofinancement requis pour les projets soutenus par l'UE. Les résultats budgétaires de la Bulgarie ont été relativement bons dans le contexte économique favorable qui prévalait avant la crise. Les objectifs budgétaires ont été systématiquement respectés et des réserves budgétaires conséquentes ont été accumulées

Bruxelles prévoit une croissance de l'économie bulgare d'environ 1,4% pour 2012.

L'économie bulgare a ravivé relativement lente en 2010-2012, le produit intérieur brut au dernier trimestre de l'année dernière reste d'environ 3%, donc la croissance économique de la Bulgarie reste en dessous de son pic de 2008. Pour l'entière 2012, la croissance économique bulgare s'est élevé à 1,4%. Malgré les prévisions abaissées pour la zone euro, la Bulgarie ne devrait pas retomber dans la récession en 2013. Toutefois, la croissance économique sera inférieure à la croissance prévue [17].

La dette des entreprises a commencé à décliner, ainsi que la dépendance du secteur financier sur le financement externe. Le secteur financier reste stable, il est prévu une reprise progressive de la consommation et une stabilisation du marché du travail. Comme un risque majeur pour la Bulgarie indiquent le stress continu sur les marchés financiers, ce qui peut retarder la reprise de la consommation et l'investissement.

Les prévisions économiques sont différentes de celles d'une croissance de 1,8 %, prévues dans le budget économique de gouvernement pour 2013.

Tableau 1. Indicateurs macroeconomiques generaux en 2011-2012

	2011	2012
PIB	34,10 milliards €	34.37 milliards €
PIB par habitant	4 475 € (contre 2 800 € en 2005)	4 575 €
Taux de croissance	1,6 %	0.8%
Taux de chômage	12,2 %	12.2%
Taux d'inflation	2,8 %	2.4%
Dettes publiques	15,3 % du PIB	15,9 % du PIB
Déficit budgétaire	- 2,1 %	-1.0%
Part de l'agriculture dans le PIB	10,1 %	9.2%
Fonds UE disponibles 2007 - 2013	6,9 milliards €	6,9 milliards €
Taux d'engagement Fonds UE	19 %	29.5%
Taux d'absorption Fonds UE	19 %	29.5%

Source : eufunds.bg

http://ec.europa.eu/economy_finance/eu/forecasts/2013_winter/bg_en.pdf

L'influence de la crise financière et économique mondiale persiste, accompagnée de la crise de la dette dans l'Union européenne. Les conséquences du contexte économique instable et du rétrécissement des marchés se traduisent par:

- une insuffisance des moyens financiers disponibles,
- une diminution de la consommation de biens et services en Bulgarie et à l'étranger,
- une diminution du volume de la production,
- la fermeture de sociétés,
- une diminution significative des investissements étrangers dans de nouvelles productions ou dans l'extension de productions existantes,
- une optimisation des dépenses, etc., ce qui entraîne des tendances négatives sur le marché du travail.

Les secteurs économiques les plus touchés par la crise sont: le bâtiment, le transport (surtout les chemins de fer), le commerce, l'industrie du vêtement et de la chaussure, la construction mécanique et la transformation des métaux, l'industrie chimique et l'industrie extractive, la menuiserie, l'industrie de la transformation du bois et la production de meubles, la transformation du lait et de la viande, le commerce, l'administration publique, etc.

Tableau 2. Principales forces et faiblesses de l'économie Bulgare

FORCES	FAIBLESSES
Faible endettement public	Faiblesse de l'industrie exportatrice
Des politiques macroéconomiques prudentes	Une forte vulnérabilité aux chocs extérieurs
Un secteur bancaire stable	La dette extérieure reste élevée
Stabilité du taux de change grâce au « currency board »	Une forte exposition des entreprises au risque de change
Une main-d'oeuvre qualifiée	Des progrès insuffisants en matière de gouvernance
Subventionnements européens / fonds structurels importants	Une bureaucratie encore lourde
	Un système judiciaire lent

Source : Auteur

Les mesures de politique économique visent en priorité à surmonter les obstacles actuels à la croissance économique et se présentent comme suit:

- renforcer l'efficacité des dépenses publiques et allouer des fonds publics à des activités qui améliorent le potentiel de croissance de l'économie;
- pourvoir à un secteur financier fonctionnel et efficace comme condition nécessaire au développement durable de l'économie;
- améliorer et rendre plus efficace l'utilisation du potentiel de main-d'oeuvre de l'économie;
- pallier les faiblesses de l'environnement commercial et améliorer l'efficacité administrative;
- augmenter la qualité et l'efficacité des systèmes d'éducation et de formation.

4. LA POLITIQUE INDUSTRIELLE ET LA COMPETITIVITE BULGARE EN 2010-2013

Le pays s'est considérablement industrialisé – près d'un tiers de la population active travaille dans l'industrie. Ce secteur dépend toujours de l'industrie lourde (métallurgie, chimie, fabrication de machines), mais les secteurs les plus dynamiques sont aujourd'hui le textile, les produits pharmaceutiques, cosmétiques et les TIC. Le secteur tertiaire, représente environ 64% de la valeur ajoutée du pays

La diversité des situations, entre les secteurs industriels autant qu'entre les régions bulgare, contraint à une grande intelligence de la situation : alors que la politique industrielle s'est jusqu'alors concentrée sur la stimulation de l'offre par la concurrence, au risque de créer de graves déséquilibres, elle doit maintenant être étoffée par une vision sectorielle et géographique dans le pays.

Les grands lignes économique après 2007 sont orientés vers :

- Le gouvernement bulgare, au début de 2010, a présenté son avis sur les défis faisant face à l'économie bulgare, où l'accent est mis sur l'impact de la crise économique mondiale sur les branches clés de l'économie et la signification de la politique d'innovation dans l'assistance à la compétitivité et à la croissance économique est décrite.
- Le document stratégique à long terme "la Structure nationale de Référence Stratégique 2007-2013" est concentré sur les quatre priorités clés - l'amélioration de l'infrastructure de base, la majoration de la qualité du capital humaine avec un accent mis sur l'emploi, la promotion de l'entrepreneuriat, d'un environnement favorable aux affaires et la bonne gestion et l'assistance pour le développement d'un territoire équilibré.
- "La stratégie d'Innovation de la République de Bulgarie et les Mesures pour sa Mise en oeuvre" couvrant la période avant 2013 doit améliorer la compétitivité de l'industrie bulgare par la construction d'une industrie basée sur la connaissance.
- Le Programme Opérationnel "le Développement de la Compétitivité de l'Économie bulgare 2007-2013" se concentre sur l'établissement et la mise en oeuvre de produits innovateurs et de technologies dans les procédés de fabrication, l'installation d'activités innovatrices, la modernisation et la rénovation technique.

La création et la stimulation d'un marché commun en Europe reste au cœur du projet européen, comme en témoigne la communication de la Commission européenne sur l'Acte pour le marché unique ", adoptée en avril 2011 et visant, par son train de mesures, à relancer l'économie européenne et la création d'emplois. Grâce à cette liberté croissante de la circulation des hommes, des biens, des services et des capitaux, les entreprises qui souhaitent se développer en Europe ont de plus en plus tendance à mettre en concurrence les territoires pour déterminer celui qui leur apporte le plus de bénéfices. Leur processus de décision prend en compte de nombreux facteurs, dont certains dépendent du secteur de l'entreprise et d'autres sont communs à toutes les industries.

La compétitivité des entreprises, quelle que soit leur taille, est l'un des principaux moteurs d'une forte croissance économique, laquelle requiert un environnement favorable aux idées et aux entreprises nouvelles. Une industrie compétitive peut abaisser les coûts et les prix, créer des produits nouveaux et améliorer la qualité, apportant ainsi une contribution déterminante à la création de richesses et à l'accroissement de la productivité dans l'ensemble de l'économie. L'industrie est également la source clé des innovations requises pour relever les défis sociétaux auxquels est confrontée la Bulgarie.

Dans le cadre de la stratégie **«Europe 2020»**, la Commission a lancé, en 2010, une nouvelle politique industrielle ambitieuse qui a mis en lumière les mesures nécessaires

pour renforcer l'attractivité de l'Europe en tant que lieu d'investissement et de production, y compris l'engagement de surveiller les politiques de compétitivité des États membres.

La Bulgarie est en phase de rattrapage, mais dont la spécialisation commerciale concerne des secteurs moins avancés sur le plan technologique. Le pays est généralement spécialisé dans les secteurs à plus forte intensité d'éducation. Toutefois, une différence majeure concerne la présence moyenne bien plus forte d'entreprises à forte croissance dans l'économie bulgare, la forte expansion de l'industrie et la spécialisation commerciale accrue dans les secteurs à vocation technologique. La valeur ajoutée de l'industrie y étant comprise entre 9,9 % et 20,4 % en 2012.

La recherche et l'innovation sont le moteur de l'accroissement de la productivité et de la compétitivité industrielle. Grâce aux nouvelles technologies, la production commerciale peut se faire dans des quantités encore plus restreintes, alors que les matériaux avancés, les technologies à faible empreinte de carbone, les biotechnologies et les nanotechnologies modifient la nature de l'avantage concurrentiel. L'industrie de la Bulgarie doit faire davantage d'efforts pour adopter ces technologies dans le but de conserver son avance concurrentielle dans l'UE et dans le monde.

Les Solutions envisageables pour renforcer la compétitivité en Bulgarie sont :

- regrouper les ressources rares afin de contribuer à atteindre une masse critique en matière de commercialisation de l'innovation; améliorer la coopération dans le domaine de l'innovation afin de créer des projets de démonstration et des infrastructures d'essais pilotes à grande échelle.
- réduire la fragmentation des systèmes d'aide à l'innovation; faciliter la commercialisation de solutions innovatrices; améliorer les perspectives commerciales des projets de recherche.

La nouvelle stratégie industrielle de la Bulgarie devrait être mise au point jusqu'au mois de juin 2013 tout comme les mesures prioritaires à ce niveau. En plus de cela, cette stratégie doit s'intégrer dans la stratégie nationale de développement Bulgarie 2020 afin de garantir son financement dans le cadre des programmes opérationnels de l'Union européenne sur la période suivante de programmation 2014-2020.

En plus du soutien à la stabilité macroéconomique du pays, ces objectifs envisagent encore le perfectionnement des conditions pour le business, la réalisation de liens plus étroits entre les structures de l'éducation et le business, l'encouragement des relations entre les différentes industries et la mise en place de conditions favorables pour leur rassemblement dans des clusters. ***La nouvelle stratégie industrielle met l'accent sur sept clusters industriels de pointe :***

- l'agriculture et l'agro-alimentaire,
- la santé publique,
- les transports et la logistique,
- les constructions mécaniques,
- les technologies de l'information ,
- les télécommunications,

- l'industrie chimique, l'électronique et l'électrotechnique.

Il est persuadé que le concept « Bulgarie 2020 » envisagera au moins 4-5 grandes villes dans différentes régions du pays où pourraient être situés les parcs technologiques. Attirer des investissements pour la réalisation de ce concept devrait d'autre part passer au rang d'objectif stratégique national.

5. PROGRAMME OPERATIONNEL ; « DEVELOPPEMENT DE LA COMPETITIVITE DE L'ECONOMIE BULGARE »

Le 26 septembre 2007, la Commission européenne a approuvé un programme de développement d'envergure destiné à la Bulgarie pour la période 2007-2013 et intitulé «Programme opérationnel pour le développement de compétitivité de l'économie bulgare». Ce programme prévoit un soutien communautaire en faveur de l'ensemble du territoire national dans le contexte de l'objectif «Convergence». Le budget total alloué à ce programme est d'environ 1,16 milliard d'euros et l'intervention communautaire par le FEDER représente 988 millions d'euros (soit à peu près 15 % du total des fonds communautaires qui seront investis en Bulgarie au titre de la politique de cohésion pour la période 2007-2013).

Le programme opérationnel «Développement de la compétitivité de l'économie bulgare» (PO Compétitivité) est le document de programmation principal visant à optimiser la compétitivité de l'économie bulgare. L'assistance proposée par ce programme permet de soutenir le développement d'une production compétitive et efficace et la mise en valeur de secteurs de l'industrie. Elle vise à augmenter la croissance économique et à faciliter la restructuration économique nécessaire de l'économie bulgare en vue de parvenir à une cohésion et à une croissance durable au cours de la période de programmation.

Il est prévu d'atteindre ces objectifs grâce à un soutien visant à améliorer la productivité et le potentiel de croissance des petites et moyennes entreprises, favoriser le développement des innovations, faciliter la transition vers une économie de la connaissance et l'introduction de nouvelles technologies, et optimiser l'environnement des entreprises. Le programme opérationnel s'inscrit parfaitement dans les objectifs de l'agenda de Lisbonne 2000 ainsi que dans les orientations stratégiques de la Communauté pour la cohésion économique, sociale et territoriale..

Le Programme doit:

- Augmenter les dépenses de recherche-développement (R-D) de 0,64 % et les porter ainsi à 1,15 % d'ici 2013;
- Augmenter de 30 % le pourcentage des exportations dans le ratio du PIB d'ici 2013;
- Réduire le niveau d'intensité énergétique de 25 % par rapport au niveau observé en 2004 et créer une capacité supplémentaire de 16 GWh pour les besoins des entreprises spécialisées dans la production d'énergies renouvelables au sein du réseau national;
- Créer 2 120 emplois, plus 300 emplois dans le domaine de la recherche;

- Au total, la contribution des petites et moyennes entreprises (PME) au PIB est fixée à 32,3 % pour 2013, soit une augmentation de 10 % par rapport aux données de 2004 et l'augmentation de la productivité du travail sera égale à 11,5 % pour la même période et sur les mêmes bases.

Axe prioritaire

Le principal objectif du PO «Développement de la compétitivité de l'économie bulgare» est de développer une économie dynamique et compétitive sur le marché européen et mondial. Cet objectif est directement lié aux recommandations formulées dans le cadre de référence stratégique national pour la période 2007-2013.

Pour parvenir à un niveau de vie élevé reposant sur un développement économique et social durable, l'économie bulgare doit se développer de manière dynamique. Or, cet objectif dépend principalement de la compétitivité des services et des produits finis sur les marchés internationaux, compétitivité propice à l'emploi et au développement professionnel de la population. L'équilibre entre l'essor économique et la protection de l'environnement, ainsi que le rapport entre la croissance économique et l'emploi et la participation économique de la population sont également pris en compte.

Pour atteindre le principal objectif du programme opérationnel, il faut mettre l'accent sur les points spécifiques suivants: encourager l'innovation, augmenter l'efficacité des entreprises et améliorer l'environnement dans lequel ces dernières évoluent. Une fois ces progrès réalisés, les entreprises bulgares seront plus compétitives au niveau international et par conséquent des acteurs clés de la création d'une croissance durable dans l'économie nationale dans le contexte d'une économie de la connaissance future et d'un contexte économique de plus en plus mondialisé.

Les principaux objectifs seront atteints selon cinq axes prioritaires:

Axe prioritaire 1: «Développement d'une économie de la connaissance et d'activités d'innovation».

Il s'agit de favoriser le développement des activités R-D pour et par les entreprises, de renforcer leur potentiel innovant et de définir une infrastructure des entreprises favorable à l'innovation, capable de renforcer les relations entre le monde des scientifiques et celui des entreprises.

Axe prioritaire 2: «Augmentation de l'efficacité des entreprises et promotion d'un environnement des entreprises de soutien».

Cet axe vise à appuyer les PME et les micro - entreprises dotées d'un potentiel de développement en favorisant la modernisation des technologies et la gestion de la qualité, ainsi que l'amélioration des services de conseil et d'information proposés aux entreprises, tout en optimisant l'efficacité énergétique de celles-ci et en encourageant la coopération entre elles et les réseaux d'affaires. Le programme sera plus spécifiquement orienté sur l'encouragement des investissements dans les technologies de production permettant des économies d'énergie, peu polluantes et respectueuses de l'environnement, afin de réduire sensiblement l'intensité énergétique des entreprises bulgares et les incidences négatives sur l'environnement et de contribuer ainsi au développement d'un environnement durable.

Axe prioritaire 3: «Ressources financières des entreprises en cours de développement»

Cet axe a pour finalité d'améliorer l'accès des entreprises au capital - développement par une augmentation de l'activité d'investissement et la mise en valeur de l'esprit d'entreprise grâce au développement d'instruments financiers spécifiques et de l'ingénierie financière pour les PME. Les interventions prévues doivent offrir aux PME de nouvelles opportunités d'accès au capital-risque dans des «niches de financement» lorsque les crédits bancaires traditionnels ne sont pas proposés ou qu'ils sont insuffisants. La réalisation de la plupart de ces objectifs passe par la concrétisation de l'initiative conjointe JEREMIE (Ressources européennes conjointes pour les PME et les micro entreprises).

Axe prioritaire 4: «Renforcement des positions de l'économie bulgare sur le marché international»:

Cet axe prioritaire vise à favoriser l'intégration de l'économie bulgare au sein du marché unique européen et mondial à travers l'amélioration de l'environnement des investissements et des exportations. Il encourage les investissements étrangers en Bulgarie, optimise le potentiel d'exportation de l'économie nationale et soutient l'infrastructure de qualité nationale en améliorant les laboratoires d'étalonnage et d'essais, ainsi que les organismes d'évaluation de la conformité.

Axe prioritaire 5: «Assistance technique»

Il s'agit de fournir une aide pour la gestion, la conduite, la surveillance et le contrôle des activités relevant du PO «Compétitivité», ainsi qu'un soutien du travail fourni par le Comité de suivi en finançant les recherches et les études nécessaires pour la réalisation et l'évaluation des projets, ainsi que des mesures d'information et de publicité, garantes de la transparence du système. L'objectif est d'améliorer la qualité des interventions à effectuer et d'augmenter l'efficacité de l'absorption des Fonds structurels.

LES FINANCEMENT PAR AXE PRIORITAIRE

Axe prioritaire	Investissement de l'UE	Contribution nationale publique	Contribution publique totale
Développement d'une économie de la connaissance et activités d'innovation	209 525 000	36 975 000	246 500 000
Augmentation de l'efficacité des entreprises et mise en place d'un environnement propice aux entreprises	504 762 113	89 075 667	593 837 780
Ressources financières destinées aux entreprises en cours de développement	170 000 000	30 000 000	200 000 000
Renforcement des positions de l'économie bulgare sur le marché international	73 960 090	13 051 780	87 011 870
Assistance technique	29 636 016	5 299 885	34 935 901
Total	987 883 219	174 402 332	1 162 285 551

Source : <http://www.eufunds.bg/?cat=2>;

Ministère de l'économie et énergie : www.mee.government.bg/eng/index.html

La Bulgarie dispose désormais de ses propres modèles mathématiques d'évaluation des effets de l'absorption des fonds européens sur l'économie. **Il s'appelle SIBILA** Simulatio of Bulgaria's Investment in Long term Advance et il montre quel sera la développement économique du pays. . Le modèle peut également prévoir l'effet macroéconomique sur la gestion des moyens de l'UE.

Le modèle bulgare est entièrement adapté aux spécificités de notre économie et il permet une évaluation des effets des différents projets, des procédures du programme et une combinaison de tels.

