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1st International Conference

Economic System of the European Union and Accession of Bosnia & Herzegovina

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ECONOMIC SYSTEM OF THE EUROPEAN UNION AND ACCESSION OF BOSNIA & HERZEGOVINA

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EU MEMBERSHIP IMPACTS; THEORY AND SOME EXPERIENCES OF SLOVENIA

ABSTRACT

For the majority of transitional countries, including those established form the territories and republics of ex Socialist Federal Republic Yugoslavia (SFRY), fully fledged membership in the European Union (EU) had been and for some is still one of the major economic and political development objectives. Reasons for such objectives are but few. From beginning of the last decade of 20th century countries in economic and political transition vision EU member countries (EU 15) as a beacon and hope for their fast national welfare grows and for democratic system development. Besides hoping to become part of EU economic and political success and stability transitional countries were often aware of the global growth in the number of economic integrations. Registered number of economic integrations – Regional Trade Agreements (RTA) - with the World Trade organization (WTO) has grown significantly after 1991; from approximately 100 to 484 registered and 293 active RTAs at the end of December 2010. The process was coupled with so called economic globalization characterized and driven by non precedential fast and structured technological progress. Technological progress in last approximately 20 years was much faster that any time in the human history. Technology advancements created a need for growing national and business investments into R&D, together with vital need for improved and growing utilization of economics of scale and scope effects. RTAs number growth was probably one of the most acceptable responses of increasing number of national governments to the new challenges and opportunities created by globalization and technological progress. Global process of growing number of RTAs was and is just one of additional arguments supporting the wish and the need of remaining transitional countries in Europe – Western Balkan Countries (WBCs)- to speed up their process of accession and membership in the EU.

Approximately 20 years after the beginning of the transition from non-market and non-democratic societies a considerable number of transitional countries are still in the process of EU accession or in the position of EU membership aspirations only. Among such countries the major part includes states formed on the territory of ex SFRY. Only exceptions are Slovenia as 2004 EU new members and Croatia who in June 2011 concluded negotiations for EU membership. Croatia expects signing of accession agreement in December 2011 after the national parliamentary elections and the EU membership in the middle of 2012.

Years and decades long efforts to finalize process of EU association and accession of WBCs, together with there high starting positive expectations and hopes related to EU, make sufficient reasons to analyze accession and expected effects of the EU membership. Based on theory the paper explains expected integration economic effects; trade growth and its orientation (TD and TC), factor mobility impacts, competition change on national and partners markets and other challenges. Theory will help to show that expected positive economic and welfare growth effects of economic integration depend mostly on national business and government effectiveness in utilizing the positive development potential created by economic integration membership. Theoretical background will help to assess EU membership impacts for Slovenia.

Achievements and problems of Slovenia as accessing and as EU member country could help to understand better present position and future potentials of transitional countries that still aspire for the EU membership. B&H is no doubt such country. Although having specific national economic and political environment it could still develop challenging additional benefits during accession process based on experiences and achievements relevant for Slovenia.

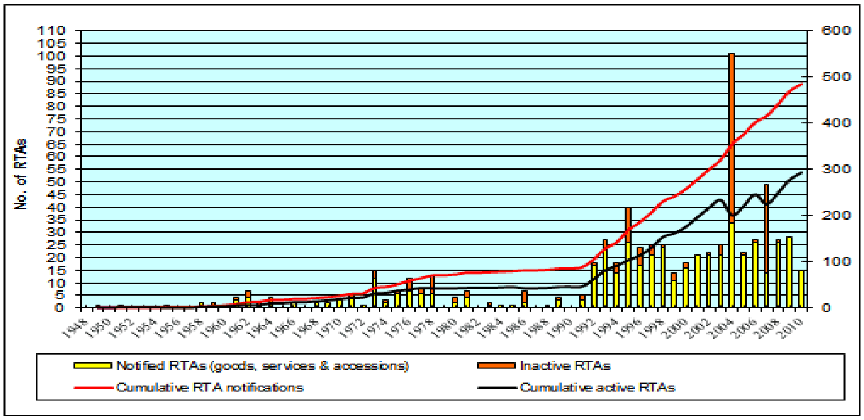
Key words: economic integration (RTA) effects: competition change, trade creation, trade diversion, Western Balkan Countries (WBCs), Slovenia EU membership; GDP/capita growth, trade structure, economic crises impacts.

JEL classification: F15

1. INTRODUCTION

For the majority of transitional countries, including those established form the territories and republics of ex Socialist Federal Republic Yugoslavia (SFRY), fully fledged membership in the European Union (EU) had been and for some is still one of the major economic and political development objectives. Reasons for such objectives are but few. From beginning of the last decade of 20th century countries in economic and political transition appreciated EU countries (EU 15) and EU membership as a beacon and hope for their fast national welfare grows and for democratic system instruction. Besides hoping to become part of EU economic and political success and stability transitional countries were often aware of the global growth in the number of economic integrations.

Figure 1 Growing global number of economic integrations (RTAs) 1948-2010



Source: WTO Secretariat

The growing global number of international economic integration agreements additionally develops strong massage to WBCs that joining the EU would mean just a needed reaction to the global integration trends. How accurate such conclusion could be one can understand looking to the growing number of registered and active number of economic integrations worldwide. Registered number of global economic integrations - by World trade Organization (WTO) called "Regional Trade Agreements" (RTA) - has grown significantly after 1991; from approximately 100 to close to 484 RTAs at the end of 2010.