Le modèle observe l'effet sur des facteurs fondamentaux de la compétitivité de notre économie, le facteur humain, les technologies d'innovations, l'activité scientifique de recherche, les technologies informatiques et les technologies de communications, les infrastructures les unités de production et de production nettes

Selon les calculs sur le nouveau modèle les investissements par des moyens européens en Bulgarie, ont augmentées le PIB réel du pays de 1,5%, depuis l'absorption de l'argent du fonds de cohésion rien que pour 2011 leur production nationale a augmenté de 6,5 % -indiquent les bilans selon la formule SIBILA d'évaluation des effets réels. Parmi les effet les plus visibles sur l'économie de la Bulgarie depuis l'introduction des moyens européens à court terme figure la diminution du chômage et l'accroissement de l'emploi. Selon l'évaluation du modèle SIBILA vers la fin 2011 le chômage a été de 1,7 % moins élevé que si les investissements européens n'avaient pas lieu, tandis que l'emploi de 2,6% plus élevé ou avec une hausse de 100 000 emplois en plus. Les prévisions indiquent que ces effets se conserveront jusqu'à la fin de 2015. En tant que résultat de l'introduction des Fonds européens dans ce domaine l'emploi augmentera d'environ 4,8 %.

La politique d'absorption et les mesures prévues

Des normes communes en matière de gestion et de contrôle financier doivent être respectées par tous les États membres dans le cadre de la gestion des fonds de l'UE. Il convient notamment d'appliquer des procédures strictes en matière de passation des marchés. L'aide financière de l'Union européenne n'est disponible qu'à partir du moment où il peut être démontré et officiellement reconnu que le pays fait preuve d'une bonne gestion financière. La Bulgarie à agir d'urgence pour assurer la mise en oeuvre des fonds de l'UE, qui sont destinés à favoriser la cohésion sociale, à améliorer le développement régional et à renforcer la stabilité et les performances économiques globales du pays.

La Bulgarie pendant les dernières trois années a orientée sa politique d'absorption vers les mesures suivantes:

- sa capacité administrative à gérer les fonds de l'UE doit être renforcée en assurant la stabilité du personnel, en le formant et en le dotant des compétences techniques nécessaires. Les conflits d'intérêt potentiels doivent être évités lors des nominations à des postes d'encadrement;
- les conflits d'intérêt dans la gestion des fonds doivent être exclus;
- le contrôle et la transparence des procédures de marchés publics doivent être améliorés;
- des contrôles et audits sur place doivent être réalisés périodiquement pour l'ensemble des programmes de financement;
- les cas d'irrégularités et de fraude doivent être signalés à la Commission sans délai et sur la base de critères clairement établis;
- des actions destinées à prévenir les violations de la confidentialité doivent être mises en oeuvre et des mesures défensives, correctives ou disciplinaires doivent être prises rapidement lorsqu'il y a lieu;
- la coordination entre les ministères, entre les différentes parties prenantes et entre les autorités centrales, régionales et locales doit être améliorée.

6. CONCLUSION

La politique d'absorption des Fonds en Bulgarie ne s'agira cependant pas seulement d'améliorer la qualité des dossiers ou de mieux communiquer sur les réalisations, il s'agira également de changer notablement la destination des fonds. Et ici la priorité est d'axer l'intervention des fonds sur les politiques qui préparent au mieux la croissance et l'emploi de demain et donc sur la recherche et l'innovation. En procédant ainsi, l'impact des fonds européens sur le développement durable des régions sera sensiblement renforcé.

En Bulgarie, même si les priorités sont plutôt axées sur les infrastructures, les projets doivent trouver l'équilibre le plus adéquat entre ceux concernant le transport, l'énergie et ceux concernant la recherche et l'innovation. Parce que c'est seulement ensemble ces deux aspects, auxquels il faut ajouter le développement du capital humain qui feront que ce pays puisse rattraper le décalage par rapport aux autres Etats membres de l'UE.

Ainsi, le travail, qui reste dore et déjà à faire engagé dans le pays pour définir les futurs programmes, poursuivi dans le cadre d'un dialogue qui se veut constructif avec la Commission Européenne, sera crucial pour l'amélioration de l'emploi et de la croissance dans les régions bulgares. Et, dans le cadre financier contraint imposé surtout au niveau des anciens Etats membres, seul un engagement autour d'une stratégie partagée faisant la part belle à la recherche et l'innovation permettra de redonner aux fonds structurels le rôle qui est le leur : assurer la cohésion en redonnant foi en l'avenir.

BIBLIOGRAPHIE

Commission européenne, « *Les fonds structurels et la coordination avec le fonds de cohésion. Orientations pour les programmes 2000-2006* », Communication COM(1999) 344 final ;

Commission européenne, « *Au service des régions* » Série « *L'Europe en mouvement* », Luxembourg, Office des publications officielles des Communautés européennes, 2001

Commission européenne, « *Les Fonds structurels en 2002* », 14ème rapport, Luxembourg, Office des publications officielles des Communautés européennes, 2003.

Commission (2003a), *Enlargement of the European Union: Guide to Negotiations Chapter by Chapter*, Brussels: DG Enlargement; http://ec.europa.eu/enlargement/archives/enlargement_process/future_prospects/negotiations/eu10_bulgaria_romania/chapters/index_en.htm

Commission (2003b), *Regular Report on Bulgaria's Progress towards Accession*, Brussels: The European Commission.

Commission (2004), *A New Partnership for Cohesion: Convergence, Competitiveness, Cooperation. Third Report on Economic and Social Cohesion*, Luxembourg: Office for Official Publications of the European Communities.

Commission européenne, RECOMMANDATION DU CONSEIL concernant le programme national de réforme de la Bulgarie pour 2011 et portant avis du Conseil concernant le programme de stabilité actualisé de la Bulgarie pour 2011-2014.

Convergence Programme (2012-2015). *Republic of Bulgaria. Ministry of Finance. April 2012*, Sofia, Bulgaria

CMRB (2010), *National Strategy for Regional Development 2010-2015*; www.mrb.government.bg

Goldsmith M. (2003), "Variable geometry, multi-level governance: European integration and subnational government in the new millennium", in K. Featherstone & C.M. Radaelli, eds., *The Politics of Europeanisation*, Oxford: Oxford University Press

Jean-François DREVET, « *Europe : les fonds communautaires et l'élargissement* », *Futuribles*, n° 282, janvier 2003 ;

Marcou G., ed. (2002), "Regionalisation for Development and Accession to the *European Union: A comparative perspective*", Budapest: Local Government and Public Reform Initiative; http://lgi.osi.hu/publications_datasheet.php?id=105

Fonds européens : <http://www.eufunds.bg/?cat=2>

Ministère de l'économie et énergie : www.mee.government.bg/eng/index.html

Projets ISPA en Bulgarie : http://ec.europa.eu/regional_policy/funds/ispa/bulga_en.htm

Rapport intéressant: The Bulgarian Investment and Infrastructure Executive Report : http://www.government.bg/fce/001/0162/files/rezumeNSI_EN.doc

Programme de convergence 2006-2009 : <http://www.minfin.bg/>

Agence d'investissement bulgare : <http://www.investbg.org/>
Parlement européen : <http://www.europarl.europa.eu/fr/pressroom/content/20110704IPR23283/html/Le-Parlement-soutient-1%E2%80%99aide-au-d%C3%A9veloppement-des-r%C3%A9gions-en-transitio>

Lucica Matei

Ecole Nationale d'Etudes Politiques et Administratives, Faculté d'Administration
Publique, Bucarest, Roumanie

Corina Lazăr

Ecole Nationale d'Etudes Politiques et Administratives, Faculté d'Administration
Publique, Bucarest, Roumanie

LA RATIONALISATION ADMINISTRATIVE ET LA PERFORMANCE ECONOMIQUE DANS CERTAINS ÉTATS DE L'EUROPE DU SUD-EST

ABSTRAIT

La littérature de spécialité établit une liaison entre la rationalisation administrative et la performance économique d'un État. Selon Dahl (1947) et Simon (1976) le modèle rationnel de l'administration influence à la fois le gouvernement et la bureaucratie corporatiste. La rationalité et la performance deviennent les bases de la bonne gouvernance. Les nouvelles études d'Evans et Rauch (1999) ou Matei et Matei (2011) mettent en évidence des analyses statistiques importantes qui démontrent l'interdépendance entre la bureaucratie et la croissance économique.

De ce fait, le travail veut réaliser et présenter une étude sur la qualité de la bureaucratie qui est mise en évidence à travers les caractéristiques de rationalité propre à la bureaucratie de Weber et la performance économique exprimée, par exemple, par des indicateurs synthétiques comme le PIB par habitant. Le groupe cible des États à analyser comprend la Roumanie, la Croatie, la Bulgarie et la Grèce.

La méthodologie de recherche fait valoir des résultats d'autres projets européens et leur interprétation statistique et économique, afin de mettre en évidence les changements issus du processus d'élargissement de l'Union européenne.

Mots-clés: rationalisation administrative, performance économique, qualité de la bureaucratie

JEL classification: D73; O10

1. INTRODUCTION

La rationalité s'occupe du choix des alternatives de comportement dans la perspective d'un système de valeurs, à l'aide duquel on peut évaluer les conséquences du comportement (Simon, 2004:66). La rationalisation administrative porte sur l'approche de Weber de l'administration publique et du service public, à présent en train de développement à l'aide des théories et des principes du choix rationnel (Matei et Matei, 2011:277). La caractéristique principale de la bureaucratie de Weber est sa rationalité, la bureaucratisation invoquant l'avantage d'une organisation qui est prédictible et efficace. Selon Max Weber, la bureaucratie représente la forme d'organisation propre à la société moderne, qui est toujours en développement. C'est la conséquence des transformations économiques, politiques, culturelles etc. Le développement de la bureaucratie est fortement lié à l'apparition de l'économie capitaliste et, particulièrement, à la pression croissante pour l'efficace économique, au développement des unités économiques de plus en plus grandes.

L'approche de Weber ne met pas à l'ombre les effets positifs du renforcement des institutions du marché, mais, elle prouve que les organisations publiques structurées bureaucratiquement, qui utilisent leur propre jeu de procédures décisionnelles, sont un attribut nécessaire aux arrangements commerciaux (Evans et Rauch, 1999:749). Plus précis, Weber a affirmé que les organisations publiques administratives caractérisées par un recrutement méritocratique et une carrière prévisible et durable seront plus efficaces afin de faciliter la croissance capitaliste que d'autres formes d'organisation de l'État.

L'organisation bureaucratique d'une structure sociale peut avoir des conséquences économiques d'envergure. Pour tous les cas, les conséquences dépendent de la distribution du pouvoir économique et social, et plus de la sphère qui est occupée par l'appareil bureaucratique émergent. De ce fait, les conséquences de la bureaucratie dépendent de la direction que les pouvoirs qui utilisent ledit appareil y confèrent.

2. CADRE THEORIQUE

2.1. Interdépendance entre les structures des autorités bureaucratiques et la croissance économique

La performance économique relève de la gouvernance. Le déchiffrement de la relation entre les structures administratives et le degré de changement du pouvoir économique, est, par conséquence, une préoccupation pérenne à la fois des théoriciens et des praticiens (Evans et Rauch, 1999: 748).

Il y a plus d'une décennie, la Banque Mondiale (World Bank, 1997) a rendu sa conclusion: „l'efficacité du gouvernement est la cause de la croissance économique” et „la gestion des ressources humaines est un des facteurs qui déterminent la performance organisationnelle” (UNPAN, 2005:27).

Dans ce contexte, la Banque Mondiale a inclus la qualité de la bureaucratie publique, de la préparation des politiques et de la fourniture des services publics dans l'index sur „l'efficacité du gouvernement”. De plus, en vertu d'une analyse réalisée en 175 États, Kaufmann (1999) a souligné qu'une forte liaison a été confirmée entre l'efficacité du gouvernement et la croissance économique et que „l'efficacité du gouvernement a contribué au revenu national supérieur” (UNPAN, 2005:27). Il y a, dans le même document, des arguments supplémentaires, en affirmant, en raison des études consistantes dans les entreprises prouvées des États industrialisés et, à la suite, dans les États en voie de développement et en transition, que la qualité de la bureaucratie et de la gestion des ressources humaines est fortement liée à leur performance globale (Matei et Matei, 2011: 278).

Selon Shafritz et Russell (1997:203), on peut résumer la théorie organisationnelle classique dans les principes ci-dessous: 1) Les organisations existent pour réaliser des objectifs économiques ou concernant la production; 2) Il y a une manière optimale d'organisation pour la production et l'on peut réaliser à travers la recherche scientifique systématique; 3) La production peut être maximisée par division du travail et spécialisations; 4) Tant les hommes que les organisations agissent selon des principes économiques rationnels.

Ces dernières années, les économistes ont souligné l'idée selon laquelle les institutions économiques favorables, surtout celles du secteur public, sont essentielles pour la croissance économique. Parmi ces institutions on trouve le gouvernement limité, une bureaucratie relativement facile et non corrompue, un système juridique qui protège les droits de propriété et les contrats imposés et une imposition modeste et régulière (La Porta et al, 1999:222).

Ce qui fait des institutions bureaucratiques des instruments efficaces c'est leur caractère rationnel manifesté dans leurs quatre dimensions principales (Weber, 1992: 25-30): 1) Elles peuvent manœuvrer un grand nombre de tâches; 2) Elles mettent l'accent sur la quantification; 3) Elles opèrent d'une manière prévisible, standardisée; 4) Elles mettent l'accent sur le contrôle de ceux qui sont entraînés dans le système des institutions.

La contribution de l'État à la croissance économique est en grande partie définie par la fourniture de biens et services. Ces biens et services sont offerts par la bureaucratie. Les structures bureaucratiques plus efficaces attireront plusieurs investissements privés, le moteur principal pour la croissance économique (Lovett, 2011). Par la suite, les facteurs qui aident une bureaucratie à mieux fonctionner, vont générer, en théorie, une croissance économique.

La performance du gouvernement d'un pays devrait être évaluée, en partie, à travers l'évaluation de la qualité de certains services publics, tels que l'éducation, la santé, l'infrastructure etc. La haute qualité de ces services est le signe d'un gouvernement qui fonctionne bien. Plus problématique, mais à la fois d'importance, un indicateur de la performance, sont les dépenses du gouvernement sur les transferts, la consommation propre et la force de travail du secteur public. Des dépenses publiques élevées peuvent refléter le désir des citoyens à payer des impôts parce qu'ils aiment ce que le

gouvernement fasse et elles reflètent, donc, une bonne gouvernance. Alternativement, les dépenses élevées pour les transferts et les subventions ou pour la consommation de gouvernement peuvent refléter un niveau plus élevé des impôts, une distorsion et une redistribution (Barro, 1991) et cela représente, donc, un échec en ce qui concerne la protection du public face à l'intervention de l'État.

On peut construire des connexions entre ces caractéristiques et la capacité accrue d'organisation dans la livraison des services et biens collectifs, des services et biens représentant la contribution de l'État au potentiel de la croissance économique (Evans et Rauch, 1999:749).

Il y a quatre manières dans lesquelles la gouvernance économique peut contribuer à la performance économique: d'abord, les actions qui contribuent à la production des idées, systèmes d'options et raisons; à la suite, les actions qui réduisent les coûts des transactions, ensuite les actions qui stimulent la créativité, l'innovation et les aptitudes; et enfin les actions qui inhibent et/ou corrigent les échecs de la gouvernance (Marsh, 1999:50).

Pour jouer un rôle efficace dans la performance économique, l'État doit envisager un cadre dans lequel, en dépit de la rationalité limitée et du degré d'incertitude, on peut recueillir les informations et encadrer les diverses perspectives (Kelm, 1996; Marsh, 1995). Lorsqu'on ne peut pas différencier les informations et les perspectives produites par l'État et celles des acteurs privés, le rôle de l'État est évidemment affaibli, même négatif, sa capacité de leader qui agit comme un catalyseur au sein des interventions sélectives étant fortement endommagée.

2.2. Qualité de la bureaucratie

L'idée de la qualité de la bureaucratie est un concept qui est entré en vogue au même temps que le renouvellement de l'importance de l'État comme un acteur clé pour la promotion de la croissance et du développement économique (Schilde, 2011:5).

Les institutions comptent! (North, 1994); cette citation reprise très largement dans la littérature, n'a pas seulement posé les bases de la mouvance New Institutional Economics, mais a également engendré un nouveau paradigme dans les politiques de coopération au développement. Après les grands axes stratégiques de mobilisation du capital et de l'ajustement structurel, l'intérêt s'est porté sur le cadre institutionnel et plus précisément sur la „bonne gouvernance” (Meisel et Ould, 2007). Etant donné que la bonne gouvernance est un concept abstrait, elle n'est pas directement observable.

La bonne gouvernance a été prouvée par la contribution au développement économique de certains pays européens ce dernier millénaire (North, 1981; DeLong et Shleifer, 1993), au développement de certains pays au long de derniers 40 ans (Knack et Keefer, 1995; Mauro, 1995; Easterly et Levine, 1997) et à la transition de succès du socialisme vers le capitalisme (Weingast, 1995; Johnson, Kaufmann et Shleifer, 1997). Les académiciens et les politiciens ont été longtemps étonnés à la fois par la coexistence des trajectoires de croissance inégale et irrégulière et par le soutien à la croissance rapide des autres pays. L'importance d'une bonne gouvernance pour la croissance économique, de ce fait, semble une proposition bien établie empiriquement.

Evans et Rauch (1999), Dahlström et al. (2011) et Matei et Matei (2011) ont prouvé qu'il y a une forte relation entre le weberianisme des capacités bureaucratiques d'un État national et les données sur la croissance économique.

Dans cet article on va entamer cette idée en utilisant les données sur la performance du gouvernement ayant comme échantillon des États sud-est européens: la Roumanie, la Bulgarie, la Grèce et la Croatie, trois pays membres de l'Union européenne et un autre pays en cours d'adhésion. On va corrélérer et analyser le PIB réel par habitant avec les indicateurs de gouvernance, en évolution, 2002-2011, dans ces quatre pays. On va utiliser le PIB par habitant parce qu'il est ajusté toutes les années et afin de surprendre à la fois les variations de prix et l'achat- la parité du pouvoir (à long terme, c'est le meilleur indicateur de la croissance économique).

Le gouvernement envisage la vie économique de l'État en plusieurs manières: en protégeant ou „empoignant” la propriété, en permettant ou en supprimant son avis, en rendant service ou en abusant le public à travers ses agents (La Porta et al, 1999:225).

Selon Montesquieu (1748) et Smith (1776), les économistes ont axé leur activité sur la sécurité des droits de propriété - l'absence d'une intervention du gouvernement, le règlement bénin, l'imposition plus basse- comme une mesure de la bonne performance.

Les théories économiques (Demsetz, 1967; North, 1981) soutiennent que les institutions soient créées lorsqu'il est efficient les créer, à savoir, lorsque les bénéfices sociaux de nouvelles institutions excèdent les coûts de transactions pour faire cela. Ainsi, les droits de propriété privée sur les terrains sont créés lorsqu'ils deviennent moins et lorsque les coûts pour leur mise en œuvre tombent sous les bénéfices. Pour évaluer la capacité des théories économiques en vue d'expliquer la variation de la performance du gouvernement entre les pays, il convient de trouver les sources exogènes de variation des caractéristiques économiques desdits pays.

L'implication directe de ces théories est que l'ampleur de l'activité économique s'étend, les institutions meilleures deviennent accessibles et, de ce fait, le gouvernement devrait améliorer la performance (North, 1981). Bien sûr, à son tour, le gouvernement améliore encore mieux la performance économique de telle sorte que l'ampleur de l'activité économique soit endogène. Cela prouve que les pays riches ont une meilleure gouvernance. D'autres signes de bon fonctionnement du gouvernement incluent la haute bureaucratie, l'assurance avec succès des biens publics de base, les charges effectives et la démocratie- qui sont à la fois un but et des mécanismes pour les institutions de changement.

Evans et Rauch (1999; Rauch et Evans, 2000) ont cherché une aide empirique pour leurs hypothèses dérivées de Max Weber - en ce qui concerne la relation entre la structure bureaucratique et la performance bureaucratique et, à la fois, entre ces variables et la croissance et le développement économique. Ces hypothèses ont été tout d'abord développées par Evans (1995). Lorsque l'ouvrage de Evans a été premièrement une contribution théorique, celui-ci et son collaborateur, Rauch, ils ont ultérieurement investigué les raisons pour lesquelles certaines bureaucraties semblent plus efficaces que d'autres, en ce qui concerne le soutien du développement économique (Schilde, 2011:8).

Pour Evans et Rauch, la mesure du weberianisme est basée sur la professionnalisation de la bureaucratie. Les caractéristiques clés institutionnelles de la bureaucratie weberienne, à la différence d'une bureaucratie corrompue et inefficace (Schilde, 2011:8) – sont le recrutement méritocratique à travers des examens vraiment compétitifs, des procédures d'emploi et licenciement pour les fonctionnaires publics, et aussi le complètement des niveaux supérieurs de l'hierarchie par la promotion interne (Evans et Rauch, 1999; Evans, 1992).

2.3. Instruments d'évaluation de la qualité de la bureaucratie

Weber a noté un nombre de points, qui se sont prêtés à une évaluation empirique et objective et, à la fois, l'importance du recrutement méritocratique, basé, d'une manière idéale, sur un mélange d'éducation et d'examen (Gerth et Mills, 1958; Parsons, 1964: 333, 339 cités dans Evans et Rauch, 1999:750) et la carrière prévisible, qui offrent à long terme des récompenses tangibles pour ceux qui sont recrutés dans la bureaucratie (Gerth et Mills, 1958:200-203; Parsons, 1964:334–335 cités dans Evans et Rauch, 1999:750; Stinchcombe, 1974 cités dans Evans et Rauch, 1999:750).

Evans et Rauch (1999), par le biais des deux théories principales, ont essayé d'expliquer la relation entre la bureaucratie et la croissance économique:

1. La première théorie, initiée par Max Weber: les caractéristiques institutionnelles d'un État influencent la croissance, ci-inclus la transparence, la gouvernance etc.
2. La deuxième, basée sur Adam Smith et sur la théorie de l'économie néoclassique: l'État est l'antithèse de la croissance vu sa nature d'éliminer la concurrence et de louer les biens publics.

Weber affirmait que les bureaucraties, comme des acteurs principaux pour la mise en œuvre, sont bien importantes pour le rôle de l'État.

Evans et Rauch (1999) affirmaient qu'il y avait deux instruments clés pour évaluer la qualité de la bureaucratie et ils tentaient d'en lier à la croissance économique:

X1. Le recrutement méritocratique et la récompense. Ils forment l'esprit d'équipe, en facilitant la création des normes et la limitation de la corruption.

X2. Le prévisible qui récompense les trajectoires de la carrière, limite les gains, les promotions à long terme ont un tel risque et elles créent une expertise à long terme, mais, il y a de grandes récompenses après la retraite.

Y. Ceux-ci conduisent à la croissance économique parce que:

1. L'horizon à long terme va conduire à plusieurs investissements dans l'infrastructure publique;
2. La cohérence induit l'efficace;
3. La baisse corruption baisse aussi les locations/impôts;
4. Une bureaucratie compétente, prévisible conduit aux investissements des politiciens.

Un des avantages du recrutement méritocratique et de la récompense/prévisibilité de la carrière c'est que ces caractéristiques sont facilement traduites dans des mesures simples, qui peuvent être évaluées dans divers pays et, par la suite, la concentration sur celles-ci facilite l'essai empirique.

En utilisant un ensemble de données bien originelles, Evans et Rauch examinent l'effet de certaines caractéristiques structurelles, des éléments clés dans la caractérisation de Weber sur la bureaucratie, sur la croissance économique à l'aide de „L'échelle

wébérienne”. Cette échelle wébérienne offre une mesure simple du degré dans lequel les agences de l’État sont caractérisées par le recrutement méritocratique et à la fois offre une prévisibilité et une récompense à la carrière à long terme (Evans et Rauch, 1999:749).

De plus, „L’Échelle de la Qualité de la Bureaucratie” de Dahlström et al. (2011) présente la qualité des institutions de l’administration - un ensemble de données sur la structure et le comportement de l’administration. Ils utilisent la base conceptuelle des données d’Evans et Rauch (1999) relative à la bureaucratie wébérienne comme un instrument théorique pour guider la récolte des données et à la fois il y a d’autres perspectives, tel que le Nouveau Management Public et „l’impartialité” administrative qui ont inspiré la conception du questionnaire (Pollitt et Bouckaert, 2004; Rothstein et Teorell, 2008 cités dans Dahlström et al, 2011:5). Le but de la recherche de Dahlström et al. (2011) est d’identifier des caractéristiques structurelles bureaucratiques bien importantes qui font la différence entre les administrations publiques. De plus, le travail s’intéresse à deux dimensions de la structure bureaucratique, „le professionnalisme” et „la fermeture” (Dahlström et al, 2011:5).

En vue d’améliorer et de compléter les statistiques disponibles concernant les indicateurs de mesure de la qualité de la bureaucratie, la Banque Mondiale a recueilli des données de mesure de la perception sur la gouvernance dès 1996. L’utilisation des indicateurs de gouvernance est en pleine expansion. Ces indicateurs sont censés quantifier la qualité des institutions de gouvernance d’un pays en mesurant le degré de corruption qui règne dans l’économie, la vigueur de „l’état de droit”, le degré de stabilité politique et l’efficacité de l’action publique etc. Par la construction des indicateurs de gouvernance, plusieurs institutions ont essayé de concrétiser la qualité du cadre politique et institutionnel d’un pays.

Les indicateurs définis par la Banque mondiale mesurent six domaines étendus de la gouvernance, notamment (The Worldwide Governance Indicators 1996 – 2011): voix citoyenne et responsabilité, stabilité politique et absence de violence/terrorisme, efficacité des pouvoirs publics, qualité de la réglementation, État de droit et lutte contre la corruption. Parmi ces dimensions majeures caractérisant le processus de gouvernement de la performance du secteur public, on choisit quatre indicateurs qui décrivent, selon les variables statistiques agrégées, les derniers deux sets de sujets majeurs. Les quatre indicateurs de la Banque mondiale sont: 1) Efficacité des pouvoirs publics (EPP): la qualité des services publics, la capacité du service civil et son indépendance par rapport aux pressions politiques; la qualité de la formulation des politiques; 2) Qualité de la réglementation (QR): l’aptitude du gouvernement à fournir des politiques saines et une réglementation qui permettent et incitent au développement du secteur privé; 3) État de droit (ED): comment les agents ont confiance et respectent les lois de la société, y compris la qualité des droits de propriété, la police et les tribunaux, ainsi que les risques de crime; 4) Lutte contre la corruption (LCC): comment le pouvoir public est exercé à des fins privées, y compris les petites et les grandes formes de corruption, ainsi que la „capture” de l’état par une élite.

L’ensemble de données concernant les indicateurs de gouvernance établi par la Banque Mondiale est l’un des plus complets pour évaluer la qualité de la gouvernance (Van de Walle, 2005:6).

3. RECHERCHE EMPIRIQUE

À la base de la recherche empirique on trouve la théorie proposée par Max Weber et avancée par Evans et Rauch (1999), Dahlström et al, (2011) et Matei et Matei (2011). Les recherches d'Evans et Rauch, 1999, Dahlström et al, 2011 et de Matei et Matei, 2011 mettent en évidence la diversité et le poids de l'échantillon, ses indicateurs et méthodologie (Tableau 1), qui permettent d'entamer ce thème.

Tableau 1. Synthèse des échantillons des recherches d'Evans et Rauch, 1999, Dahlström et al, 2011 et de Matei et Matei, 2011

Source	No. de pays	Genre d'Etats	Période de recherche	No. d'experts	Indicateurs communes analysés
Evans et Rauch, 1999	35	Etats en voie de développement et semi-industrialisés	1970 - 1990	126	Recrutement méritocratique, stabilité de carrière et salaire compétitif
Dahlström et al, 2011	97	Etats développés et en voie de développement	2008 - 2010	291	Professionalisme, promotion interne et apprentissage pendant la carrière, salaire compétitif
Matei et Matei, 2011	4	Etats balkaniques	2009	12	Recrutement méritocratique, stabilité de carrière et salaire compétitif

Source: Auteurs

La recherche d'Evans et Rauch a supposé l'examen des caractéristiques de base des agences économiques d'État et les enregistrements d'une croissance sur un échantillon de 35 pays en voie de développement et „semi-industrialisés” pendant 1970-1990. Les données ont été fournies par des experts de chacun des 35 pays. Les pays utilisés comme des échantillons ont été de l'Afrique, de l'Amérique Latine, de l'Asie de l'Est et de l'Europe.

"L'Échelle wébérienne" d'Evans et Rauch est un questionnaire qui comprend dix questions. La première question relève l'importance des agences pour préparer des politiques économiques. Parmi les autres questions, deux (q2 et 9) mesurent l'importance des examens de recrutement des fonctionnaires publics. Trois autres questions touchent des problèmes sur la carrière, à savoir: si, une fois recrutés, les fonctionnaires publics peuvent rester dans le service public (q3 et 5) et s'ils restent dans le service public, cela implique des possibilités de promotion dans l'hierarchie (q4)? Et un nombre de quatre questions posent le problème de la récompense dans la

carrière, à la fois aux termes de salaire et de prestige (q6, 7, 8, et 10) (Evans et Rauch, 1999:755).

Le questionnaire s'est concentré sur les caractéristiques propres, descriptives de la bureaucratie qui ont été soumises à l'expertise objective. On a mêlé ces caractéristiques descriptives pour construire une mesure simple qui relève une structure bureaucratique wébérienne construite sur le recrutement méritocratique et la satisfaction dans la carrière à long terme. Pour découvrir la relation entre ces caractéristiques et la croissance économique dans la période durant 1970 – 1990, Evans et Rauch ont utilisé les mesures des sets de données standard, à la disposition pour créer la variable dépendante PIB par habitant et les variables de contrôle, le niveau du revenu initial et le capital humain préexistant. Le résultat de la recherche a relevé qu'il y a une forte et significative corrélation entre le score de l'Échelle Wébérienne et la croissance totale du PIB réel par habitant durant la période 1970-1990 ($r = 0.67$, $p < .001$).

La recherche de Dahlström et al. (2011) a supposé l'examen de la qualité des institutions de l'administration sur un échantillon de 97 pays pour la période 2008 – 2010 en appliquant un questionnaire. Les données ont été fournies par des experts de chacun des pays. Les pays utilisés comme échantillon ont été par tout le monde: L'Europe Occidentale et l'Amérique du Nord, les pays post - communistes de l'Europe de l'Est et l'ancienne Union Soviétique, l'Amérique Latine, l'Asie et même le Moyen Orient. On note que l'échantillon vise une grande partie tant du monde développé qu'en voie de développement.

Tout le questionnaire couvre une variété de sujets qui, selon la littérature de spécialité, sont considérés comme bien importants pour la structure et le fonctionnement de l'administration publique. Dans leur ouvrage, Dahlström et al. (2011) n'ont exploité que huit éléments représentatifs pour l'occupation de la force de travail au sein de la bureaucratie de Weber. Ces éléments incluent le degré dans lequel le recrutement est plutôt basé sur le mérite (q2_a) et des examens formels (q2_c), que sur des critères politiques (q2_b, q2_d), et à la fois le degré dans lequel la promotion dans le cadre de l'hierarchie est un problème interne (q2_e) et elle est basée sur la carrière pendant toute la vie (q2_f). Les salaires compétitifs (q2_k) et la protection sociale à travers des lois propres sur le travail (q8_1) sont d'autres composants de cet ensemble de caractéristiques (Dahlström et al, 2011:15). Le questionnaire de Dahlström et al. (2011) questionne plutôt sur les perceptions que sur les faits – c'est ça la différence par rapport au questionnaire d'Evans et Rauch (1999; Rauch et Evans 2000).

Dans leur recherche, les auteurs en appellent, principalement, à deux dimensions de la bureaucratie, à savoir, la professionnalisation et „la fermeture”. La contribution principale de la recherche est une empirique et elle prouve que le recrutement et les caractéristiques de la carrière avec les deux dimensions sont retrouvées dans les démocraties occidentales et dans les pays post - communistes. Au contraire, dans d'autres parts du monde, tel que l'Amérique Latine, l'Asie, l'Afrique est applicable seulement la dimension concernant la professionnalisation.

De plus, Matei et Matei (2011) ont réalisé une recherche comparative théorique et empirique pour les États de Balkans dans le but d'établir la corrélation entre la qualité

de la bureaucratie, la croissance économique et la performance du gouvernement. La méthode de recherche a consisté dans l'utilisation d'un instrument sociologique, à savoir „l'analyse économique de la bureaucratie” dont le contenu est basé sur les principes de rationalisation administrative de Weber, adaptés aux objectifs de recherche de l'ouvrage et groupés dans des salaires compétitifs, promotion interne et stabilité dans la carrière et recrutement méritocratique.

La méthode d'investigation représente une extension „à l'échelle wébérienne”. L'instrument d'investigation utilisé a été conçu comme un questionnaire avec 20 questions. Le groupe cible de la recherche empirique a compris quatre États balkaniques: la Bulgarie, la Croatie, la Grèce et la Roumanie, bien importants pour les évolutions enregistrées dans les réformes du secteur administratif et public. Les données ont été fournies par des experts de chacun de 4 pays.

Afin d'être compatible avec d'autres recherches ayant un objectif pareil (Rauch et Evans, 1999, Hyden, Curtea et Mease, 2003, Curtea, Kristen et Weder, 1999, Henderson et al, 2003, Matei et al. 2011), Matei et Matei (2011) ont utilisé les mêmes indicateurs concernant la qualité de la bureaucratie: le recrutement méritocratique, la stabilité de la carrière et le salaire compétitif.

Il y a des résultats issus de la corrélation des indicateurs sélectionnés des données de Dahlström et al. (2011) et ceux obtenus par Evans et Rauch (2000). L'indicateur d'Evans et Rauch, "le mérite" qui est un indicateur composite, mais qui est dans une grande mesure basé sur l'utilisation des systèmes formels d'examen, est corrélé à 0.83 avec l'indicateur correspondant des examens formels (q2_c) et à 0.64 avec les questions générales par le recrutement méritocratique (q2_a) de Dahlström et al. (2011). La mesure d'Evans et Rauch concernant „la stabilité de la carrière” est corrélée à 0.74 avec la mesure de la promotion interne et à 0.72 avec „l'apprentissage pendant la vie”. Enfin, la mesure de Dahlström et al. (2011), des salaires compétitifs sont corrélés à 0.46 avec l'indicateur correspondant d'Evans et Rauch (2000) (Dahlström, et al, 2011:25).

Matei et Matei (2011), dans leur recherche, ont noté que, d'un point de vue statistique, les trois variables de la qualité de la bureaucratie n'ont pas une corrélation très forte. Cependant, tous les coefficients de corrélation sont positifs et ils varient de 0.043 (mérite/salaire) à 0.265 (salaire/carrière).

Les explications de ces résultats consistent dans la complexité et la diversité des processus de la réforme dans le service public des États balkaniques et leur développement insuffisant (Matei et Matei, 2011).

3.1. Indicateurs de la qualité de la bureaucratie

En utilisant les indicateurs de la qualité utilisés par Matei et Matei (2011) et les indicateurs de gouvernance de la Banque Mondiale et le PIB par habitant, on tente de mettre en évidence la relation entre la qualité de la bureaucratie et la performance économique des quatre États balkaniques, en réalisant une comparaison avec les résultats de la recherche de Matei et Matei (2011) et Matei et al (2011).

Les indicateurs de la qualité de la bureaucratie utilisés dans la présente recherche sont ceux de Matei et Matei, 2011:

Indicateur MERITE = $[(q4 - 1)/3 + (q5 - 1)/3] / 2$

Indicateur CARRIERE = $[(q4 - q6)/3 + (q7 - 1)/2 + (q8 - 1)/3 + (q10 - 1)/3 + (q11 - 1)] / 5$

Indicateur SALAIRE = $[(q14 - 1)/4 + (q16 - 1)/3] / 2$

Tableau 2. Indicateurs de qualité de la bureaucratie

Etat	MERITE Indicateur	CARRIERE Indicateur	SALAIRE Indicateur
BG	0.39	0.44	0.41
HR	0.28	0.36	0.33
GR	0.45	0.54	0.44
RO	0.51	0.59	0.56

Source: Matei et Matei, 2011:280; Matei et al, 2011:7

3.2. Indicateurs de la performance économique et les indicateurs de la gouvernance

Les indicateurs avec lesquels on va corrélérer les indicateurs de la qualité sont quatre des sept indicateurs de la Banque Mondiale: efficacité des pouvoirs publics (EPP); qualité de la réglementation (QR); État de droit (ED); lutte contre la corruption (LCC).

Tableau 3. Indicateurs de gouvernance (2011)

ID	EPP	QR	ED	LCC	PIB (USD)
BG	0.01	0.56	- 0.09	- 0,17	14.825
HR	0.55	0.56	0.18	0,02	19.469
GR	0.48	0.51	0.57	-0,15	25.850
RO	-0.22	0.72	0.04	-0,20	15.139

Source: La Banque Mondiale et World dataBank,
<http://databank.worldbank.org/ddp/home.do?Step=12&id=4&CNO=2>

3.3. Interprétations et conclusions

En considérant le mérite, la carrière et le salaire des indicateurs de la qualité, on présente dans le Tableau 4 les corrélations entre les indicateurs de la qualité de la bureaucratie, les indicateurs de la performance économique et ceux de la gouvernance.

Tableau 4. Corrélations statistiques entre les indicateurs de la qualité de la bureaucratie et les indicateurs de la performance (2011) et de la gouvernance (2011)

		MERITE	CARRIERE	SALAIRE
EPP	Pearson Correlation	-.663	-.558	-.782
	Sig. (2-tailed)	.337	.442	.218
QR	Pearson Correlation	.531	.508	.755
	Sig. (2-tailed)	.469	.492	.245
ED	Pearson Correlation	.083	.214	-.108
	Sig. (2-tailed)	.917	.786	.892
LCC	Pearson Correlation	-.909	-.832	-.834
	Sig. (2-tailed)	.091	.168	.166
PIB	Pearson Correlation	-.060	.062	-.267
	Sig. (2-tailed)	.940	.938	.733

Source: Auteurs

Dans ce cas, d'un point de vue statistique, la réalité offre des évolutions diverses de la performance du secteur public et des processus spécifiques pris en compte pour la qualité de la bureaucratie. Il n'y a aucune corrélation significative spécifique. Le même résultat est relevé par la recherche de Matei et Matei (2011) avec les indicateurs de performance et PIB pour l'année 2009.

Les explications découlent de l'inconsistance des données statistiques, des évolutions contradictoires entre les processus économiques et la bureaucratie, spécifiques au secteur public.

De plus, en corrélant les indicateurs de gouvernance de la Banque Mondiale et le PIB par habitant on tente de mettre en évidence la relation entre la qualité de la bureaucratie et la performance économique pour chaque des quatre États balkaniques pour une période de 10 ans, 2002-2011, pour chaque pays (voir les Tableaux 4, 5, 6 et 7), en suivant particulièrement la corrélation entre chaque indicateur de gouvernance et le PIB.

Tableau 4. Corrélations statistiques entre les indicateurs de la performance économique et les indicateurs de la gouvernance pour la Bulgarie

		EPP	QR	ED	LCC	PIB
EPP	Pearson Correlation	1	-.012	.115	.691*	-.798**
	Sig. (2-tailed)		.974	.753	.027	.006
QR	Pearson Correlation	-.012	1	-.278	.143	.168
	Sig. (2-tailed)	.974		.436	.693	.643
ED	Pearson Correlation	.115	-.278	1	-.230	.294
	Sig. (2-tailed)	.753	.436		.523	.410
LCC	Pearson Correlation	.691*	.143	-.230	1	-.574
	Sig. (2-tailed)	.027	.693	.523		.083
PIB	Pearson Correlation	-.798**	.168	.294	-.574	1
	Sig. (2-tailed)	.006	.643	.410	.083	
*. La corrélation est significative au niveau de 0.05 (2-tailed).						
**. La corrélation est significative au niveau 0.01 (2-tailed).						