Evidently and by some surprise the numbers of active and registered RTAs were growing continuously in the first years of world's financial and economic crises as well. The surprisingly high numbers of RTAs might reasonably support the idea that economic integrations among stets are good, acceptable and promising solution whether in good or bad economic development periods. To the recent times the interest to join one of the largest and most elaborated economic integration groupings which is European Union (EU), was extremely strong. Among the countries aspiring for the membership were and are so called Western Balkan Countries (WBCs) too. The countries from WBCs are: Albania, Bosnia and Herzegovina, Croatia, the Former Yugoslav Republic of Macedonia, Montenegro, Serbia and Kosovo.[1]

Ten transitional countries get into the EU in 2004, and 2007. Among them was Slovenia. All this countries have rather different economic development levels and performance before and after EU accession. During last years economic crises performance and long term results of the new EU members have started to differ largely. Their economic performance results range from relative successful growth and development (Poland for example with 3,8% growth in 2010) to large decreases and

[1] Kosovo under UNSCR 1244/99.

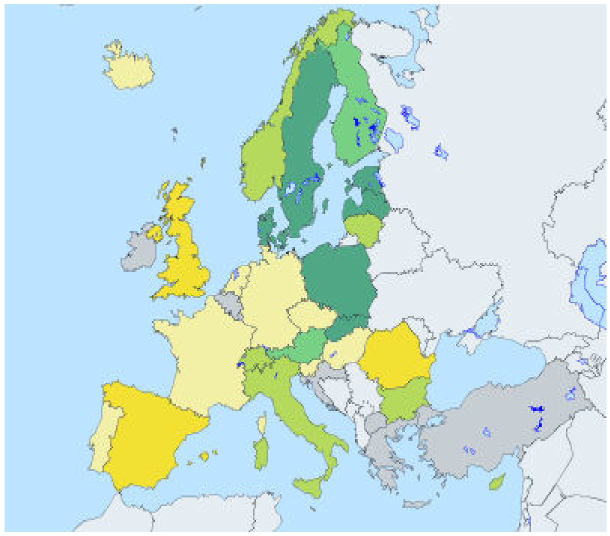
negative growth what happened in Slovenia (close to -8% real GDP growth in 2009 and slightly positive in 2010). We will examine same aspects of what has happened in Slovenia that after few successful years in the EU membership its economic downturn was so strong. Major focus of examination is related to the question whether EU integration impacts or the international financial and economic crises or perhaps national economic and political realities in Slovenia have been the reason for present rather difficult economic situation. The situation is characterized by low and uncertain economic growth rate by large and growing public dept and budged deficit coupled by high unemployment.

2. EU DEVELOPMENTS AND PRESENT EURO ZONE PROBLEMS AS WBCs ASSOCIATION PROCESS BACKGROUND

EU especially the members of the Euro zone are presently faced with threats to monetary and integration stability based on growing danger created by potential financial bankruptcy of Greece. The dilemmas created on such developments are questioning the entire future stability and sustainability of the EU as economic integration of 27 countries. The risks for the future successful EU functioning are growing especially in the case of 17 EU euro zone members. Growing concerns about the EU future are confronted by the notion that EU has been one of the most successful economic integrations worldwide up to recently. However EU stability and its future developments are additionally increasingly debated after accumulation of too high public financial deficits in cases of Ireland, Portugal, Spain and Italy especially.

Beside too high public financial debts of a number of the EU members the economic performance of the EU and of majority of its members is not strong. For 2011 major economic indicators for EU 27 and for some of the key members are not in fact really promising. GDP increased only by 0.2% in both the euro area (EA17) and the EU27 during the second quarter of 2011, compared with the previous quarter. (Second estimates released by Eurostat, Sept. 2011) In the first quarter of 2011, growth rates were +0.8% in the euro area and +0.7% in the EU27. This years EU growth rate is not sufficiently promising to effectively help in solving the public financial debt problems of an increasing number of euro zone members. Additionally realized positive average EU GDP growth is calculated based on negative growth rates of 8 members, and of 4 with the highest growth rates but which are still not in any case higher of 2%. Additionally data for Ireland and Greece are not available in Eurostat report. Highly indebted Portugal has negative growth rate, and highly indented countries like Spain and Italy have only slightly positive GDP growth rates (see fig.2). Obviously current data for these EU and euro zone members are not optimistic and are creating doubts and worries about the economic and political future of the EU and of the euro zone countries.

Figure 2 **Gross domestic product, volumes;** ***Percentage change q1/q2, 2011***



Legend	%	Cases
	-2.8 - 0.1	8
	0.1 - 0.2	3
	0.2 - 0.4	7
	0.4 - 0.7	2
	0.7 - 2.0	6
	Data not available	7

Note: minimum value: - 2.8 %; maximum value: 2.0 %
Source: http://epp.eurostat.ec.europa.eu/tgm/mapToolClosed.do?tab=map&init=1&plugin=0&language=en& pcode=teina011&toolbox=types

EU growth and other data suggest that it is probably not possible to solve present public debts and economic growth problems shortly. Following such assessment obviously the future stability of these countries and of the entire EU is increasingly under the question mark. Following such reasonable conclusion intensity of skeptic doubts about rational of the further association efforts might be intensified. Such doubts might be accelerated by the notion that proposal made to solve the above debt and growth problems mainly focus on different restrictive measures directed to public spending, social and health security. Proposals don't contain suggestive solutions, ideas or instruments to boost economic growth and employment whether in the most indebted or in other EU member countries. On such grounds EU association process might loose its high past attractiveness among the population of the accessing countries. This could be the case especially in those countries that have not got EU candidate status yet. And as well among all those who have not even started the accession negotiations. Such potentially growing passive and eventually even negative attitude towards association and accession could easily be develop among a number of WBCs including B&H. Critically growing internal EU uncertainties about the EU future, about its stability, functioning and ability to solve the euro zone crises all together create additional set of inside and outside impacts. The "internal" EU problems negatively affect the inside level of actual interest and support among present EU members to genuinely proceed with their efforts for the successful finalization of the EU enlargement process towards WBCs. Such signals could further decrease willingness and interest among WBCs to continue with all necessary "domestic" efforts to move continuously further along the association and accession process.