Source: Auteurs

Pour la Bulgarie, on observe qu'il y a une corrélation significative statistiquement, très forte, entre l'EPP et le PIB = - 0.798.

Tableau 5. Corrélations statistiques entre les indicateurs de la performance économique et les indicateurs de la gouvernance pour la Croatie

		QR	ED	LCC	PIB	EPP
QR	Pearson Correlation	1	.908**	-.586	.579	.577
	Sig. (2-tailed)		.000	.075	.080	.081
ED	Pearson Correlation	.908**	1	-.741*	.765**	.754*
	Sig. (2-tailed)	.000		.014	.010	.012
LCC	Pearson Correlation	-.586	-.741*	1	-.913**	-.892**
	Sig. (2-tailed)	.075	.014		.000	.001
PIB	Pearson Correlation	.579	.765**	-.913**	1	.870**
	Sig. (2-tailed)	.080	.010	.000		.001
EPP	Pearson Correlation	.577	.754*	-.892**	.870**	1
	Sig. (2-tailed)	.081	.012	.001	.001	
**. La corrélation est significative au niveau 0.01 (2-tailed).						
*. La corrélation est significative au niveau de 0.05 (2-tailed).						

Source: Auteurs

De même, pour la Croatie, on retrouve des corrélations statistiquement significatives. Il y a des très fortes corrélations entre l'ED et le PIB = 0.765 et l'EPP et le PIB = 0.870; une corrélation très forte il y a aussi entre la LCC et le PIB = -.913.

Tableau 6. Corrélations statistiques entre les indicateurs de la performance économique et les indicateurs de la gouvernance pour la Grèce

		QR	ED	LCC	PIB	EPP
QR	Pearson Correlation	1	.664*	.847**	-.496	.805**
	Sig. (2-tailed)		.036	.002	.145	.005
ED	Pearson Correlation	.664*	1	.820**	-.245	.832**
	Sig. (2-tailed)	.036		.004	.494	.003
LCC	Pearson Correlation	.847**	.820**	1	-.688*	.971**
	Sig. (2-tailed)	.002	.004		.028	.000
PIB	Pearson Correlation	-.496	-.245	-.688*	1	-.680*
	Sig. (2-tailed)	.145	.494	.028		.030
EPP	Pearson Correlation	.805**	.832**	.971**	-.680*	1
	Sig. (2-tailed)	.005	.003	.000	.030	
*. La corrélation est significative au niveau de 0.05 (2-tailed).						
**. La corrélation est significative au niveau 0.01 (2-tailed).						

Source: Auteurs

Pour la Grèce, on observe qu'il y a une corrélation significative statistiquement entre la LCC et le PIB = - 0.688 et l'EPP et le PIB = - 0.680.

Tableau 7. Corrélations statistiques entre les indicateurs de la performance économique et les indicateurs de la gouvernance pour la Roumanie

		QR	ED	LCC	PIB	EPP
QR	Pearson Correlation	1	.925**	.685*	.945**	.173
	Sig. (2-tailed)		.000	.029	.000	.632
ED	Pearson Correlation	.925**	1	.497	.882**	.185
	Sig. (2-tailed)	.000		.144	.001	.608
LCC	Pearson Correlation	.685*	.497	1	.736*	.010
	Sig. (2-tailed)	.029	.144		.015	.978
PIB	Pearson Correlation	.945**	.882**	.736*	1	-.078
	Sig. (2-tailed)	.000	.001	.015		.830
EPP	Pearson Correlation	.173	.185	.010	-.078	1
	Sig. (2-tailed)	.632	.608	.978	.830	
**. La corrélation est significative au niveau 0.01 (2-tailed).						
*. La corrélation est significative au niveau de 0.05 (2-tailed).						

Source: Auteurs

De même, pour la Roumanie aussi, on observe qu'on retrouve des corrélations significatives statistiquement, très fortes, entre la QR et le PIB = 0.945 et l'ED et le PIB = 0.882 et une très forte entre la LCC et le PIB = 0.736.

À remarquer c'est qu'on ne retrouve pas le même indicateur qui a été corrélé avec le PIB pour les quatre pays. Les plus fréquentes corrélations sont entre l'indicateur EPP et le PIB (pour trois pays, la Croatie, la Grèce et la Roumanie) et la LCC et le PIB (aussi pour trois des quatre pays, la Croatie, la Grèce et la Roumanie); à la suite, il y a la corrélation entre l'indicateur ED et le PIB (pour deux pays, la Croatie et la Roumanie) et l'indicateur QR et le PIB (pour un seul pays, la Roumanie).

Toutes ces analyses déterminent l'expression d'une conclusion commune pour les quatre pays, qui peut être généralisée au niveau des États de l'Europe du Sud-est en ce qui concerne l'incompatibilité des politiques pour la qualité de la bureaucratie et l'efficacité de la gouvernance. Il est très important de mentionner qu'à la fois, la recherche de Matei et Matei (2011) et la présente ont été réalisées durant la crise économique et financière, ce qui a déterminé la réduction de l'appareil bureaucratique dans tous les quatre États.

Ainsi, il résulte une forte détermination directe entre les indicateurs de la qualité de la bureaucratie et le PIB. La même conclusion résulte pour les indicateurs de la gouvernance.

BIBLIOGRAPHIE

- Barro, R. (1991), *Economic Growth in a Cross-Section of Countries*, Quarterly Journal of Economics, Vol. 106, No. 2 (May), 407–443.
- Dahlström, C., Lapuente, V. et Teorell, J. (2011), *Dimensions of Bureaucracy II: A Cross-National Dataset on the Structure and Behavior of Public Administration*, University of Gothenburg: The Quality of Government Institute, www.qog.pol.gu.se.
- DeLong, B. et Shleifer, A. (1993), *Princes and Merchants: Government and City Growth Before the Industrial Revolution*, 36 (2) Journal of Law and Economics, 671–702.
- Demsetz, H. (1967), *Toward a Theory of Property Rights*, American Economic Review Papers and Proceedings, Vol. 57, No. 2, 347–359.
- Easterly, W. et Levine, R. (1997), *Africa's Growth Tragedy: Policies and Ethnic Divisions*, Quarterly Journal of Economics, Vol. 112, No. 4, 1203–1250.
- Evans, P. (1995), *Embedded Autonomy: States and industrial Transformatio*, Princeton University Press, Princeton.
- Evans, P. et Rauch, J.E. (1999), *Bureaucracy and Growth: A Cross-National Analysis of the Effects of "Weberian" State Structures on Economic Growth*, American Sociological Review, Vol. 64, No. 5 (October), 748-765.
- Evans, P.B. (1992), *The state as problem and solution: predation, embedded autonomy, and adjustment*, Haggard, S. et Kaufman, R.R. (Eds.), *The Politics of Economic Adjustment*, Princeton University Press, Princeton, NJ, 139–191.

- Gerth, H. et Mills, C. W. (1958), *From Max Weber: Essays in Sociology*, Oxford University Press, New York.
- Johnson, S., Kaufmann, D. et Shleifer, A. (1997), *The Unofficial Economy in Transition*, Brookings Papers on Economic Activity, Vol. 2, No. 2, 159–240.
- Kelm, M. (1996), *Evolutionary and New Institutional Economics: Some Implications for Industrial Policy*, ESRC Centre for Business Research, University of Cambridge, Working Paper no. 46.
- Knack, S. et Keefer, P. (1995), *Institutions and Economic Performance: Cross-country Tests Using Alternative Institutional Measures*, Economics and Politics, Vol. 7, No. 3, 207–227.
- La Porta, R., Lopez-de-Silanes, F., Shleifer, A. et Vishny, R. (1999), *The Quality of Government*, Journal of Law, Economics and Organization, Vol. 15, April, 222 – 279.
- Lovett, K. (2011), *Institutional Design and Economic Growth: The Relationship between Bureaucracy and Economic Performance in a Global Economy*, <http://www.gobookee.com/bureaucracy-test/>.
- Marsh, I. (1999), *Economic governance and economic performance*, Democracy, governance, and economic performance: East and Southeast Asia, Marsh, I., Blondel, J. et Inoguchi, T. (Eds.), United Nation University Press, Tokyo, New York, Paris, 47 – 78.
- Marsh, I. (1995), *Beyond the Two Party System: Political Representation, Economic Competitiveness and Australian Politics*, Cambridge University Press, Melbourne.
- Matei, A. et Matei, L. (2011), *The Impact of Quality of Bureaucracy on Governance Performance. A Comparative Study in Balkan States*, Proceedings of the 7th European Conference Management Leadership and Governance, Charles Despres (Ed.), SKEMA Business School Sophia – Antipolis, France, October, 277 - 284.
- Matei et al. (2011), *The Quality of Bureaucracy and Public Sector Performance. A Comparative Study in South-Eastern Europe*, available at <http://ssrn.com/abstract=1695076>.
- Mauro, P. (1995), *Corruption and Growth*, Quarterly Journal of Economics, Vol. 110, No. 3, (August), 681–712.
- Meisel, N. et Ould, A.J. (2007), La «Bonne gouvernance» est - elle une bonne stratégie dedéveloppement?, DGTPÉ, http://www.cepii.fr/francgraph/bdd/instit_form/documents.asp.
- North, D. (1981), *Growth and Structural Change*, W. W. Norton, New York.
- North, D. (1994), *Institutional Change: A Framework of Analysis*, <http://129.3.20.41/eps/eh/papers/9412/9412001.pdf>.
- Parsons, T. (1964), *Max Weber: The Theory of Economic and Social Organization*, Free Press, New York.
- Pollitt, C. et Bouckaert, G. (2004), *Public Management Reform*, Oxford University Press, Oxford.
- Rauch, J.E. et Evans, P. (2000), *Bureaucratic Structure and Bureaucratic Performance in Less Developed Countries*, UC San Diego: Department of Economics, UCSD. Retrieved from: <http://escholarship.org/uc/item/OsbOw38d>.
- Rothstein, B. et Teorell, J. (2008), *What Is Quality of Government? A Theory of Impartial Government Institutions*, Governance, Vol. 21, No. 2, 165-19.
- Schilde, K. (2011), *Conceptualizing the Bureaucratic Quality and Capacity of the European Union*, EUSA Papers, <http://euce.org/eusa/2011/browse.php?sort=panel>.
- Shafritz, J. M. et Russell, E. W. (1997), *Introducing Public Administration*, Longman, New York.

- Simon, H. (2004), *Comportamentul administrativ. Studiu asupra proceselor de luare a deciziilor în structurile administrative*, Știința, Chișinău.
- Stinchcombe, A. (1974), *Creating Efficient Industrial Administrations*, Academic Press, New York.
- UNPAN. (2005), *World Public Sector Report (WPSR) - Unlocking the Human Potential for Public Sector Performance*, United Nations, New York.
- Van de Walle, S. (2005), *Measuring bureaucratic quality in governance indicators*, Paper for the 8th Public Management Research Conference, Sep 29th - Oct 1st Los Angeles.
- Weber, M. (1992), *Politica, o vocație și o profesie*, Anima, București.
- Weingast, B. (1995), *The Economic Role of Political Institutions: Market-Preserving Federalism and Economic Development*, Journal of Law, Economics & Organization, Vol. 11, No. 1, 1–31.
- World Bank, *The Worldwide Governance Indicators 1996 – 2011*,
<http://info.worldbank.org/governance/wgi/index.asp>.
- World Bank. (1997), *World Development Report (WDR) - The State in a Changing World*,
<http://econ.worldbank.org>.

Igor Cvečić
University of Rijeka, School of Economics, Croatia
Vladimira Ivandić
Zagreb, Croatia

EU FUNDS ABSORPTION PROBLEMS – EXPERIENCE SO FAR

ABSTRACT

The considerable amounts of EU funds are available for the Member States, particularly for those of Central and Eastern Europe. The analysis showed that EU countries have only poorly and slowly absorbed EU funds. Absorption of EU funds has been disappointingly slow in most countries while the lack of absorption capacity has been a particular problem in New Member States Countries from the last enlargement (Romania and Bulgaria).

The purpose of the paper is to draw lessons from the experience under the implementation of Structural Funds and Cohesion Fund to date and review the main developments in absorbing EU funds over the last decade, highlighting the role of absorption capacity. It also points out the relevance of the administrative capability and issues of governance that have been main reasons for the poor EU funds absorption. Particularly, it is shown how the absorption of EU funds has been attributed to other factors one of which has been success of the financial management.

The paper seeks to explain reasons for the low absorption rate of EU funds and to identify different types of absorption problems in countries that relatively recently joined the EU. Romania is characterized as a poor performer as it has difficulties at all levels of program implementation. Nevertheless, lessons and experiences drawn from the “new” Member States may provide useful “benchmarks” in the endeavor of assessing the extent and types of absorption problems for Croatia.

Keywords: Central and Eastern European Countries, pre-accession programs, Structural Funds, absorption capacity of EU funds, new Member States

JEL classification: O1

1. INTRODUCTION

This paper is about the absorption problems of the European Union (EU) financial assistance in Central and Eastern European Countries (CEECs) in the pre and post-accession process to the EU. In the pre-accession period EU financial assistance to CEECs was allocated in the form of programs (such as PHARE etc.) while as a member they have been eligible for the use of Structural Funds (SFs) and Cohesion

Fund (CF). Different rules and procedures applied for these two broad categories of EU financial assistance that have been reflected to the system of financial management. The aim of the paper is to point out factors that influence on the absorption of the EU financial assistance in CEECs and explain reasons for the poor absorption results in some countries (like Romania).

Paper firstly resents developments in the implementation of the pre-accession programs in CEECs and then issues connected with the implementation of EU Structural Funds. The usage of the Structural Funds in New Member States (NMSs) from Central and Eastern Europe is seen as of particular interest for Croatia and presented in the separate chapter. Main factors of the slow absorption of EU funds in CEECs are analyzed in details in order to capture relevant elements for the future successful implementation of Structural Funds in Croatia.

Last part is conclusion.

2. EU FINANCIAL ASSISTANCE AND CENTRAL AND EASTERN EUROPEAN COUNTRIES

In the early 1990s when the Central and Eastern European Countries (CEECs) had applied to join the European Union (EU) they were presented with a quite substantial set of various conditions for membership. The aspirations of post-communist CEECs to membership resulted in much more comprehensive conditions for membership that had been set for any previous applicant (Michalski and Wallace, 1992). European Commission (EC) was of opinion that such conditions, set out at the Copenhagen European Council in 1993 (Copenhagen Conditions), had a primary role to ensure that the countries joining the EU could be integrated relatively easily (EC, 2003).

In order to direct post-communist transformation in CEECs European Commission created two instruments that were crucial for the enlargement process. The first one was related to the Europe Agreements and the second one was a PHARE financial assistance (aid) program. These were later incorporated into the 'pre-accession strategy'¹. The preparations that began in 1993 led to a pre-accession strategy emphasizing the role for PHARE pre-accession program.

In 1998 the European Union in the process of eastward enlargement introduced new approach to membership in which dominant role was given to so-called 'Accession Partnership' (AP)² that brought together conditions for membership and financial aid (EC, 2004).

The Copenhagen Council of December 2002, and the conclusion of accession negotiations with ten countries out of which eight were from CEECs (the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia) determined an unprecedented enlargement of the European Union in terms of scope and diversity. The positive outcome of the negotiations marked the conclusion of the preparation of CEECs for EU membership and their eligibility for a new type of EU financial assistance known as Structural Funds and Cohesion Fund.

¹ That was set out at the Essen European Council in 1994.

² The Accession Partnerships were central pillar of the pre-accession strategy. They set out the key short and medium-term priorities for preparation of EU membership.

The governance of Structural Funds and Cohesion Fund is a matter of share competence between the EU and the member state. Priorities and the Operational Programs (OPs) are negotiated between the European Commission and the Member States (MSs) but the implementation of EU funds is managed completely by the MSs. It is evident that EU funds are only partially and in any case too slowly absorbed. A country's absorption capacity is captured by the evolution of the difference between commitment appropriations and executed payments. Financial management and EU financial flows are regulated by the so-called de-commitment rule, which states that if committed funds are not spent by the second or third year following the year of budget commitment, they are lost.

3. FROM PRE-ACCESSION TO ACCESSION

PHARE program is the oldest pre-accession program. It is also the largest of the three originally (so-called first generation of programs) pre-accession instruments in terms of funding. Namely, the approximate proportion of annual allocations between PHARE, ISPA and SAPARD is 3:2:1.

On its establishment in 1989, its primary instrument was direct grants used to fund technical assistance in a wide range of areas. Following revision of the pre-accession strategy in 1997, its focus was narrowed to funding accession preparations alone through the Accession Partnerships. Sedelmeier and Wallace (1996) state that initially, the European Union used PHARE funds to channel advise on economic transformation. PHARE program was also the most diverse compare to other pre-accession programs. It included capacity building technical assistance, twinning, as well as cross-border projects, but also the "Economic and Social Cohesion" component as the anticipation of the Operational Programs for cohesion after the EU membership. Because of its various intervention PHARE program allowed more flexibility in the implementation.

The guidelines for PHARE were set out in 1997 Commission Decision³ including the critical principle of accession-led programming on the basis of the Accession Partnership, the National Program for the Adoption of the Acquis and the Regular Reports. The reforms also set out new instruments and structures to tackle the lack of impact and sustainability of PHARE projects. As it was highlighted in Commission reports, it also reflected preparations for implementation structures needed after accession and to reduce the high backlog of budgetary commitments that had been criticized by the Court of Auditors and the European Parliament (EC, 2004).

These basic Orientations were updated in 1999 so as to redirect the PHARE funds that were liberated by the arrival of SAPARD and ISPA (from rural development and from selected infrastructure projects in the sectors of transport and environment) towards the area of economic and social cohesion. They also included projects not addressed under these two new pre-accession instruments.

In 1999 EC started to examine the performance of the PHARE program in order to propose necessary adjustments to enhance its impact in meeting the rapidly evolving

³ It was entitled "New PHARE Orientations for Pre-Accession Assistance".

requirements of the candidate countries as they move towards accession. Two areas of challenges for PHARE program were identified with the aim to be tackled in the next financial perspective period. First one was devoted to the past reforms mainly to respond to the constructive criticisms of the Court of Auditors and European Parliament and to streamline the efforts to raise impact and absorption capacity in the applicant countries. Second area contained actions that need to be introduced in order to move with preparations towards the system of Structural Funds. The objective of PHARE program also changed in order to prepare candidate countries for the implementation of Structural Funds by putting in place the necessary administrative and budgetary structures.

PHARE program was used for institutional building support mainly through ‘twinning’ and technical assistance and for investment support to help applicant countries in their efforts:

- to strengthen their public administrations and institutions to function effectively inside the European Union,
- to promote convergence with the EC’s extensive legislation and reduce the need for transition periods,
- to promote economic and social cohesion.

PHARE program has made a substantial contribution in helping candidate countries to install the *acquis*. However, program (and projects) has suffered from weaknesses in design and inefficiencies in implementation that were more evident in some CEECs than others (EC, 2006).

PHARE program was mainly structured around five main categories called measures. During the last financial perspective those categories were:

1. political criteria,
2. economic criteria,
3. *acquis* obligations,
4. economic and social cohesion,
5. specific actions and
6. Community programs.