The possibility of such reactions might be supported by general underperformance of the EU and euro zone area countries. Namely present and some last years data on some other aspects of EU economic performance like; consumption, investment, trade and employment, are in general not really encouraging either. During the second quarter of 2011, households final consumption expenditure decreased by 0.2% in the euro area and by 0.1% in the EU27 (after +0.2% and 0.0% respectively in the previous quarter). Gross fixed capital formation increased by only 0.2% in the euro area and by 0.4% in the EU27 (after +1.8% and +1.2%). Exports grew by 1.0% in the euro area and by 0.6% in the EU27 (after +2.0% and +2.2%). Imports rose by 0.5% in the euro area and by 0.4% in the EU27 (after +1.5% and +1.4%).

Economic success and stability of the EU is further threatened by developments in USA and Japan who are often major EU members' trading and business partners. In the United States GDP increased only by 0.2% during the second quarter of 2011, after small increase of +0.1% in the first quarter of 2011. Japan GDP fell by 0.3% during the second quarter of 2011, after its decrease of -0.9% in the previous quarter. Compared with the second quarter of 2010, GDP grew by 1.5% in the United States (after +2.2% in the previous quarter), and decreased by 0.9% in Japan (after -0.7%). (Data; Eurostat News Release; 127/2011 - 6 September 2011).

Ongoing political dialog and different suggestions for the euro zone stability crises solution are often not unison or are in the reactions of the international financial markets not transparent or are too late. Evidently Germy and France are havening their own (nationally based) interests and agendas while EU Commission and potentially some other members see the solution in increasing powers of the EU intuitions. One of the reflections of such wives is recent Mr. Barossa's proposal to start issuing joint EU bonds. German's reaction to his proposal was openly and strongly negative. On such grounds believes into successful future economic growth and institutional stability of the EU in reality could be at least seriously questioned. Present economic and institutional situation in the EU certainly and unfortunately does not make association process and efforts in WBCs to access EU easier or more attractive. Incising pressure from major EU members and from EU institutions to reduce public spending in member countries and especially in the euro zone create increasing public unrest combined with growing number of public demonstrations. Such developments, especially because they are mostly of long term nature, create increasing doubts about the rational related to the EU association and EU enlargement process. In the past in a number of associated countries often were developed irrationally high expectations of EU membership benefits. In the EU enlargement process among peoples was accepted with probably not too much considering its potential positive or negative impacts. By economic and public debt crisis extending to increased unemployment, growing taxes and uncertain economic future antidotes of people to enlargement process started to change. They are starting to be more conscious of the real costs of the enlargement process. Potential benefits of the enlargement process whether in economic, political or any other aspect are becoming for those loosing jobs and paying increasing taxes less and less acceptable and reasonable.

EU enlargement reserved reactions and potential negative sentiments need serious consideration. Considering and assessing of good and bad outcomes of the EU association and of its enlargement process is getting more and more necessary for WBCs and for countries from transitional group who joined EU in 2004 or in 2007. Such at least analytical effort is necessary when we understand and appreciated the long term positive impacts which were created in Europe by EU integration and enlargement processes in the period after the WW II and after 1989.

3. WBCs ECONOMY AND THE EU

Economic crises evidently still hold EU and especially euro zone member countries in its grip. The countries from WBCs aspire for the EU membership and are in very different stages of their EU association process (Table 1). Similarly WBCs economic performance (Annex, Table 1) indicators are not too promising too. Among them most problematic are rates of unemployment. They range between lowest of close to 13% of labour force in Croatia to 23% in case of B&H. Additionally balance of payments deficits and public debts are generally highly negative in case of all WBCs (Annex, Table 2).

Approximately 20 years after the beginning of WBCs' transition, from non-market and non-democratic societies to market economy and to political democracy, still a considerable number of these countries is in the relative early fazes of the EU association process. From countries established on the territory of ex-SFRY only Slovenia succeeded to become member of the EU in 2004. More than 7 years after that Croatia is second in the row to join EU (signing of accession Treaty is expected in December 2011).

Years or even decades long process of EU association and of eventual accession, together with big expectations and hopes of transitional countries that have not yet succeeded to join EU, suggest the need to analyze reasons for their present lagging behind "normal" schedule accession status related to some other transitional countries. These reasons are of WBCs internal nature by general opinion but probably are at least partly explained too by the EU activities and procedures related to WBCs in the past. In such present constellation of EU-WBCs relation and activities it becomes necessary to search for the major reasons or drivers which (could) still keep WBCs and EU in the negotiating process.

Table 1 WBCs and stabilization association process with the EU

Event	Republic of Macedonia	Croatia	Albania	Montenegro	Bosnia and Herzegovina	Serbia	*Kosovo* (under UNSCR 1244)
SAA negotiations start	5.4.2000	24.11.2000	31.1.2003	10.10.2005	25.11.2005	10.10.2005	(?)
SAA initialled	24.11.2000	14.5.2001	28.2.2006	15.3.2007	4.12.2007	7.11.2007	(?)
SAA/IA signature	9.4.2001	29.10.2001	12.6.2006	15.10.2007	16.6.2008	29.4.2008	(?)
Interim Agreement:							
EC ratification	27.4.2001	30.1.2002	12.6.2006	15.10.2007	16.6.2008	8.12.2009	(?)
SAP state ratification	27.4.2001	30.1.2002	9.10.2006	14.11.2007	20.6.2008	22.9.2008	(?)
entry into force	1.6.2001	1.3.2002	1.12.2006	1.1.2008	1.7.2008	1.2.2010	(?)