The overall PHARE performance of funds was mixed (EC, 2010). One of the reasons was the fact that the pre-accession agenda was huge, demanding and unfamiliar. Moreover, the candidate countries had a relatively short time for its accomplishment. There was also an absence of adequate National Development Plans or sector strategies, which would have provided focus to relevance and underpinned a more detailed needs assessment. On another hand the needs assessment were frequently too superficial to enable the design of a fully relevant support program. This contributed to the launching of projects that had insufficient relevance to the precise needs of the sector or the target region. Such projects were approved by both sides without having a closer look at the merits of the each project. That was partly due to the annual programming cycle, but it is also result of the tendency to give a higher priority to the allocation and spending of funds. The latter point resulted from the political emphasis on disbursement, rather than giving priority to ensuring that projects were justified and had well defined, clear and achievable objectives.

Two other pre-accession programs (SAPARD and ISPA) were introduced a decade after PHARE. SAPARD pre-accession assistance program for rural development anticipates the large similar program to be funded from Common Agricultural Policy. SAPARD was primarily targeting a private agricultural sector (Kandžija, Cvečić, 2011). It also finances rural measures for the local governments mainly for the rural infrastructure projects (roads, water supply, sewage etc.). The other measure was focused on farms and private entrepreneurs. One of the main problems that all CEECs encountered in the implementation of SAPARD program was the availability of the matching funds. The administrative burdens and problems in assessing projects for SAPARD program were also one of the key issues that influenced relatively slow absorption of the available funds as the implementation of SAPARD program was regulated under the so-called EDIS (*Extended Decentralization Implementation System*) in which all responsibilities were given to the national side⁴. SAPARD financial management and implementation contributed to the existing difficulties in absorbing the allocated funds from the pre-accession program. Furthermore, all CEECs encountered difficulties in agriculture and had many weaknesses with a private agricultural sector that was especially more evident in a case of Romania.

ISPA program provided funds for the large transport and environment infrastructure. As the most of the type of ISPA projects are works contracts it takes time to prepare and actually implement those projects so most of disbursements of the funds greatly exceeded planned timeframe.

PHARE program was a key tool of the pre-accession strategy and thus played an essential role in the accession process (Cace, Cace and Iova, 2010).

Accession Partnerships were intended to make conditions stricter on both financial assistance through PHARE, and ultimately on accession itself, by uniting all EU demands and assistance for meeting them in a single framework (Grabbe, 1999). The APs also changed conditions for the implementation of PHARE program. Namely, previously PHARE priorities were 'demand-driven' and it was depended on meeting very general economic and political objectives. Latter on PHARE became more explicitly driven by the Commission, with funds that were geared specifically towards meeting the priorities set out in the APs. The aid was tied to conditions for accession, not more general transition and development goals. As a result of that EU aid policy moved towards privileging more the third Copehnagen conditions (the obligations of membership) over the first two⁵ (Grabbe, 1999). PHARE program progressively evolved during the time of negotiations of CEECs to EU. Its focus evolved over time, starting from its inception as an essentially demand-driven support to the process of transition. It has been developing in parallel with the pre-accession strategy into an entirely accession-driven instrument that was mostly targeted on several areas (like Administrative and Judicial Capacity, Economic and Social Cohesion).

⁴ While PHARE program was implemented through so-called DIS (*Decentralization Implementation System*) in which the EC performs ex-ante checks.

⁵ Copenhagen conditions are: 1) political, 2) economic, and 3) obligations of membership.

The management of PHARE program also changed over time. PHARE program was in all CEECs firstly managed under DIS (*Decentralization Implementation System*) and later on with a strengthening of administrative capacity to manage and control pre-accession financial assistance it was achieved under the Extended Decentralized System (EDIS).

Problems in financial management of pre-accession programs in CEECs and slow preparation for Structural Funds and Cohesion Fund influence that European Commission started closely monitor the implementation of the commitments made in the accession negotiations and progress made in implementation of agreed actions within the management system for EU funds.

PHARE program provided all together almost EUR 20.2 billion⁶ to ten candidate countries (Europa Media, 2010). For the eight countries acceding in 2004, the PHARE 2003 program that was implemented until 2006 was the last of its kind, though additional support was available under the Transition Facility⁷ (implemented until 2009).

PHARE allocations by countries differ also depending on the financial perspectives. During the last financial perspective the biggest recipient of PHARE program was Poland, then Romania, Bulgaria and Hungary. Looking at the cumulative PHARE allocations by countries from the period from 1990 to 2005 the situation with the allocated funds is identical. Poland receive by far the largest amount (EUR 3.9 billion), then Romania (EUR 3.1 billion). Detailed numbers of allocated and contracted funds by countries are presented in the following table (Table 1).

⁶ That amount includes all candidate countries not only EU 12, but also Turkey and Croatia.

⁷ The purpose of the Transition Facility was to continue assist the new Member State in their efforts to strengthen their administrative capacity to implement Community legislation and to foster exchange of best practice, as an extension to assistance provide until accession under PHARE program.

Table 1: PHARE program by country (1990-2005)

Country	Allocated Million €	Contracted Million €	Payments Million €	Contracting Rate (in %)	Absorption Rate (in %)
Lithuania	806.27	797.38	692.87	98.90	85.94
Hungary	1,473.36	1,385.73	1,265.84	94.05	85.92
East Germany	34.49	28.86	28.86	83.68	83.68
Czech Republic	910.04	829.64	749.35	91.17	82.34
Slovenia	356.73	318.53	292.71	89.29	82.05
Estonia	343.04	304.24	277.99	88.69	81.04
Poland	3,973.89	3,639.11	3,211.08	91.58	80.80
Latvia	419.61	364.89	331.12	86.96	78.91
Slovakia	712.39	643.30	561.34	90.30	78.66
Bulgaria	2,069.35	1,501.10	1,244.42	72.54	60.14
Romania	3,178.90	2,179.03	1,847.89	68.55	58.13
Cyprus	76.10	55.13	36.48	72.44	47.94
Malta	53.81	35.98	24.94	66.86	46.35
Turkey	1,411.95	693.46	295.65	49.11	20.94
Multi-country	3,127.02	2,398.94	1,971.32	76.72	63.04
Total ⁸	19,254.83	15,175.32	13,059.74	80.02	67.83

Source: Annex to the Report from the Commission to the Council and the European Parliament – 2005 Report on PHARE, pre-accession and transition instrument - country selections, Brussels, 12.1. 2007.

Contracting rates for all candidate countries were in average 80%, while the absorption rates were in average for that period 67.83%. Contracting rates are usually above the absorption rates as the paid amounts are also less than contracted amounts. During the period 1990-2005 contracting rates stand around 13 percent above the absorption rate. Looking at absorption of funds by specific countries it is evident that from all CEECs Romania had the lowest results with only 58.1% absorption rate.

Reasons of the poor performance in the term of absorption by Romania, which is after Poland the second largest recipient of the PHARE program, are widely debated not only with experts of EU matters and EC officials, but also within the academic forums⁹. Several systematic problems in program implementation in Romania were pointed out of which the most important are:

⁸ EU also allocated PHARE funds before the breakdown of Czechoslovakia in the amount of EU 230.49 million that are added at the total allocated amount.

⁹ Romanian Academic Society (SAR) organized several thematic issues on the EU administration of EU funds in Romania during the pre-accession period.

1. Preliminary selection of project by Romanian side was often poor because of insufficient technical capacities. This led to some incomplete projects documents being sent to EC that caused unavoidable delays in implementation;
2. Rigid administrative system that hindered the efficient allocation of resources and posed a problem of matching co-financing;
3. The institutional issues as the Contracting Authorities were often passive and not proactively engaged with project management and were not focused on finding solutions for the unpredictable problems which were inevitable;
4. There was a deficit of qualified human resources, a high employee turnover and relatively small salaries in the public institutions dealing with EU projects. The average time per person spent dealing with EU matters in one institution was maximum 2-3 years. After that period they were moving to private sector that offered them much better conditions and benefits.

Looking at the specific country results on absorption of EU funds it is evident that Poland achieved high absorption rates while Romania had bad results achieving poor absorption. Both countries had been benefiting of the EU pre-accession assistance from early 1990s and started to use it almost at the same time. Poland established and maintained efficient system of financial management while Romania had problems even with the introduction of PHARE program. At the beginning the implementation of PHARE program was initially centralized managed and managed directly by the European Commission in Brussels for the Romanian government and gradually become decentralized¹⁰. Under Decentralized Implementation System, the commonly referred as DIS, European Commission retained an ex-ante control on all the implementation cycle (including endorsing tender dossiers, evaluation reports, contract dossiers, contract addenda, etc). Mrak and Tilev (2008) pointed out that the crucial issue why absorption was not good is because of inadequate numbers of skilled staff at the right level.

An essential change in Romania occurred in 1997 when a Central Finance and Contracting Unit (CFCU) was set-up for PHARE, designed to relieve the beneficiaries (most of the time sectoral ministries) off the burden of contract financial management. Under the EC official terminology, the CFCU was an Implementing Agency and it was basically responsible for tendering, contracting and paying for various projects for and in the name of the beneficiaries (line ministries etc.), which were responsible solely for the technical management of projects. Another milestone was set with the establishment of the National Fund (NF), headed by the National Authorizing Officer, established in the Ministry of Finance. The financial management system was carried out in decentralized manner (commonly referred as DIS - Decentralized Implementation System) while ensuring a high degree of protection of EC funds, required a very high number of permissions to be obtained from the Commission prior to any step during the implementation cycle. As a result, the PHARE program was

¹⁰ Decentralized implied that pre-accession programs were managed directly (both technically and financially) by beneficiaries or Implementing Agencies (most of the time the same entity).

sometimes perceived as unnecessarily cumbersome while administration costs on both sides (EC and beneficiaries) were escalating.

PHARE program provided in Romania more than EUR 1 billion during the previous financial perspective or around EUR 260 million annually. It was co-financing in average around 25% from the national sources depending upon the type of the interventions implemented (technical assistance, 'twinning', supply etc.).

Bulgaria also similar like Romania demonstrated weaknesses in management and implementation of PHARE projects, in large part because of institutional instability (EC, 2011). The low level of absorption in Bulgaria was related to poor financial management and coordination, as well as problems in procurement. On the other hand it was also great reluctance to cancel any project even being completely ineffective because it was driven by the general notion to achieve as highest disbursement rates as possible. The question of adequate coordination also contributed to the PHARE absorption problems. It was also present a lack of effective dialogue between key stakeholders that was especially evident at the design stage of program. Furthermore, the issue of a lack of clarity about responsibilities for activities also contributed to the low absorption results.

On contrary, Slovenia and Latvia stand out as the most effective in achieving programs' stated immediate objectives. In Slovenia and Latvia, PHARE assistance was largely effective in all sectors because of good program management (EC, 2004).

4 IMPLEMENTATION OF EU FUNDS IN CEECS

In the current multi-annual financial framework (MFF) that covers period from 2007-2013 for the Members States (MSs) is allocated for the Structural Funds (SFs) for growth and conversion of the EU budget more than tri hundred billion EUR. The envelope for cohesion policy of the current financial framework¹¹ was fixed at EUR 307 619 million in 2004 prices. This envelope was then slightly adjusted in the first months of 2006 to arrive at its final value of EUR 308 041 million in 2004 prices (EC, 2006¹²). From the total amount 99.75 per cent is made available for the financing multi-annual operational programs whereas the remaining 0.25% was reserved for technical assistance.

That total amount for cohesion policy is equal to around 2.8 percent of EU GDP. This is quite significant amount that could stimulate economies for a growth. Therefore, EU Structural Funds are seen as powerful instrument having an important role in shaping further development in the MSs.

In the current financial perspective the financial envelope for SFs and Cohesion Fund (cohesion policy) is broken down by three objectives: Convergence, Regional Competitiveness and Employment as well as Territorial Cooperation.

¹¹ It was decided at the Brussels European Council of December 2005.

¹² OJ no. 139 of 14/06/2006.

Of the overall amount excluding technical assistance 81.6% is dedicated to Convergence, 15.9% to Regional competitiveness and Employment and 2.5% to European Territorial Cooperation.

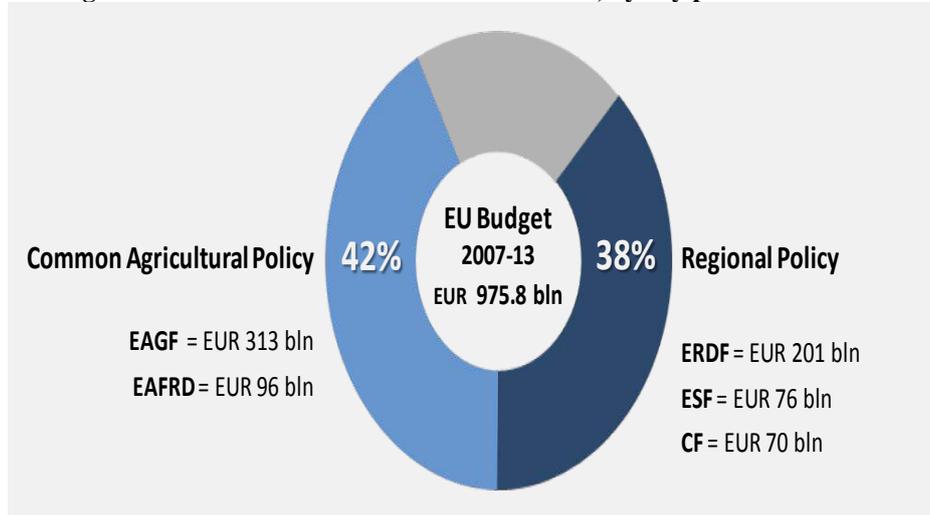
According to these three objectives the EU resources are available under three main instruments (funds), namely:

1. European Regional Development Fund (ERDF), which finances: investment in companies (in particular SMEs) to create sustainable jobs; infrastructure linked to research and innovation, telecommunications, environment, energy and transport; financial instruments (capital risk funds, local development funds, etc.) to support regional and local development and to foster cooperation between towns and regions;
2. European Social Fund (ESF) which seeks to improve employment by supporting actions in the following areas: adapting workers and enterprises through lifelong learning schemes and innovative working organizations; access to employment for job seekers, the unemployed, woman and migrants; social integration of disadvantaged people and combating discrimination in the job market and strengthening human capital by reforming education systems;
3. Cohesion Fund (CF) is aimed at Member States that Gross National Income per inhabitant is less than 90 percent of the Community average and finances activities under the following categories: trans-European transport networks and environment including renewable energy, rail and public transport.

The three funds (ERDF; ESF and CF) represent about 38 per cent of the EU budget (Figure 1).

In addition to the Structural Funds, specifically designed to foster growth and convergence, there are two smaller funds - European Agricultural Fund for Rural Development (EARDF) and the European Fisheries Fund (EFF). These two funds provide funding to the farming and fishing communities to help them adapt to changing conditions and become economically resilient.

Figure 1 : The EU 2007-13 financial allocations, by key policies and funds



Source: European Commission, 2011

The ten new Member states (EU-10) receive just over half (51 per cent) of funds available under these three funds.

While considerable funds are available for the Members States, and particularly for those of Central and Eastern Europe, absorption has been disappointingly slow in most countries. The lack of absorption has been a particular problem in Romania and Bulgaria, where only 12 per cent and 15 per cent, respectively, of the available funding under the ERDF, ESF and CF in the Financial Perspective 2007-2013 has been mobilized. Once payments of cash advances are subtracted the absorption rate drops to 3 per cent and 5 per cent, respectively. In the same time Estonia and Lithuania achieved 34 per cent of absorption while Latvia 25% and Slovenia 24%. In 2009 absorption of funds differ among countries while in 2008 all countries disbursed almost the same percentage (around 5% of total). In mid 2010 more than half of the Financial Perspective 2007-2013 had elapsed, but far less than 50 per cent of the available funding has been absorbed. Bottlenecks in fund absorption are encountered at different stages of the program implementation process and differ in accordance to the Operational Programs and country.

Table 2: EU funds allocation 2007-2013 per selected Member State (million EUR) by mid 2010

Member State	2007	2008	2009	2010	2011	2012	2013	Total
BE	365	355	339	324	308	292	275	2.258
BG	491	713	967	1.019	1.090	1.161	1.233	6.674
CZ	3.011	3.684	3.587	3.754	3.921	4.088	4.258	26.303
DE	1.451	1.760	1.769	1.777	1.785	1.792	1.799	12.434
EE	370	403	439	479	522	570	621	3.403
ES	6.222	5.680	5.113	4.634	4.363	4.337	4.308	34.658
IT	1.879	1.909	1.940	1.970	2.002	2.034	2.066	13.800
LV	496	542	591	643	696	752	810	4.530
LT	753	819	887	960	1.036	1.119	1.202	6.775
HU	2.985	3.177	3.384	3.570	3.728	3.933	4.145	24.921
MT	112	115	118	120	123	125	127	840
PL	8.033	8.566	9.113	9.337	9.650	9.962	10.561	65.222
PT	2.959	2.992	3.025	3.059	3.092	3.126	3.159	21.412
RO	1.275	1.854	2.513	3.027	3.264	3.512	3.768	19.213
SI	541	555	570	585	601	617	633	4.101
SK	1.270	1.376	1.495	1.630	1.752	1.873	1.966	11.361
Subtotal	35.370	37.280	38.553	39.510	40.468	41.826	43.463	276.469
Other member states	8.544	8.656	8.555	8.518	8.477	8.582	8.689	60.021
Total	43.914	45.936	47.108	48.028	48.945	50.409	52.152	336.490

Source: European Commission, 2011

In 2007 level of disbursement of all countries were around 2.5%. The reason for the delayed absorption is the late agreement on the multi-annual financial framework, which has caused consequent delays in the negotiations of the National Strategic Reference Frameworks and of the Operational Programs. Most programs were adopted in 2007, some only at the end of 2007. Moreover, given the nature of the policy, slow absorption in the first year of the programming period after the adoption of the programs is expected. The absorption rates continued to be low despite the changes introduced in the approval process in 2008 to speed up disbursement in the wake of the financial crisis. These changes in essence introduced greater flexibility in allocating funding under different programs and reduced the administrative burden. Moreover, some flexibility in co-financing rates was introduced, allowing full grant financing under some programs (World Bank, 2010). Part of the explanation for the low absorption rate of Bulgaria and Romania is their relatively recent accession to the EU in 2007, prior to which they had a little time to become familiar with the relevant

procedures. The new Member States as a whole, however, perform only marginally worse than the rest of the EU, as the absorption rate excluding advances was roughly 9 per cent versus 11 per cent for the old Member States.

The new Member States have a lower commitment ratio (51 per cent versus 57 per cent) meaning less efficiency in the evaluation and selection of projects that could be eligible for EU funding. It should be noted, however, that the payment ratio includes the cash advance, which in relative terms have been more generous for the new Member States, notably for the Cohesion Fund. In the period 2007-2013, roughly 9.5 per cent of the available EU funds (ERDF, ESF and CF) have been received in advanced payments by the new Member States compared to 7 per cent for the old Member States.

Latvia has a high payment ratio leading to an overall good absorption of EU funds. However, due to a commitment ratio of 50.5 per cent, project selection and evaluation remains below average. In the group of the new Member States, Hungary is an average performer, mainly due to a good commitment ratio (63.4 per cent) while Romania is on all scores a poor performer and has difficulties at all levels of program implementation, starting with the evaluation and selection of the projects. Usually, the lack of administrative capacity has been the main reason for the poor EU funds absorption, and Romania is not an exception.