Source: http://en.wikipedia.org/wiki/Stabilisation_and_Association_Process

WBCs are part of a broader EU enlargement process. Within the enlargement and association process South East Europe countries are having different statuses. Turkey for instance shows much longer history of association process with the EU as majority of the WBCs. The first agreement on forming Customs Union with Turkey was signed in 1963 providing its implementation in 1996.

Figure 3 South Easter Europe and country's positions in the enlargement/accession process

Member states

Interim SAA signed

Candidates

Kosovo: disputed

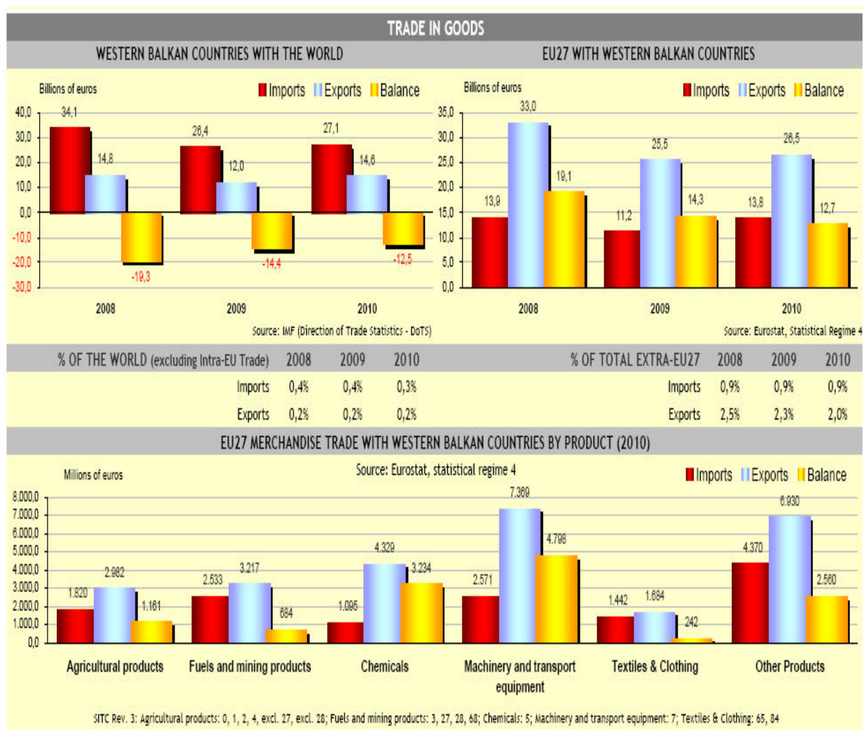
Application submitted

Source:
http://ec.europa.eu/enlargement/enlargement_process/accession_process/how_does_a_country_join_the_eu/sap/index_en.htm

Evidently EU enlargement history suggests that in some (specific) cases the association and accession process might be really long in terms of years. Combination of long lasting and not clearly defined period of association combined with last years of increasing euro zone crises and staggering economic performance of the EU in general could really lead to high drop of the efforts and of aspirations to proceed with association or/and enlargement activities. The danger of slowing or close to stopping association and enlargement prosesses is in fact potentially developing on both sides _ on the side of the WBCs and on the side of the Eu member countries.

We believe that it is important to make all necessary efforts to continue successfully the association activities on WBCs and enlargement efforts on EU side. At present and in the future it is highly important for WBCs to improve the level of practical utilization of all autonomous trade concession measures grated by the EU. Equally WBCs have to develop and utilize all trade possibilities which are potentially offered among them by CEFTA membership and by diagonal cummulation of rules of origin. The following data show trade developments for WBCs globally and with EU27. WBCs have negative balance of payments for goods in total and with EU.

Figure 4 WBCs trade in goods 2008-2010



Source: Eurostat

Structure of trade by product groups shows that WBCs have rather high export share of their products that have potentially low level of added value. Agriculture products together with textile and closing products for example presented 23,6 % in 2010 of their total exports to the EU. Trade deficit and structure of trade in goods suggest that WBCs are not yet able to fully utilize the EU autonomous trade concession.

Recalling the fact of having joint economic space for majority of today's WBCs twenty years ago – based on one state territory - supports the idea that there are probably still some good potentials for more regional trade and for its faster growth. Having strong trade dependence with the EU makes WBCs intra regional trade growth dependant on rules of product origin defined by EU for all trade with the WBCs.

Based on Commission notice concerning the date of application of the protocols on rules of origin providing for diagonal commutation of origin between the European Union, Albania, Bosnia and Herzegovina, Croatia, the Former Yugoslav Republic of Macedonia, Montenegro, Serbia and Turkey

(Table 2) one can conclude that actual support for regional trade growth in the region, based on rules of origin, has not been fast enough. Diagonal cumulation of rules of origin in the region has been introduced only gradually which makes creation of new regional business opportunities a slow and complicated process. Specific technical requirements additionally create limitations in practical implementation of diagonal rules of origin among WBCs. The diagonal cumulation can only be applied if the countries of final manufacture and of final destination have concluded free trade agreements, **containing identical rules of origin**, with all the countries participating in the acquisition of originating status, i.e. with all the countries in which all the materials used originate. Materials originating in a country which has not concluded an agreement with the countries of final manufacture and of final destination must be treated as non-originating. Further should also be recalled that the materials originating in Turkey covered by the EU-Turkey customs union can be incorporated as originating materials for the purpose of diagonal cumulation between the European Union and the countries participating in the Stabilization and Association Process with which an origin protocol is in force.

Table 2 Overview of the protocols on rules of origin - dates from which diagonal cumulation becomes applicable between WBCs [1], EU and Turkey (overview valid from July 21, 2011)

	EU	AL	BA	HR	MK[**]	ME	RS	TR
EU	-	1.1.2007	1.7.2008	1.6.2011	1.1.2007	1.1.2008	8.12.2009	[3]
AL	1.1.2007	-	22.11.2007	22.8.2007	26.7.2007	26.7.2007	24.10.2007	1.8.2011
BA	1.7.2008	22.11.2007	-	22.11.2007	22.11.2007	22.11.2007	22.11.2007	
HR	1.6.2011	22.8.2007	22.11.2007	-	22.8.2007	22.8.2007	24.10.2007	
MK	1.1.2007	26.7.2007	22.11.2007	22.8.2007	-	26.7.2007	24.10.2007	1.7.2009
ME	1.1.2008	26.7.2007	22.11.2007	22.8.2007	26.7.2007	-	24.10.2007	1.3.2010
RS	8.12.2009	24.10.2007	22.11.2007	24.10.2007	24.10.2007	24.10.2007	-	1.9.2010
TR	[3]	1.8.2011			1.7.2009	1.3.2010	1.9.2010	-

[1] Albania, Bosnia and Herzegovina, Croatia, the former Yugoslav Republic of Macedonia, Montenegro and Serbia are the countries participating in the Stabilisation and Association Process.

[**] ISO code 3166. Provisional code which does not prejudge in any way the definitive nomenclature for this country, which will be agreed following the conclusion of negotiations currently taking place under the auspices of the United Nations.

[3] For goods covered by the EU-Turkey customs union, the date of application is 27 July 2006.

Source: *Official Journal C 215 , 21/07/2011 P. 0027 – 0028 (data technically organized by author)*

Beside efforts to develop more intensive use of advantages contained in the implementation of the protocol on diagonal cumulation WBCs should further develop necessary efforts to optimally utilize all other forms of EU supports. They have to care that amounts of the EU economic and financial assistance are dully utilized and properly used in full. WBCs are interested that the economic and functioning crises in the EU and in euro zone will not eventually create some reductions or other changes in the EU policy of financial and other supports developed and implemented within the association process up to now.

4. SOME THEORY OF ECONOMIC INTEGRTION IMPACTS

Theory of economic integration effects starting by Viner's explanations about Trade Creation (TC) and Trade Diversion (TD) effects have been developing through research and publications of Bela Balassa, R.G. Lipsey, Fritz Machlup, Vanables, and of many others. Beside the theoretical explanations of the expected effects of different forms of economic integration agreements among states stil there is a major question. Why in last 20 years the world is faced with intensive growth in the number of economic agreements or of RTAs as the term is used in the WTO terminology? There are many possible answers. Among them the one which is related to EU and its enlargement process and to its trade relations with Mediterranean, Western Balkans and many other countries like Mexico, Chile, and South Korea etc. Although in last 20 years EU contributed a significant number of new economic agreements, number presented in the Fig. 1, could not be explained just by the EU enlargement and trade policy effects. Countries not related to the EU have signed a great number of economic integration agreements. For them as for the EU and for its integration partners there are some **general reasons that** stimulate the growth in number of new economic integration agreements in the last 20 years. Reasons could be divided into:

1. General reasons related to positive effects expected on the bases of economic integration impacts (trade growth, additional economic growth, welfare improvements, stronger economic/political position in global economy, etc.);
2. Specific reasons which have been developed in the international economic and business environment in approximately last twenty years. This new developments in global economy created conditions to which economic integration effects are best suited.

Theoretical static and dynamic impacts of economic integrations are known and studied for EU and for other economic integration world vide. New dimension in positive impacts created by economic integration base on specific reasons developed from mid eighties of twenty century are:

1. **Unprecedented fast progress in technology** of manufacturing, transport, communication, in new products inventions, informatics technology, etc. Big part of huge technological changes is related to different aspects of fast and extensive informatics and communication technology progress;
2. Parallel development of **global economy and competition** effects together with increasing and dominant role of consumers on the markets functioning;

3. Increased importance of proper utilization of **economics of scale and scope** impacts in activities focused on improving international competitiveness;
4. Development of new competition type on global markets. New competition is combination of old market concept and new ways of their implementation. The so called **monopolistic competition** in global trade is a new way of understanding and implementing the competition behaveour. Monopole and competition in classical theory could not be linked together. Nowadays in global economy we see growing number of monopolists who compete with others, meaning that monopoly is just a short and not secured position due to new concepts and fast changes in international competitive environment.

Global economic, technology and competition change make economic integrations, especially in the cases of customs union or higher integrations levels, a solid economic and business environment with conditions for better utilization of positive and easier protection against negative changes that are described above. Any economic integration and especially EU create specific supportive economic and business environment to **accelerated economic growth** in member states. Acceleration drivers are based on:

1. **Increased trade** with TD and TC effects;
2. **Increased (expected) FDI**;
3. **Competition inducing economic and business improvements;** production restructuring, productivity increases, innovatively, all flowed by new increases in competitively creating further lowering of production and transaction costs,….;
4. **Additionally in case of the EU; access to the EU funds**; pre-accession funds, for accessing countries and structural and cohesion funds for members.