It is obvious that significant delay in the absorption of EU funds can be observed across all CEECs. One of the main obstacles include limited capacity of the Managing Authorities, complicated application process by EC and lack of co-financing as well as upfront resources for investments (Marinov, Malhasioan, 2006). Significant delays were recorded within the process as it was caused by late opening of the calls, difficulties within the procurement procedures etc. The most common obstacles are evident not only in CEECs, but there are evident in all new Member States. Delays in the procurement process cause delays in contracting. In some cases there were also problems during implementation in regard to the contract administration.

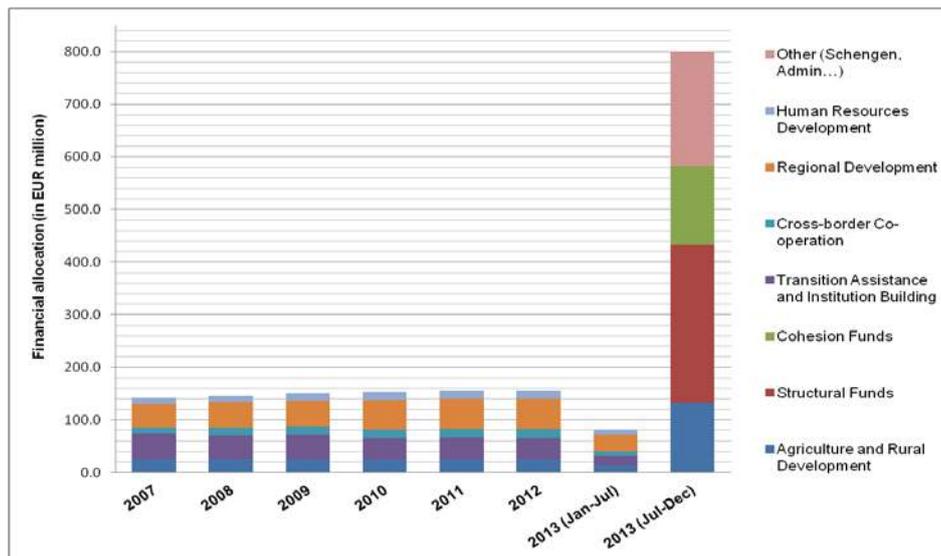
The inability, ineffectiveness and improper preparation of Managing Authorities are seen as widespread problem in CEECs. That was further exacerbated by the high administrative burden for applicants (Horvat, 2004). The complexity of the application procedure is another powerful disincentive – applicants often lack experience to deal with the application criteria, required data, technical and legal documents, assessment of expected impacts of the project, reporting and monitoring requirements, etc. These requirements represent a considerable administrative burden especially for small projects carried out by individuals. Local administrations and agencies often lack capacity to support applicants in presenting solid projects. The long bureaucratic process of preparing and approving applications caused delays in implementation and influence to the low absorption of EU funds. There are considered to be important factors that caused the slow and poor process of absorption of EU funds in CEECs.

5. WHAT WE CAN LEARN FROM THE PREVIOUS EXPERIENCES?

Croatian public administration is in the process of absorbing EU resources from the pre-accession programs and preparing for the implementation of Structural Funds which would be available after becoming EU member. Main Government goal is to achieve maximum rate of absorption of EU funds and spend all allocated resources from the EU Structural Funds and Cohesion Fund. In that sense Croatia is not exception as all countries that have joined EU tried to utilize EU funds at the same manner. The absorption has been one of the objectives that usually all parties in the country agree on. However, almost all CEECs' governments have been faced with the absorption problems and missed opportunity to use all allocated money from the EU funds. The reasons are widely recognized although some could be country specific. In order to avoid some of the mistakes done by CEECs in implementing EU Structural Funds Croatia needs to learn from their experience and try to combine it at best possible way.

It has been proven that in order to successfully use allocated funds it is necessary to have adequate financial management capacity. Management capacity should be seen as the ability to create and manage projects on the transparent way and in accordance to the strict EU rules and regulation. Management capacity for pre-accession programs is completely different then the one for the Structural Funds. Croatia has never been granted with such a high level of foreign assistance extended over a such a long period of time that would be in a case of SFs. The same problem was detected in all CEECs. Huge EU financial assistance inflows were difficult to handle. Namely, EU appropriations are in average of almost 2% of the GDP during the first year of implementation of EU Structural funds and about 5-6% of the GDP in the peak years (ending the financial framework). The challenge that Croatia would be confronted is obvious from the Figure 2.

**Figure 2: The Challenge of Accession - Post-accession versus pre-accession EU assistance in Croatia
(6 months after accession versus annual allocations before accession, broken down by fund)**



Source: European Court of Auditors, 2011.

In order to deal with the huge inflow of EU funds it would be necessary to have on the demand side sufficient number of projects eligible for EU funding. On the supply side

the need of strong administrative capacity is crucial, as well as co-financing secured. In order to raise the absorption rates of Structural and Cohesion Funds a list of actions taken by other countries could be considered. These include an accelerated process of selection and production of project proposals whose results will be assessed based on the number of projects that are submitted to Commission services, the establishment of special central account that collect budgetary appropriations intended to co-finance SFs and CF etc. (Marzinotto, 2011). These interventions address the most typical absorption problems described previously on CEECs.

6.CONCLUSION

The EU financial assistance especially from SFs is huge and EU appropriations are in average of almost 2% of the GDP during the first year of implementation of EU Structural funds and about 5-6% of the GDP in the peak years (ending the financial framework). It is also evident from the analysis that it is difficult to implement primarily because of the complicated structure of EU assistance available. Namely, as it is explained in the paper EU financial assistance is different in the size and nature, different because of the institutions that manage them. Different financial management system applied for pre-accession programs from the one for the Structural Funds. There are also different types of beneficiaries involved. The size of the pre-accession programs is quite different of the size of SFs. Even pre-accession programs vary one from another. Besides, the complexity is generally linked with administrative setup of EU financial assistance.

Significant delays in the implementation of EU funds in the current financial perspective and relatively low absorption rates of SFs can be observed across all CEECs. One of the main obstacles include overall limited absorption capacity at the national level (mainly by the Managing Authorities), complicated application process by EC and lack of co-financing as well as need to have up-front resources for investments. The inability, ineffectiveness and improper preparation for the implementation of EU SFs are seen as widespread problem in CEECs. In order to avoid such situation Croatia would need to learn from the previous CEECs experience and find a way to efficiently use all allocated financial assistance from the SFs and CF.

REFERENCES

- Cace, C., Cace, S., Iova, C. (2010) *Capacity of PHARE and Structural Funds Absorption: Pre-accession Versus Post-accession*, Revista de cercetare si interventie sociala, Vol. 28, Lumen Publishing House, Pp. 78-96.
- Europa Media Non-Profit Ltd. (2010). *Quick guide to EU Funds*. 3rd edition, Budapest, Europa Media Non-Profit Ltd.
- European Commission (2003), *Commission Staff Working Paper on the Implementation of Commitments Undertaken by the Acceding Countries in the Context of Accession Negotiations on Chapter 21 – Regional Policy and Co-ordination of Structural Instruments*, SEC (2003) 828,16.7.2003., Brussels
- European Commission (2004), *From Pre-Accession to Accession”, Interim Evaluation of PHARE Support Allocated in 1999-2002 and Implemented Until November 2003*, DG Enlargement, Evaluation Unit, Brussels.

- European Commission (2006), *PHARE Support to Economic and Social Cohesion in Bulgaria and Romania*, Thematic Evaluation Report, DG Enlargement, Evaluation Unit, December 2006, Brussels.
- European Commission (2010), “*2009 Annual Report on PHARE, Turkey Pre-accession Instruments, CARDS and the Transition Facility*”, Report from the Commission to the
- European Parliament, the Council and the Economic and Social Committee; 20. 12. 2010., Brussels.
- European Commission (2011), *Analysis of the Budgetary Implementation of the Structural and Cohesion Funds in 2010*, EC, Directorate General Budget, May, 2011, Brussels.
- European Commission (2011), *Monitoring Report for Bulgaria 2011.*, <http://ec.europa.eu/dgs/bulgaria>
- European Parliament (2011), *Report on Absorption of Structural and Cohesion Funds: Lessons Learnt for the Future Cohesion Policy of the EU*, Committee on Regional Development.
- European Court of Auditors (2011), *Has EU Assistance Improved Croatia's Capacity to Manage Post-accession Funding?*, Special Report No. 14, pages: 49.
- Grabbe, H. (1999), *A Partnership for Accession? The Implications of EU Conditionality for the Central and East European Applicants*, Robert Schuman Centre Working Paper No. 12/99, San Domenico di Fiesole (FI): European University Institute, 1999.
- Horvat, A., (2004), *Absorption Problems in the EU Structural Funds*, NARG, Ljubljana
- Kandžija, V., Cvečić, I. (2011), *Ekonomika i politika Europske Unije*, Rijeka: Ekonomski fakultet Sveučilišta u Rijeci.
- KPMG (2011), *EU Funds in Central and Eastern Europe*, Progress Report, Budapest, Hungary.
- Marinov, V., Malhasioan, D. (2006), *Partnerships in Structural and Cohesion Funds Planning and Absorption: A Comparative Review of the Practices of Selected EU Member States and Lessons Learned for Bulgaria*, UNDP, Sofia.
- Marzinotto, B. (2011), *A European Fund for Economic Revival in Crisis Countries*, Brugel Policy Contribution No. 2011/01, February 2011.
- Michalski A., Wallace, H. (1992), *The European Community: The Challenge of Enlargement*, London: RIIA.
- Mrak, M., Tilev, D. (2008), *Absorption for EU Pre-Accession Funds: Concept and Implication for Kosovo*, Forum 2015, Priština, March 2008.
- Sedelmeier, U., Wallace, H. (1996), *Policies Toward Central and Eastern Europe*, in *Policy-making in the European Union*, eds. Helen Wallace and William Wallace, Oxford: Oxford University Press, pp. 353-387.
- World Bank (2010), *EU-10 Regional Study*, July 2010., Washington.

Vinko Kandžija

University of Rijeka, Faculty of Economics, *Ad Personam Jean Monnet Chair*, Rijeka, Croatia

Marko Tomljanović

University of Rijeka, Faculty of Economics, Rijeka, Croatia

Tomislav Kandžija

County of Primorsko-goranska, Rijeka, Croatia

POSSIBLE ECONOMIC EFFECTS OF EU CONVERGENCE INSTRUMENTS ON WESTERN BALKAN COUNTRIES

ABSTRACT

After a very unstable period in the 90th - s, Western Balkans countries begun the process of establishing democracy and the rule of law, and expressed a desire for faster integration into the EU. Full membership in the EU is a key goal and aspiration of Western Balkans countries, which represents a path towards prosperity and stability. However, towards full integration there are various economic and political problems. To help Western Balkan countries in solving these problems, EU created special financial instruments. EU funds are allocated in specific projects, and each country is responsible for their own progress.

In their accession process, Western Balkans countries had to make some adjustments in terms of regional cooperation, and then sign the Stabilization and Association Agreement (SAA). SAA increased macroeconomic stability in the region and opened the way for countries towards EU membership.

Furthermore, to overcome the difficulties of transition, until the year 2006, to the Western Balkan countries were available pre-accession funds ((ISPA, PHARE and SAPARD, when they where replaced with unique IPA programme in the year of 2007. The purpose of the pre-accession programs was to help these countries in adjusting legal and political acquis and strengthen their economies in order to be able to cope with competition within the Union. The biggest problem is the unwillingness of countries in the creation of quality programs to allocate approved funds.

By leveraging resources of the EU, the countries of the Western Balkans lay the foundation for future integration into the EU, whose (long-term) benefits are undetectable, and associated costs with transition process are short-term. As most important costs can be specified payments to the common budget (up to 1.24% of GDP), the elimination of tariffs and loss of coordinated acts of VAT. The most significant aspect of the association is related to the launch of reforms in all areas of economic and social activity, which will ultimately achieve economic growth and political stability. The Western Balkan countries that meet the criteria, will become active participants in shaping EU policies, which will continue to have a positive impact on the stability of the entire region. Using the Structural Funds, the countries

will modernize and become more efficient and cheaper. Funding opportunities from the EU Structural Funds, with increased foreign investment, will accelerate the economic growth of new member states.

Successful restructuring of the company in the long run will generate income and increase the competitiveness and standards of employees. Consumers will benefit from EU membership through lower prices for goods and services, and greater protection and security.

Membership in the EU will not have the same effects on all sectors of society, and some groups will benefit more than others. This particularly refers to young people with entrepreneurial skills, qualified individuals for the challenges of a flexible labour market, and groups that deal with related issues.

Key words: EU, Western Balkan, structural funds, pre-accession funds, economic growth, cost, benefits

JEL classification: E 24; F; 36; J 11; O 11; O 40

1. INTRODUCTION

Western Balkan countries have been affected by recent political and economic changes in the last 20 years, which were manifested through transformation from planned market system to market oriented on economy. Political changes in the most of the countries were completed relatively quickly and without significant effects (except Croatia and Bosnia and Herzegovina). On the other side, economic changes were more difficult and requires already mentioned transition from centrally planned management methods on the market. Such process is called transition and requires long and tedious engagement of all members of public and commercial sector. Full membership in the EU is the main goal of less developed and still politically unstable Western Balkan countries. With full membership in EU, these countries wants to achieve economic development and increase degree of political stability. In order to achieve successful adjustment, EU created specific financial instruments for these countries, whose fund are dedicated, to specific objectives and each country is responsible for their own progress. Biggest problem of Western Balkan countries is unwillingness to creation of high – quality programs. Western Balkan countries has not created stable foundation for achieving long term growth, and it is unlikely that the EU membership will automatically "delete" all the problems in those countries.

EU membership will not have the same effect on all segments of society, and some groups will benefit more than others. This especially refers to young people with entrepreneurial skills, qualified individuals for the challenges of a flexible labor market, and groups dealing with issues related to the EU.

2. ACCESSION OF WESTERN BALKAN COUNTRIES TO THE EU

Western Balkan countries are, unlike countries of Central and Eastern Europe which accessed in EU in the year of 2004th and 2007, affected by harder and difficult accession process.

Former socialist countries that have joined the EU, signed the European Agreements. Western Balkan countries, affected by the war in previous period, did not have that option, even though they had a developed economy and economic structure closer to the market model. For this countries EU created a different approach, and they had to make some adjustments and reforms and meet EU requirements in terms of regional cooperation, and after that sign the Stabilization and Association Agreement.

The Stabilisation and Association includes:

- making an agreement with a view to becoming a member when conditions are met;
- development of trade and economic relations in the region;
- development of economic and financial assistance;
- development of democratic institutions and civil society;
- cooperation in justice and home affairs and the promotion of political dialogue.

Although the EU wants to integrate Western Balkan countries into its membership, that, in addition to solving problems in the neighborhood, brings new problems in operational system operation and collaboration (increased number of states complicates the functioning of the EU).

First countries that signed Stabilisation and Association agreement were Republic of Croatia and Macedonia in the year of 2001. and they started accession negotiations in the year of 2005. Accession process started later in Serbia (2009) and BiH and (2008.)

Table 1. Progress of Western Balkan countries toward EU membership

Country/stage	Signing SSP	Applying for membership	Opening of negotiations
Croatia	2001.	2003.	2005.
Macedonia	2001.	2004.	2005.
Serbia	2006.	2009.	
Albania	2008.	2009.	
Montenegro	2007.	2008.	
Bosnia and Herzegovina	2008.		
Kosovo			

Source: www.europa.eu.int

Great progress was achieved in the Republic of Croatia. This country fulfilled all criteria and she will became the full EU member in July 2013.

Establishment of SAA increased macroeconomic stability in the region. However, the deficit of the payment balance is still too high and tends to increase, since the structural reforms in the countries were inadequate and uneven. In order to establish a functioning market economy, Western Balkan countries must ensure further privatization and impose appropriate regulatory framework and structures of corporate governance.

3. EU PRE-ACCESSION AND ACCESSION INSTRUMENTS FOR WESTERN BALKAN COUNTRIES

EU developed many programs to help candidate countries to make faster and better implementation of numerous economic, political and institutional reforms and meet the criteria for EU membership.

Most important forms of assistance to candidate and potential candidate countries were united in pre-accession programs PHARE, ISPA and SAPARD.

PHARE program was launched in the year of 1989 as a program for help Poland and Hungary, and then for the other transition countries of Central and Eastern Europe, to promote multi-party democracy and the economy after the fall of communism. Phare program was completely focused on the pre-accession priorities and became the main financial and technical instrument for pre-accession strategy for the candidate countries. EU Directorate General for Enlargement of the European Union was in charge for PHARE program.

The main objective of the program was to prepare candidate countries for EU membership, and enable them to make full implementation of *acquis communautaire* and use of structural and Cohesion funds after accession.

Spacial focus of the program was on two areas: institution building, which provided 30% of PHARE program intended for a particular state, institutional projects, which provided 70% of PHARE program aimed at a specific country.

ISPA program was launched by Council Regulation of the No.1267/1999. and its financial value for the seven-year period (2000th-2006th) was amounted to 1.040 billion euros. EU Directorate General for Regional Development was in charge for ISPA program. The main goal of the program was to help the candidate countries in preparation for membership, and it intended to finance infrastructure projects in the fields of transport and environment.

SAPARD program was launched in the year of 1999 by Council Regulation (EC) no. 1268/1999 as a program aim to support rural development and agriculture, and to prepare candidate countries for using agricultural and fishery fund after becoming the full EU member. Additionally, SAPARD was directed toward legal, institutional and administrative training. Difference between SAPARD and other programs is that proponents of SAPARD projects may be private sector bodies. SAPARD disburses funds creditworthy counterparties customers, with an emphasis on projects focused on particular areas: adjustment of agricultural structure, food industry, quality, market

entry and development of rural areas. Management of the SAPARD program is based on the model of ex-post decentralized control where the responsibility for the financial management of the funds is transferred to the national authorities, while the European Commission provides control procedures of tendering and contracting, and financial returns to the end user if the entire process is properly executed. European Union can finance up to 75% of the total project value. In financing investment projects with a certain gain 50% of the funds are funded through public grants, of which the share of the European Union to finance 75% and the remaining 25% is financed by the national budget.

From the year of 2002, total available funding from SAPARD program to 10 candidate countries was amounted to 520 million euros per year.

In the period 2007 – 2010, for Western Balkan countries was distributed 2,47 billion euros from preaccession funds. (Table 2)

Table 2. Allocation of pre-accession funds in Western Balkan countries (million euros)

Country	2007.	2008.	2009.	2010.	Total
Croatia	140	138,5	146	151,2	575,7
Macedonia	43,6	58,5	70,2	81,8	254,1
Albania	45,5	60,1	70,7	81,2	258,4
B&H	51	67,1	74,8	89,1	277
Montenegro	23	31,4	32,6	33,3	120,3
Serbia	167	186,7	190,9	1894,8	739,4
Kosovo	59,5	63,3	64,7	66,1	253,6

Source: Eurostat, 2011

In the reporting period, most of the funds were allocated to Serbia and Republic of Croatia. Also, 253 million euros were intended for Kosovo as a separate part.

More complete picture of the aid intended for Western Balkan countries can be obtained by analyzing areas use the IPA program. With such an analysis can be recognized in the Union in what each region puts the greatest emphasis and which are the biggest problems that country must solve before full membership in the Union. (Table 3)

Table 3. IPA funds intended to Western Balkan countries in the period 2007-2010 (million euros)

Country / Component	Transition assistance and institution building	Cross-border cooperation	Regional development	Human resources development	Rural development	Total
Albania	186	26,6	-	-	-	212,6
BiH	211,9	14,1	-	-	-	226
Montenegro	84,2	13,1	-	-	-	97,3
Macedonia	119,6	15,1	40,5	16,3	19	210,5
Croatia	140,6	40,3	142,4	38,3	76,9	438,4
Serbia	540,5	31,9	-	-	-	572,4
Total	1 282,8	141,1	182,9	54,6	95,9	1757,2

Source: Eurostat, 2011

Again, most of the fund were allocated to Croatia and Serbia.