Economic integration drivers creating higher economic growth (other conditions unchanged) and increasing national welfare depend in their actual efficiency on two sets of conditions:

1. Institutional specifics and size of the economic integration agreement,
2. Interests and abilities of institutional and business players to use extensively all economic and business advantages created by economic integration agreement.

Institutional specifics of the individual economic integration agreement in the direction of the size of its potential impacts might be illustrated by developments of EU (European Economic Community-EEC, from beginning) and EFTA. Higher level of economic integration and vision to deepen its level (from customs union to internal market) made EU in the past more successful and event attractive to members of EFTA. That is documented by the first and with some further enlargements of the EEC. Theoretical explanation of the reasons for more intensive static and dynamic positive effects in cases of more complex types of integration ere broadly explain in different studies. We would like here to illustrate importance of second grup of drivers which are important for the economic integration success.
Activities and results of economic and business subjects within member countries of the economic integration are conceptually in practice close to the major theoretical

RTAs characteristics. This characteristics are suggesting different forms and levels of integration benefits; easier access to larger markets, faster economic and welfare growth, positive effects of growing competition, etc.. To put it simple if businesses and other subject, including governments from member state don't react and don't adjust to positive and to some negative impacts created by economic integration agreements then actual integration effects are limited, highly reduced and potentially even net negative. Let as illustrate such fact by the following figure, explaining changes of competitive position of companies on national and on partners' markets after following elimination of (just) trade barriers among partners.

Figure 5 Illustration of the changed competitive position created by economic (trade) integration agreement on national, partners' and on third markets

Markets to enter by the company from country A – member of integration or country R – non-integration member					
		A	B	C	R
Company from County A relative to company from Country B, C or R	B	-	+	0	short 0 long +
	C	-	0	+	short 0 long +
	R	0	+	+	short 0 long +
Company from County A relative to company from Country B, C or R	A	(+)	-	-	
	B	-	(+)	-	
	C	-	-	(+)	

\+ Improvments of relative market competitiveness
\- Decrease in relative market competitiveness
0 No change in relative market competitiveness
(+) Possible under certain assumption (for example: because of customs union the entry trade barriers are lowered) in genera it is supposed to be minus to
A, B, C are countries within the economic integration
R - rest of the World or country which is not integration memeber

Commenting opportunities and threats created by integration changes (see Fig. 5)) of the competitive environment on national, partners' and rest of the world markets, has to be extended over the impacts created only by trade based integration. Higher level of economic integration – moving from customs union to internal market or event to monetary union, creates additional, new changes on domestic, partners' and rest of the world markets. Enlargement – accepting new member countries - of economic integration similarly again creates new opportunities and threats related to economic integration market effects. Looking to the EU one can easily conclude that process of competition environment change to which businesses and all other subjects in the society have to adjust is practically continuous from 1958 onwards. Even more so because creation of other new economic integration agreements world vide continuously puts all EU member states into the position of the "rest of the world". In relation to new integrations outside the EU its members are exposed to all negative economic and business impacts from changed competitive position on the markets of (newly) integrated states.
Business and other subject adjustments to impacts – opportunities and threats created by the EU and by global economic integration processes have to be obviously

organized, focused and continuous. If that is not the case business and national economic results are at least sub optimal. In many accessing countries and to some extend for example as well in Slovenia one could find a lot of elements showing that the continuous and focused change needed to utilize economic integration environment effectively is not really developed and implemented adequately. The situation could be attributed to:

1. **Limited understanding and knowledge** about economic and business changes created by integration among businesses, politicians and even among general population;
2. **Expectations based on wrong assumptions** that just becoming a member of integration itself creates enough and permanent positive business and economic results. Assumption is wrong even in the case of EU structural and cohesion supports, because their use against the rules create obligation of refunding to the EU budget;
3. **Passivity against economic integration impacts,** following believe that integration is dominantly only political activity. Additional passivity is based on assumption that economic integration is not affecting businesses that are focused dominantly on national market. Economic integrations include obvious political elements. But by creating economic integration political elements create changed economic, business and social environment. Changes continuously and more or less directly affect all businesses, all citizens and national institutions too. So passivity in relation to economic integration is not acceptable or vice attitude in any country. It is even more not acceptable in any country associated with the EU.

The suggestions not supporting passivity of different subjects within the functioning of the economic integration are relevant even in present stated of the EU functional, monetary, and financial crisis. On one side EU and before EEC had already different problems of functioning and stability in the past. The past shows (oil crises, exchange rate floting …) that for all members acceptable solutions for problems were always created. Following the theoretical explanations of economic integration impact probably common solutions were found following the general believe that joint problems slowing was more acceptable and better within the integration instead of getting out of the integration. Such understanding of functioning and of impacts of the EU has probably to be restated and reconfirmed among the member countries and as well among the associated countries.

5. SLOVENIA AND EVIDENCES OF EU MEMBERSHIP

For every (new) member of the economic integration it is vital to create positive difference between trade creation (TC) and trade diversion (TD) diversion. Obviously in case of more complex integration as the EU is, other integration potentials has to be creatively utilized as well. We will in this paper stick to trade effects only, because in case of Slovenia they are still highly important and are relevant for WBCs associated countries too.

As we showed the text above impacts of economic integration in fact a major part depends on proper active businesses attitude towards changes in competitive environment created by economic integration. Slovenia as any other accessing country utilized positive trade and restructuring effects of economic integration with the EU on large scale already during the association period**.**
In Slovenia net positive impacts of integration with the EU were mostly evidenced through higher economic growth rates supported by open EU market for exports. Free EU market access was extended after 2004 by entering into internal EU market.