Fund for potential candidate countries are intended only in two areas: transition assistance and institution building and cross-border cooperation. Candidate countries biggest challenge is the area of regional development (regional disparities) because they appear to be the greatest threat to economic and social cohesion within the EU.

EU wants candidate countries, in the period before full EU membership, to engage in reducing regional disparities as the fundamental preconditions of the internal market and increasing economic and social cohesion.

EU created special transnational program for Western balkana countries called SEES (South East Europe Transnational Cooperation Programme). Main goal of the program is stabilization in the region in the period between the year 2007 and 2013. Program includes joint projects of member and candidate countries in order to achieve a balanced development in the region. Countries involved into project realization are: Austria, Bulgaria, Greece, Hungary, Slovenia, Slovakia, Romania and part of Italy and Western Balkan countries: Bosnia and Herzegovina, Serbia, Montenegro, Croatia, Macedonia, Albania, Moldova and part of Ukraine. Implementation of the project is carried out in such a way that if the project involves three countries (of which one

member of the EU), the EU finances 85% of the project and the Member States 15% of the value.

Table 4. Total amount intended for financing transnational programs

Fund	Country	Total amount in euros
ERDF	EU member countries	58 287 044
IPA	Albania	200 020
	BiH	453 020
	Montenegro	670 000
	Croatia	400 000
	Macedonia	500 000
	Serbia	1 114 228

Source: www.ardanw.org

Transnational programs in EU member states are financed by resources of ERDF. In Western Balkana countries these projects are financed through IPA programme. Most of the funds for realization of SEES programme in Western Balkan is intended to Serbia and Montenegro.

Funds of EU preaccession programmes have an important role in tranformation of economy and certain activities in Western Balkan countries. However, funds aren't intended for achieving development of production and economic capacity, which would be able to provide stable and high economic growth rate. Western Balkan countries in a transition period haven't made stable and sustainable basis for long-term sustainable development and is therefore illusory to expect that EU membership will automatically solve all their problems.

4. ECONOMIC EFFECTS OF ACCESSION OF WESTERN BALKAN COUNTRIES AND USING EU INSTRUMENTS OF CONVERGENCE

As already mentonied, the main objective of Western Balkan countries is accession to the EU, which will have direct impact on all segments of society and economy. The most important precondition for faster accession is an effective use of EU instruments of convergence.

Among population in Western Balkan countries is present concern that accession to the EU could also have negative consequences. Eurosepticism in candidate countries is a consequence of prejudice connected with lack of confidence in state institutions. Problem of scepticism can initially been solved by increasing transparency, efficiency and accountability of state institutions and bodies. Also, informing citizens about integration process is insufficient. Citizens have fear that accession to the EU will worsen their position. Solution for this problem is possible by achieving improved communication with citizens and allowing them to get closer to all the details about process of EU membership.

When Western Balkan countries become the full EU members, producers from these countries will be allowed to access the EU Internal market with more than 500 million potential consumers. Economy systems of these countries must be open to free movement of goods, services and labour force toward EU member states. Increasing in opening market will result in higher pressure of stronger foreign competitors but also it will create a foundation for stronger inflow of foreign direct investment. EU membership of the Western Balkan countries will have, because of the liberalization process (elimination of tariffs), easier access to better quality and inexpensive goods and services, which will increase their standard of living.

Abolition of customs duties will reduce state revenues. States will also have to reduce grants, which will result in the bankruptcy of a specific number of businesses, which can be viewed as a cost for producers and workers. However, this procedure will relieve the burden from states that are supporting the uncompetitive businesses and realize greater opportunities for investment in more profitable sectors.

Biggest benefits of future membership will be addressed to young, flexible and educated population and groups dealing with issues related to the EU. Realization of the free movement of capital will result in a more stable financial markets in which citizens will be safer to invest in foreign securities and legal entities to manage assets in a safer environment. Upward trend in the property market will be attending to continue to further growth leverage.

By full EU membership, institutions in Western Balkan countries will, by applying European standards, increase level of democracy, rule of law and protection of human and minority rights, which will result in more stable political environment, and create the foundation for sustainable and stable economic growth. European standards will contribute on further de-politicization of government services.

Common features of judicial systems of Western Balkan countries are lack of independence and low level of transparency, which can be identified through a lack of professionalism and impartiality of court staff, long duration of the proceedings, and huge backlog of unsolved cases. Reform of the judicial system will result in a reasonable time of dispute resolution and introduction of system of supervision and management, and alternative dispute resolution system.

EU accession process brings benefits to agriculture and rural development through the guidance of reform, opening up new markets and rationalization activities. Experience of new member states testify to the regular payment of agricultural subsidies and reduced irregularities and fraud.

Using the resources of the European Social Fund (ESF), the Western Balkan countries will become better equipped to combat high unemployment. The greatest benefit will have educated population, which, due to the resulting economic growth will have large employment opportunities. For unemployed population will be open greater opportunities to participate in the process of retraining. On the decrease in

unemployment will impact and implementation of the free movement of workers. However, this achieving will not be possible immediately after joining the EU. Specifically, Member States have the right to introduce a moratorium on the liberalization of their own labor markets for the population of new members within 7 years. United Kingdom, Sweden and Ireland have opted for a policy of "open" door for all new members. Alignment with the *acquis* in the area of employment introduces significant reforms in the system of employment that all citizens benefit. They will allow better control of employers, stricter anti-discrimination measures and generally better guarantees regarding the rights of employees. Accession will improve the social security system and the legal status of employees.

Active employment policies and joint actions and funding projects that promote employment of the structural funds, to achieve a higher rate and employment rate, achieved the approaching to the common goal of the Lisbon strategy, while taking into account the particular problems of social protection and social exclusion. A large number of EU countries have relatively high rates of unemployment and low participation rates in the labor market and high disparities in employment by region.

Table 5. Employment and unemployment rate in selected new member states and Croatia

		2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Bulgaria	employed	49,7	50,6	52,5	54,2	55,8	58,6	61,7	64,0	62,9	59,7
	unemployed	19,5	18,2	13,7	12,1	10,1	9,0	6,9	5,6	6,8	10,2
Czech	employed	65,0	65,4	64,7	64,2	64,8	65,3	66,1	66,6	65,4	65,0
	unemployed	8,0	7,3	7,8	8,3	7,9	7,2	5,3	4,4	6,7	7,3
Hungary	employed	56,2	56,2	57,0	56,8	56,9	57,3	57,3	56,7	55,4	55,4
	unemployed	5,7	5,8	5,9	6,1	7,2	7,5	7,4	7,8	10,0	11,2
Poland	employed	53,4	51,5	51,2	51,7	52,8	54,5	57,0	59,2	59,3	59,3
	unemployed	18,3	20,0	19,7	19,0	17,8	13,9	9,6	7,1	8,2	9,6
Romania	employed	62,4	57,6	57,3	57,7	57,6	58,8	58,8	59,0	58,6	58,8
	unemployed	6,8	8,6	7,0	8,1	7,2	7,3	6,4	5,8	6,9	7,3
Slovakia	employed	56,8	56,8	57,7	57,0	57,7	59,4	60,7	62,3	60,2	58,8
	unemployed	19,3	18,7	17,6	18,2	16,3	13,4	11,1	9,5	12,0	14,4
Slovenia	employed	63,8	63,4	62,6	65,3	66,0	66,6	67,8	68,6	67,5	66,2
	unemployed	6,2	6,3	6,7	6,3	6,5	6,0	4,9	4,4	5,9	7,3
EU 27	employed	62,6	62,4	62,6	63,0	63,5	64,5	65,4	65,9	64,6	65,4
	unemployed	8,5	8,9	9,0	9,1	8,9	8,2	7,1	7,0	8,9	9,7
Croatia	employed		53,4	53,4	54,7	55,0	55,6	57,1	57,8	56,6	54,0
	unemployed		14,8	14,2	13,7	12,7	11,2	9,6	8,4	9,1	11,8

Source: Eurostat, 2011

As we can see in this Table, all transition countries, which became the EU member states in last accession round, reduced their unemployment rate in the period before and after accession to EU.

EU require new member countries to adjust their economic structure (agriculture and industry) to economic and environmental standards. Focus of European institutions is on environmental problems through supranational approach combined with subsidiarity principle.

Table 6. GDP per capita (PPP) in transition countries in the period 2003-2010

	2003	2004	2005	2006	2007	2008	2009	2010
EU-27	100	100	100	100	100	100	100	100
EU-15	114	113	113 ^b	112	111	111	110	110
Bulgaria	32	35	37 ^b	38	40	44	44	44
Czech	74	78	79 ^b	80	83	81	82	80
Hungary	63	63	63 ^b	63	62	64	65	65
Poland	49	51	51 ^b	52	54	56	61	63
Romania	31	34	35 ^b	38	42	47	47	46
Slovakia	55	57	60 ^b	63	68	73	73	74
Slovenia	83	87	87 ^b	88	88	91	87	85
Croatia	54	56	57 ^b	58	61	64	64	61

Source: Eurostat, 2011

After accession to EU economic growth in all new member states has accelerated. In Czech Republic and Slovakia, after first year of membership, GDP growth rate almost doubled. Average growth rate in new member states was 4,5% before accession, but then, except in Hungary, increased to 6%, which indicates gap reduction between old and new members, and the convergence of GDP per capita measured in purchasing power parity terms. New Member States putting pressure on a common policy in a way that differences in income translate into different political priorities, they give reasons for the great migration between countries and regions, putting pressure on the EU budget upwards to increase and provide new incentives for discussions on the allocation of funds between member countries.

All new member states increased balance of payments deficit, which is a clear indication of how the national economy, and its production, could not cope with the new opening trend and liberalization. Causes of the deficit should be found not only in joining to internal market, but perhaps more in the liberalization to the rest of the world (various trade agreements and benefits), because it is such a commodity makes a significant component of the newly created deficit. High deficit balance of payments current account are not harmful if capital is imported, but not consumer goods.

Table 7. Balance of payments in selected EU member states and Croatia (billion euros, 2003-2010)

	2003	2004	2005	2006	2007	2008	2009	2010
EU27	-	-36,0	-82,90	-146,2	-127,2	-243,30	-127,50	-
Bulgaria	-0,47	-1,31	-2,70	-4,64	-7,75	-8,18	-3,11	0,47
Czech	-5,02	-4,65	-1,04	-2,39	-5,67	-3,29	-3,42	4,66
Hungary	-5,93	-6,83	-6,37	-6,63	-7,22	-7,72	-0,15	1,06
Poland	-4,88	-10,81	-5,86	-10,42	-19,25	-23,81	-12,05	16,48
Romania	-3,11	-5,10	-6,87	-10,22	-16,75	-16,17	-4,93	4,91
Slovakia	-1,74	-2,66	-3,26	-3,49	-2,91	-4,02	-1,62	2,27
Slovenia	-0,19	-0,71	-0,49	-0,77	-1,64	-2,57	-0,45	0,29
Croatia	-1,80	-1,46	-1,98	-2,71	-3,24	-4,37	-2,42	0,56

Source: Eurostat and Croatian National Bank

Accession to the European Union should not lead to long-term price increases. Experience of new member countries shows that increasing of prices in first period after accession was around 1,4%.

Primary purpose of pre-accession assistance is to improve administrative capacity, but development assistance from the Structural and Cohesion fund has much wider character. Structural and Cohesion Fund will be directed to SMEs and to strengthen entrepreneurship.

Western Balkan countries will be obligated to contribute to common EU budget in total amount of max. 1,24% of their GDP. At the same time, this countries will generate almost 4% of their GDP from Structural and Cohesion funds.

Differences between amounts that country received as a candidate and as a full member state will be approximately one billion euros. Benefits of development assistance from EU funds will became more tangible for Western Balkna countries after accession to EU.

5. CONCLUSION

Western balkan countries were affected by the war and several poltical problems in past 20 years. Also, current economic crises further deepened economic problems that have been present in this area. The main goal of Western Balkan countries is accession to the EU, from whom they expect to achieve stabile political environment and prosperity for their citizens. However, accession process is very complex and requires a large number of reforms.

One of the most important instrument in accession process of Western Balkan countries toward EU membership in previous period were EU preaccession funds. Total allocation in this countries is amounted to 2,64 billion euros till the year of 2010. In this structure, most of the funds were allocated to Serbia nad Republic of Croatia, which finished its accession process and will became the full EU member in July 2013. Western Balkan countries show weaknesses in creation of high-quality and sustainable projects, by which they could allocate more funds from the European programs.

EU membership will result in large number of benefits in Western Balkan countries. That benefits will improve living standard. Many changes will occur in the area of democracy, rule of law and protection of minority and human rights. Also, the country will have access to EU structural funds and Cohesion Fund which will reduce unemployment, encourage entrepreneurship and help them to achieve economic and social cohesion. Integration will have certain costs that are manifested through the commitment of countries to contribute to common EU budget (up to 1.24% of GDP). Abolition of taxes will result in losing of a significant part of state revenues. In general, the maximum benefit from the integration will have a young and educated population, which will have, by achievement of free capital movement, new nad better opportunities for employment and further education.

Taking into consideration current economic situation in the Western Balkans countries, EU integration will have primarily positive connotation. However, achieving of positive results of integration requires fundamental reforms, which must be carried out in cooperation of all segments of society.

REFERENCES

- Acin, D. Todorovic, M., Cingulinski, S. 2004. „International economic relations“, Pigmalion, Novi Sad
- Borchardt, B.C. 1995. „Europska integracija“, Ured za europske integracije, Zagreb
- Butković, H.; Dujmović, K.; Ondelj, I. 2007. „Hrvatska u EU: Što građani mogu očekivati?», Institut za međunarodne odnose, Zagreb
- Jovančević, R. 2005. „Ekonomski učinci globalizacije i EU“, Mekron promet, Zagreb
- Kandžija, V.; Bezić, H.; Andrijanić, I. 2002. „Structural funds of the EU, Transitional impacts and EU enlargement complexity», University of Ljubljana, Faculty of Economics, Ljubljana
- Kandžija, V. 2003. „Gospodarski sustav EU“, Sveučilište u Rijeci, Ekonomski fakultet, Rijeka
- Mintas – Hodak, Lj. 2004. „Uvod u Europsku uniju“, MATE, Zagreb

Samardžija, V. 2006. „Reforms in Lisbon strategy implementation – economic and social dimension, Institute for international relations, Zagreb

Šimić, D. 2002. „Europska unija – danas i sutra“, Mala geografska biblioteka, Hrvatski zemljopis, Samobor

www.ecb.org

www.oecd.org

www.imf.org

www.europa.eu.int

Jamila Jaganjac,
University "Vitez" Vitez, Bosnia and Herzegovina

BOSNIA AND HERZEGOVINA EXPERIENCE IN THE PROCESS OF INTRODUCING DECENTRALIZED IMPLEMENTATION SYSTEM - FROM IPA I TO IPA II

ABSTRACT

Applying decentralized implementation system (DIS) involves the transfer of competencies in managing funds from the European Commission to the beneficiary country, which means:

- 1. Procurement / tendering, contracting, budgeting and allocation of European Union funds performs institution established for this purpose: Central Finance & Contracts Unit (CFCU) and*
- 2. Demand and management of the funds, as well as submission of financial statements is performing institution established for this purpose: the national fund (NF).*

The goal of transition from centralized to decentralized system is a gradual preparation of Bosnia and Herzegovina to gain competencies in the management of EU assistance when entering the EU. Taking some responsibility in the management of funds, Bosnia and Herzegovina gets a chance to establish and effectively implement the necessary internal procedures and structures. IPA supports a high degree of participation of the beneficiary countries in the programming and implementation of assistance. At the same time, for the decentralized management of assistance, in which the Commission confers the management of certain actions on the beneficiary country, it's practically a rule set. Exceptions can be made in components: transition assistance and institution development and cross-border cooperation component, but the decentralized management remains as the goal. The other three components of IPA I (Regional Development, Human Resources Development and the Agricultural and Rural Development) were available to the countries with candidate status and by the European Commission accredited system for the decentralized management of assistance (DIS).

Proposal for a new Regulation on the establishment of IPA II abolishes distribution on the previous five components, and introduce the policy areas within different interventions will be implemented. Financial assistance may be available in all areas of policy, regardless of whether the country has the status of a candidate or potential candidate. The subject of this work is to determine the steps that have been taken in the process of DIS during the IPA I and how this process can be affected by modified IPA II approach.

Keywords: pre-accession funds, implementation, decentralized

JEL classification: O1

1. INTRODUCTION

Introduction of a new instrument for Pre-Accession Assistance IPA II, involves the dissolution of the five components and the introduction of the concept of policy areas. This approach opens up the possibility that financial assistance is available in all areas of policy, regardless of the status of a candidate or potential candidate. That includes Regional Development, Human Resources Development and the Agricultural and Rural Development as well as previously available Transitional Assistance and Institutional Building and Cross Border Cooperation.

Adoption of the Regulation on the establishment of IPA II is expected in mid of year 2013. The preparation of the implementing regulations for the IPA II is ongoing, and its finalization is expected in the second half of the 2013 year. Presentation of IPA II was jointly organized by the Office of the National IPA Coordinator, European Union Delegation to Bosnia and Herzegovina and the Regional Cooperation Council. At the presentation were invited representatives of the Cabinet of the Chairman of the Council of Ministers, members of the Joint Committee on European Integration of the Parliamentary Assembly of Bosnia and Herzegovina, IPA members of the Coordinating Committee and project managers.

All the details of using the IPA II are still not known, but what is emphasized is the importance of establishing appropriate management structure for the implementation of funds: Bosnia and Herzegovina should strive for the establishment of indirect / decentralized management system, in order to enable full absorption of IPA II funds. Given that Bosnia and Herzegovina has not fully established management structure, on several occasions it was requested to clarify whether the establishment of decentralized management system (DIS) is a condition for access to funds from all IPA II components / policy areas.

Theoretically DIS is no longer a condition for access to funds from any of the policy areas (former IPA components), but in practice it will be very difficult to absorb / deploy funds from the IPA II without the necessary management structures, and Bosnia and Herzegovina will face a limited ability to absorb EU funds, especially with regard to economic and social development. Accordingly, Bosnia and Herzegovina should restart activities in establishing decentralized management of EU funds. Regardless of the final draft of the Strategic document for Bosnia and Herzegovina for IPA II, planned for May/June 2013, DIS is still actual and needed for strengthening absorption capacity.

The pre-accession assistance provided through the EU budget is designed to help candidate countries and potential candidates prepare for future membership: the IPA is designed to give countries a 'test run' of the obligations of membership before

accession, such as putting in place institutions for managing post-accession EU funds, and/or adopting the acquis and EU standards (European Commission, Regulation IPA II proposal 2011:8). Therefore, importance of DIS is undoubted, since having access to funds is not the same as to manage them. Assistance should continue to make use of the structures and instruments that have proved their worth in the pre-accession process. The transition from direct management of pre-accession funds by the Commission to decentralised management delegated to the beneficiary countries should be progressive and in line with each beneficiary country's capacities (European Commission, Regulation IPA II proposal 2011:17).

2. STRATEGY OF IMPLEMENTATION OF DIS

The strategy for decentralized implementation system in Bosnia and Herzegovina was adopted by the Council of Ministers on June 23rd, 2008 (revised version). Roadmap for DIS for Bosnia and Herzegovina (Allocation of management through ex-ante control for IPA Component I - Transition Support and Institutional Building and II - Regional and cross-border cooperation) was presented in December 2009. Given that the Roadmap has not been adopted, no one follows the activities in the Roadmap because it is not a formal legal document. According to the Roadmap for DIS, his assignment should have been completed in July 2011. The research determines the degree of implemented activities; which activities are still not done and what are potential shortcomings in the monitoring of process of decentralization.