Figure 6 Quarterly GDP growth rates in Slovenia 2007-2011

Source: http://www.tradingeconomics.com/slovenia/gdp-growth

Twenty years after independence the growth and development problems of Slovenian economy are unfortunately well beyond the impacts which could be attributed solely to the global financial and economic crises. Or perhaps to the problems of euro zone and of EU functioning additionally. In the last probably five years, following the inherited structural and legal problems combined with the global economic crises, Slovenia has turned its past successful transition process and economic progress into uncertain and potentially long lasting struggle with the serious production restructuring problems in combination with the needs of fast implementation of more efficient legal and judiciary system. In fact today's structural problems of Slovenian economy were building continuously and gradually up from the time of its independence declaration. Reasons were of different nature but among the most important were:

1. After the independence major national political objective was fast realization of the EU membership with no elements of creative and reasonable eventuation of potential negative impacts created through the integration process;
2. Economic growth its sustainability and national economic development policy were in practice subordinated to the EU's membership political objective;
3. Government's and nation's objective of EU membership created legal and economic restructuring and transition which were not always consistent in their implementation or were not really efficient on longer term. Often integration impacts were underestimated by a great number of business and political actors;
4. Privatization process which was based on public vouchers caused slow, non transparent and non efficient market based restructuring of the economy. The

privatization was realized in fact in two waves which have extended over a long number of years. Approaching to some form of final stage just in the years before or during the beginning of the global financial and economic crisis (2007-2009).

The structural and development problems of Slovenian economy were observed already in nineties, in fact in the period when economic results of transition were still positive. Inotai András and Stanovnik Peter (2004) pointed out with regard to some development problems of Slovenia the following. "The repeated delays in privatization, the slow and selective inflow of foreign capital, the weaknesses in the banking sector, and the country's high production costs compared with the Czech Republic, Hungary, Poland and Slovakia noticeably narrowed Slovenia's competitive advantages in the second half of the 1990s." All the problems mentioned have continued to be part of Slovenian economic development to recent time. Relating to such observations in connection with expected net positive effects of the EU membership one can understand that expected net positive effects could not be best utilized on log term. Under optimal utilization of integration impacts was in fact based predominantly on internal Slovenian developments and activities of business, political and other national actor.

However Slovenia was relatively successful in economic growth achievements for a number of years after 1991. Positive growth results were mostly based on the export oriented production structure inherited from the previous economic system. Successful growth achievements were supported for more than a decade by more effective and more market orientated managing and employment structures which were inherited from the past socio-economic system. Market orientation and experience of mangers and employees in Slovenia was due to historic differences in the past socio-economic systems much stronger and more efficient as in the cases of other transitional countries. Looking to not to optimistic economic position of Slovenia at present in combination with association to the EU of most of WBCs suggests even more warnings to these countries. They have to search even more actively for using advantages created by association and accessions to the EU. Their less advanced ”inherited” economic, educational and other socio historic elements compared to Slovenia suggest that intensive work on developing association and membership benefits will deserve proportionately larger and continuous efforts.

Contemporary EU economic and functional problems together with euro zone crises make utilizing association and accession EU effects optimally a much more demanding and complex venture. However following the history of EU hopes and believe into successful solving of present problems could be rather high. Efforts to utilize EU integration effects offered in theoretical and practical frameworks are still the most optimal solution for Slovenia and for associated WBCs.

Discussing Slovenia experiences and future of the WBCs association process it might be good to point out another element affecting integration impacts. Slovenia developed strong external trade. Majority of external trade and its growth have been directed to the EU member countries.

Table 3 Slovenia external trade and trade with EU 27 (2009-2010)

Million of EUR	Exports				Imports			
	2009	2010	January		2009	2010	January	
			2010	2011			2010	2011
Total	16,018	18,238	1,219	1,519	17,115	19,638	1,272	1,590
EU 27	11,183	13,054	933	1,164	13,473	15,343	987	1,204

Source; Monthly Bulletin Banka Slovenije April 2011

Slovenia trade with EU27 in total external trade for 2009 was 69,8% for export and 78,7% for import and 72,0% and 78,1% respectively in 2010. Data suggest perhaps too large dependence of Slovenia companies and economy only on "domestic" – EU internal market. This high dependence on EU internal market is partially understandable. Evidently Slovenia trade data with EU support the theory suggesting needed positive effect between trade creation and diversion. On other side Slovenia is possible too highly dependant on economic performance of the EU internal market. The negative sides of such too high internal market dependence are seen in last few years. In fact Slovenia GDP growth rate depend dominantly on German economy growth. Low German growth rates create strong reductions in Slovenia growth rates and similarly in opposite direction with high differences in levels where Slovenia is far below German growth rate. Although Slovenia is theoretically and practically a small economy we believe that more internationally diversified market structure of trade in spite of the EU membership could be positive. On one side economic performance and impacts of crises have not the same characteristics in the EU and in other countries like India, China Brazil, South Africa and some other. More trade with these countries could reduce economic crises impacts which are present in the EU. On the other side developing of "genuine" external trade with partners outside the EU makes companies more flexible and more able to respond to competitive changes and challenges developed in global economy.