As it is stated in Strategy of implementation of DIS (2008:5), before deciding on the transfer of fund management to Bosnia and Herzegovina, the European Commission need to determine whether the state meets the requirements, especially those related to the management and control systems, and that accreditation of the below listed is made:

- National authorizing officer (NAO) and the National Fund (NF), authorized by the competent accrediting officer - (CAO), and
- The operating structures, authorized by the national authorizing officer (NAO).

As a rule, the European Commission, in the framework of DIS, makes ex-ante approval of project selection, tendering and contracting carried out by the beneficiary countries. System for the verification carried out by the Commission is independent to the management and control systems that are formed by the institutions of Bosnia and Herzegovina. The Commission conduct ex-ante control for its own account and it is not supplement to the system of verification of the beneficiary country. Accordingly, the Bosnia and Herzegovina institutions should ensure regularity of the transactions presented to the Commission for prior approval.

According to the rules for the implementation of the IPA, it is required to establish an operating structure for each IPA component for the management and implementation of assistance in accordance with the Regulation on IPA. Operating Structure is responsible for the management and implementation of the program in accordance with the principles of sound financial management.

DEI and the Ministry of Finance and Treasury are the main institution responsible for the implementation of the Strategy DIS. They are responsible for carrying out the activities listed in the Strategy of DIS. Both institutions need to cooperate and to ensure timely communication. According to the administrative procedure, it should be realized through the work of a special body, i.e. the Committee for monitoring the implementation of the Strategy. Committee members are NIPAK, CAO and NAO, and the person in front of DEI responsible for coordination of component II, Head of the Department for the Coordination of IPA Component I, Head of Operating Structure for component II. If necessary, the meeting may be attended by representatives of the relevant authorities for DIS, at the request of individual members of the Committee. The proposal is that the works of the Committee meetings are held 2-3 times a month.

2.1. Structures, organs and responsible institutions in DIS

In accordance with the Regulation on the implementation of the IPA, the state is required to appoint a number of structures and organs that will manage the assistance under DIS in Bosnia and Herzegovina:

1. National IPA Coordinator (NIPAK) – from 2010 it is Director of DEI (Official Gazette 62/10)
2. Strategic Coordinator for the regional development component and the development of human resources – there is indication of the need for the appointment even though the existing strategy DIS does not include activities related to the institution of the Strategic Coordinator.
3. Competent accrediting officer (CAO)- Minister of Finance and Treasury (decisions from Official Gazette 62/10 and 44/12)
4. National authorizing officer (NAO)- Head of the Department of National Fund of the Ministry of Finance and Treasury of Bosnia and Herzegovina (Official Gazette 62/10)
5. National fund - (Official Gazette 26/06)
6. Operating structures for each IPA component:
Operating structure for IPA II component (Official Gazette 82/11)
Operating structure for IPA I component – not established
7. Audit Authority – not established
8. Central Finance and Contract units (CFCU) – (Official Gazette 26/06) – at the Ministry of Finance and Treasury, managed by Program Authorizing Officer – (PAO)
9. Senior Program Officer (SPO)- (Official Gazette 05/09)

Integral part of the strategy for the implementation of DIS makes Roadmap for implementation of decentralized system.

2.2. Road map for DIS in Bosnia and Herzegovina

The purpose of the Roadmap is to identify individual activities with dynamic execution, leading to the final goal - the European Commission's decision on the transfer of responsibilities to the institutions of Bosnia and Herzegovina. Decentralised management of funds involves transfer of responsibilities from the Commission to the

beneficiary country for the implementation of public procurement, contracting and payments. The Roadmap was prepared by the model which was submitted by the European Commission. On the other hand, Bosnia and Herzegovina has never built its own system for managing IPA, which is a disadvantage in meeting its obligations in the accession process.

Road map consists of five phases:

1. Stage 0, involves the establishment of a framework for management and control system and covers legal and physical establishment of appropriate institutional structures, appointment of the necessary bodies, to ensure adequate human and other resources, the establishment of a detailed organizational structure, detailed descriptions of the functions, roles, responsibilities and operating procedures these institutional structures, as well as the appropriate induction and training
2. Phase 1: Identification of gaps (Gap Assessment), to determine which requirements for DIS are currently fulfilled and to identify specific activities, changes and improvements that are needed to be made, based on the report of the identified shortcomings.
3. Phase 2: (Gap Plugging) - in the form of necessary changes and improvements to be made in the target institutions and in procedures of implementation of the recommendations from Gap Assessment
4. Phase 3: (Compliance assessment), which is carried to enable the national authorities responsible for financial management of the IPA instrument to determine whether they meet the prerequisites for submitting an official request for the introduction of DIS.
5. Phase 4: National accreditation and application for the transfer of authority.
6. Phase 5 is a process that consists of two parts. First, European Commission analyzes the report on the assessment of compliance from Phase 3, and checks the status using its own audit services. If the assessment is satisfactory, European Commission prepares a decision on granting the status of DIS. The second and final part of this stage is to manage the allocation of authority to the beneficiary country by European Commission. This transfer can take place at different times for different IPA components.

Table 1 shows steps made in this process, information on update of Roadmap is provided by DEI, upon request. Table 1 shows only Phase 0, since this phase is not yet completed, details about activities under other phases are not here presented. Some of the activities in Phase 1 have been made (Gap assessment), but since that was made few years ago, new one should be made. Table 1 shows information about Phase 0, updated in April 2013. by DEI.

Table 1 Roadmap Phase 0

DIS with ex-ante control for IPA I and II - Current status and next steps - status in april 2013

Phase	Activities	Current state	Next steps	Duration	Indicative time table	Executive
	Phase 0: establishment of a framework for the management and control system					
1.	Appointment of (NIPAC) for IPA	NIPAC- Director of DEI-a (sl.g. 62/10)	Capacity building projects for cross-border co-operation is currently completed (Phase 2), and has completed a service contract (Phase III) with the aim of further capacity building of DEI is extended (Phase IV), till third quarter of year 2013.	done ongoing	First till 2010 Extended till 2013	DEI
2.	Establishment of monitoring and evaluation section of the IPA program in the Office	Amendments to the Regulations on the internal structure DEI		done		DEI

Phase	Activities	Current state	Next steps	Duration	Indicative time table	Executive
	NIPAC					
3.	Establishing a structure for the supervision and monitoring of IPA in accordance with Article 58 and 59 Regulation on the implementation of the IPA	No activities undertaken	Prepare a legal basis for the work of the structure, procedures for work and train capacity to produce reports	no activities undertaken	Till 2010	DEI
4.	Establishment of the National Fund	Established by the Decision of Council of Ministers on 2 nd of March 2006	Text of the decision on the establishment should be clarified to reflect the requirements of the Regulation on the implementation of the IPA in terms of specifying the function	done status not known	till February 2010	MFT
5.	Making organizational structure and description of duties of officers at NF, CFCU and the Department	Developed and included in the manual of internal procedures for NF, CFCU and Sector for		done		MFIT DEI

Phase	Activities	Current state	Next steps	Duration	Indicative time table	Executive
	for cross border cooperation	Coordination of EU assistance programs	The final organization charts should be incorporated into the Regulation on the internal organization of MF T and DEI	not done	till 2010	
6.	NF staff	The current staff is 3, but the overall long-term staffing needs is estimated at 6	Continue employment to achieve full staffing Providing specific training a new employee staff	not done	Till end od September 2010	MFIT
7.	Establishment of CFCU	Established by the Decision of Council of Ministers on 2 nd of March 2006	Text of the decision on the establishment should be clarified to reflect the requirements of the	done not done	Till end of February 2010	MFIT

Phase	Activities	Current state	Next steps	Duration	Indicative time table	Executive
			Regulation on the implementation of the IPA in terms of specifying the function			
8.	CFCU staff	The current staff is 12, but the overall long-term staffing needs is estimated at 24	Continue employment to achieve full staffing Providing specific training a new employee staff	not done	Till the end of September 2010 Till the end 2010	MFT
9.	Establishment of Project Implementation Units in ministries and other administrative bodies (PIU)	A small number of ministries involved in the IPA 2009 founded the unit to support SPO's.	All involved ministries and agencies should formally establish units and engage staff. Then it will be necessary to organize staff training.	not done	Till the end of September 2010	Relevant ministries and other administrative bodies
10.	PIU staff	No of staff to support SPO is very limited in	It is necessary to analyze workload,	not done	Till the end of September 2010	Relevant ministries and

Phase	Activities	Current state	Next steps	Duration	Indicative time table	Executive
		several ministries.	determine the need for staff and provide continuous training in all ministries where they have been appointed SPOs			other administrative bodies MFT, DEI
11.	Appointment of CAO	Done (2010, 2012)		done		MFT/Council of ministries
12.	The introduction of the duties and role of the CAO	No activity	To be done after appointment	not done	end of March 2010	CAO
13.	CAO support staff	No activity	At least one person needed	not done	end of March 2010	CAO
14.	Appointment of NAO	Decision of the Council of Ministers Sl.g. 62/10-Mrs. Sehija Mujkanović (MFT)		done		MFT/Council of Ministires
15.	Appointment of PAO	Decision of the Council of Ministers of 2 March 2006 - PAO has not yet officially been named, and upon function it is	PAO should be re-appointed in accordance with the IPA Implementing Regulation. Decision	not done	end of March 2010	NAO

Phase	Activities	Current state	Next steps	Duration	Indicative time table	Executive
		Head of CFCU, which is established (that is Mrs. Vera Leticia)	of 2006 refers to the function, and not to a specific person. Must be changed.			
16.	Agreement on implementation between NAO and PAO to be signed	Prepared for NAO and PAO	Signing must follow the re-appointment of the NAO and PAO	not done	end of April 2010	MFT
17.	Appointment of SPO	Identification of the SPOs done	List of SPO was delivered, but so far not on the agenda of the Council of Ministers	not done	end of February 2010	MFT
18.	Operational Agreement between PAO and SPO to be signed	Prepared by CFCU	All relevant operating agreements should be signed	not done	till September 2010	MFT; Appointed SPO
19.	Establishment of Audit Authority for IPA in and prepare organizational charts and job descriptions	Not yet done MoFT has prepared draft decisions but it was not discussed. The Audit Authority is supposed to be located	Create a legal basis for the establishment of the Audit Body, engage staff and provide training.	not done	till end of June 2011	MFT; DEI/Council of Ministries

Phase	Activities	Current state	Next steps	Duration	Indicative time table	Executive
		in the office of Chairman of the Council of Ministers.				
20.	DIS Strategy adoption	Done- June 2008	Implementation of strategies to conferral of DIS by the EC	done not done	end of June 2011	MFIT DEI
21.	The written description of the roles and responsibilities of all participants DIS	It is necessary that the Council of Ministers adopts a Decision on the functions and structures of the DIS for the first and second component of the IPA The decision to establish an operating structure for IPA component II done in 2011 The decision to establish an operating structure for IPA component I	Submit a draft decision to the Council of Ministers for adoption	Done 2001 not done	end of January 2009	MFT Council of ministrie

Phase	Activities	Current state	Next steps	Duration	Indicative time table	Executive
22.	Prepare a protocol with the Central Bank on the management accounts of EC	Prepared for NF and CFCU and discussed with the Central Bank	Reconcile the demands and open bank accounts	not done	end of May 2010	MFT
23.	Purchase and implement information system in the CFCU	No activity	Make tender	not done	end of June 2010	MFT
24.	Appoint officer for irregularities	No activity	To appoint in the NF, CFCU and ministries / agencies and to act in the exercise of functions (probably SPO in Ministries and Agencies.	not done	end of May 2010	MFT SPO
25.	Implementation of the management and control systems in accordance with the Annex of the Regulation on the implementation of the IPA	All elements relating to the procedures are covered in the manuals NF and CFCU. SPO / PIU manuals need to be updated regarding the specific procedures that are not covered.	It is necessary to ensure that all regulations adequately reflect the new procedures that describe the requirements of EU Provide additional training to appointed	not done	end of September 2010	MFT

Phase	Activities	Current state	Next steps	Duration	Indicative time table	Executive
		<p>Prepare procedures related to reimbursement, finances, protect employees who report irregularities, risk management.</p> <p>Capacity of internal control is currently inadequate in relation to the requirements of EC</p>	<p>SPO</p> <p>The need for a specific legal basis</p> <p>Create an internal audit function in all ministries / agencies that receive IPA funds</p>			

Source: Directorate for European integration (informative)

On the Roadmap towards decentralized management of IPA programs Bosnia and Herzegovina is in the stage 0. Looking at the individual structures and functions (such as CFCU or NIPAC office), then they are in the advanced stage. As it can be seen from the Roadmap, certain activities from other phases are implemented (not shown in table 1). But again, without a comprehensive legal framework and established institutions / structures it can not be formally say that we are in the second phase. Gap Assessment is made, however, it should be done again due to the time distance (previous one was made in 2009).

The Council of Ministers has appointed persons in charged for the given functions for DIS: NIPAK, CAO and NAO. In addition, the Coordinating Committee for the IPA as an advisory body to NIPAK has been established, which is not requirement of the Framework Agreement or IPA regulations, but for these purposes is appropriate and useful. The Strategy for DIS has noted that the DEI and the Ministry of Finance and Treasury are the main institutions responsible for the implementation of the strategy of DIS. Due to the actions already carried out and those still to be implemented, and when looking who accredits and who seeks accreditation from the European Commission, MFT is a leading institution because there are placed CAO and NAO. DEI plays a big role in all of this, because DEI gives opinion on the proposed documents by MFT (NAO and PAO).

The problem for which the process has stopped is the appointment (but not establishment) of CFCU, as it is usually called from the time of PHARE instrument that preceded the IPA. The Ministry of Finance and Treasury has established sector in year 2007, which was supposed to take over the role of CFCU, also Department of National Found was established. Sector has initially engaged staff that is trained and internal procedures are prepared for the operation, but CFCU has never been authorized by the Council of Ministers to carry out its role, such as: the launch and implementation of tender procedures, contracting, and financial performance of contracts, accounting and reporting. This "national accreditation" is the legal basis to the Agency for payment, to manage the funds of the EU and it is a document that, among other things, must be presented to the Commission with a request for decentralization.

Also insurmountable obstacle to decentralization is the lack of audit authority for IPA. There are no activities in this process due to waiting for implementing line regulations for IPA II, and in accordance with the requirements contained therein for the establishment of the system, the activities will be continued. Bosnia and Herzegovina has never built its own system for managing IPA, which is a disadvantage in meeting its obligations in the accession process.

Many of functions and structures for DIS are the same for both components (NAO, the CAO, NF, and others), while of course the operational structure varies by component. Introduction of DIS for Component II in relation to the Component I is in more advanced stage. There is adopted decision on the appointment of Head of operating structure for the implementation of cross-border cooperation program with the countries using pre-accession instrument IPA (Official Gazette 36/12). There is also

adopted decision on establishing a control system for cross-border programs with European Union member states as the first level of control the (Official Gazette 66/11). However, DIS for Component II has not been established, because there is no accreditation. In addition, it is necessary to make a Decision on the establishment of operational structures for component I.

4. CONCLUSION

The transfer of responsibility for the management of EU funds, the European Commission used to divide by components. There will be need to form a new Road map for the DIS, which depends on the IPA II implementing regulation, which is expected to be completed by the end of June 2013. Although IPA II defines the division into five policy areas, the new Roadmap will also need to define the phases and activities for each of the policy, as it was the case with the Roadmap for component I and II. Actual Strategy for the implementation of DIS partially covers the existing IPA I components that Bosnia and Herzegovina is not using, and these are the parts defining Functions and responsibilities of the Strategic Coordinator in case of component III and IV. New version of the Strategy for DIS will need adjustments also in terms of components of V, i.e. policy area Agriculture and Rural development.

The question of the establishment of DIS within IPA II can not be considered only as pre-condition for accessing financial assistance in policy areas, it is certainly important from the standpoint of absorption capacity of Bosnia and Herzegovina in terms of managing funds. Establishing DIS is indicator of the ability of Bosnia and Herzegovina to respect deadlines and execute activities in designated periods, and to adapt to EU standards. It is also important from the point of IPA II, where it will be possible to reallocate funds from one to another policy area; also to relocate funds from one year to another (from one program to another program), but also between the beneficiary countries depending on the results and progress achieved. Each of the beneficiary countries will be motivated to keep the funds entirely in their own country, and the DIS is one of the indicators that the beneficiary country is prepared in terms of managing funds.

As the conducted survey showed, although some of the institutions involved in the implementation of the DIS can be in the advanced stage, as a whole it is necessary to reach the same stage at all levels in order to establish DIS. In this moment it can look that there is no need to rush with DIS implementation, since Delegation of the European Union in Bosnia and Herzegovina is successfully managing IPA funds for some years and now DIS is not precondition to use all five policy areas. But, establishing DIS represents a step towards EU membership and prepares the country for the use of the Cohesion and Structural Funds, which are several times higher than the pre-accession funds.

While working on the process of implementation of the DIS it is important to have up to date record of implementation progress in accordance with defined Roadmap activities schedule. Current Roadmap was not updated until requested, even though the date of the planned implementation of all the activities has passed two years ago.

Process of introducing DIS should be recorded using information system, where relevant institutions to implement DIS (Directorate for European integration/DEI and Ministry of Finance and Treasury) could input all information and activities related to the introduction of DIS, so it can be followed easily by all interested parties.

Since the Committee for monitoring the implementation of the Strategy is not active, and DEI and Ministry of Finance and Treasury are producing reports separately, each in the domain of its competence, information system could be useful for knowledge management in process of implementing DIS.

There are opinions that DIS is not relevant in terms of absorption capacity for IPA II because it is no longer requirement to access funds, and because the EU delegation successfully manages funds, which is undeniable. However, it should be noted that the decentralized implementation system is system in which the European Commission transfers the management of certain activities to the beneficiary country, but retain ultimate responsibility for the execution of the EU budget. Activities that are transferred to the beneficiary country should minimally refer to tender procedures, contracting and payments.

The purpose of decentralization of fund management is to enable a candidate country to manage EU funds without prior approval and verification by the Commission. In this context, it is necessary to distinguish two forms of decentralization-decentralization with ex-ante control by the European Commission and the decentralization without ex-ante controls. The planned establishment of DIS system in Bosnia and Herzegovina is with the ex-ante control performed by the European Commission, and the transition to the expanded system without ex-ante control is possible only with a demonstration of system with constant smooth functioning. Decentralized management of EU funds, whether with the ex-ante control by EC or without ex-ante control, may be granted only after fulfilling the criteria of accreditation.

Preparation for accreditation requires full participation of national institutions and the mobilization of resources, as well as coordination and leadership, and overcoming obstacles in order to reach agreement for the establishment of the system at the state level of Bosnia and Herzegovina. Process of establishing bodies, structures and institutions in connection with the decentralization of the management of EU assistance programs started under the CARDS program in year 2006 and it is still not complete. Experiences from the CARDS are not fully utilized, as personnel trained in CARDS has not been involved in the IPA I, and now, when from year 2006 to beginning of year 2013 a lot of effort has been made, institutions are waiting for new Regulation on the establishment of IPA II and process is on hold. But, as it is mentioned above, at presentaion of IPA II it is stressed that this process should continue.

REFERENCES

<http://www.mft.gov.ba> Ministry of Finance and Treasury

www.dei.gov.ba Directorate for European Integration BH

www.delbih.ec.europa.eu EU Delegation BH

www.ec.europa.eu European Commission

www.parlament.ba Parliamentary assembly BH

www.vpi.ba Foreign Policy Initiative BH (NGO)

www.lgi.osi.hu Local Government and Public Service Reform Initiative

Official Gazettes Bosnia and Herzegovina