Such external trade orientation in fact was extremely positive for Slovenia in the first years after independence. At that time EU was foreign market for Slovenia. While after 2004 it becomes domestic or internal market. Developing and keeping of reasonable high proportion of "proper" external trade is strongly recommended policy as well for all countries associated or accessing to the EU. This makes businesses and entire economies more flexible and less exposed to eventual negative impact created on internal EU market. The evidence of positive impacts of developing and keeping adequate level of "proper" external trade even after EU membership could be illustrated by case of Germany. External trade is driver of their economic growth. Beside strong EU internal trade Germany keeps to devlop strong Eu external trade. In 2010 (as in previous years) Germany realized the highest individual part of total extra EU exports, reaching the figure of 28,1%. Slovenia (taking in account its size) has created only 0,5% of total extra EU exports in 2010. The Slovenia figures were low in previous years too. To give at least some comparison for the Slovenian extra EU exports we may mention extra EU exports share in the total EU extra exports for Slovakia. Slovaks created 0,6% of total EU extra exports in 2010, which is substantially higheras in case of Slovenia. (EU data: http://appsso.eurostat.ec.europa.eu /nui/show.do?dataset=ext_lt_intratrd&lang=en).

6. CONCLUSION

Having the EU functioning, economic and euro zone crises should not be used to create negative attitude to the process of accession or enlargement. Rational for further activities and efforts related to the EU association and enlargement process is based on:

1. Theoretical evidences and integration's practical positive effects and results;
2. Changes in the global economy from last two decades, especially related to the growth in RTAs numbers and on creating new forms of global competition, and by;
3. Past EU experiences showing its ability of overcoming and solving economic, functional or other crises and problems.

Theory and experiences from Slovenia association and accession to the EU suggest at least two messages relevant for the future successful WBCs' integration activities:

1. First it should be understood and accepted actively that a great deal of theoretically and practically expected positive economic and business impacts created by the EU largely depend on active and proper actions of all national business and of other subjects. They have actively and continuously act and adjust following the continuous changes created through the economic integration process;
2. The second message is the need to keep substantial portion of "genuine" extra integration trade. Too high dependence only on integration's market makes such member state too vulnerable to functioning or other problems created in the integration. Additionally adequate part of extra integration trade help to develop and keep necessary business and competitive flexibility together with better understanding of global markets' demands, challenges, opportunities and changes.

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ANNEX

Table 1 Major economic indicators for the WBCs (shaded parts are IMF estimates)

Country	Subject Descriptor	Units	Scale	2008	2009	2010	2011
Albania	Gross domestic product, current prices	U.S. dollars	Billions	12.990	12.090	11.773	13.032
Albania	Gross domestic product based on purchasing-power-parity (PPP) valuation of country GDP	Current international dollar	Billions	21.909	22.839	23.864	24.946
Albania	Investment	Percent of GDP		32.375	29.089	25.161	26.565
Albania	Gross national savings	Percent of GDP		17.121	15.059	15.048	15.392
Albania	Inflation, average consumer prices	Percent change		3.359	2.223	3.600	4.500
Albania	Unemployment rate	Percent of total labor force		12.500	13.100	12.500	11.500
Bosnia and Herzegovina	Gross domestic product, current prices	U.S. dollars	Billions	18.501	17.043	16.830	18.294
Bosnia and Herzegovina	Gross domestic product based on PPP valuation of country GDP	Current international dollar	Billions	30.471	29.804	30.327	31.366
Bosnia and Herzegovina	Investment	Percent of GDP		27.988	22.101	20.253	20.808

Country	Subject Descriptor	Units	Scale	2008	2009	2010	2011
Bosnia and Herzegovina	Gross national savings	Percent of GDP		13.518	15.236	14.215	14.771
Bosnia and Herzegovina	Inflation, average consumer prices	Percent change		7.433	-0.381	2.123	5.000
Bosnia and Herzegovina	Unemployment rate	Percent of total labor force		23.408	24.068	27.202	23.000
Croatia	Gross domestic product, current prices	U.S. dollars	Billions	69.308	63.040	60.589	65.137
Croatia	Gross domestic product based on PPP) valuation of country GDP	Current international dollar	Billions	82.511	78.428	78.090	79.944
Croatia	Investment	Percent of GDP		30.714	26.671	23.592	24.491
Croatia	Gross national savings	Percent of GDP		21.557	21.212	21.667	20.936
Croatia	Inflation, average consumer prices	Percent change		6.067	2.375	1.048	3.500
Croatia	Unemployment rate	Percent of total labor force		8.273	9.052	12.343	12.843
Kosovo	Gross domestic product, current prices	U.S. dollars	Billions	5.668	5.449	5.601	6.488
Kosovo	Gross domestic product based on PPP valuation of country GDP	Current international dollar	Billions	10.981	11.398	11.968	12.777
Kosovo	Investment	Percent of GDP					
Kosovo	Gross national savings	Percent of GDP					
Kosovo	Inflation, average consumer prices	Percent change		9.350	-2.410	3.476	8.151
Kosovo	Unemployment rate	Percent of total labor force					
FYR of Macedonia	Gross domestic product, current prices	U.S. dollars	Billions	9.155	9.747	9.108	10.113
FYR of Macedonia	Investment	Percent of GDP					

Country	Subject Descriptor	Units	Scale	2008	2009	2010	2011
FYR of Macedonia	Gross national savings	Percent of GDP		13.986	19.453	22.061	20.410
FYR of Macedonia	Inflation, average consumer prices	Percent change		8.356	-0.814	1.509	5.200
FYR of Macedonia	Unemployment rate	Percent of total labor force		33.761	32.179	32.179	32.179
Montenegro	Gross domestic product, current prices	U.S. dollars	Billions	4.541	4.152	4.017	4.174
Montenegro	Gross domestic product based on PPP valuation of country GDP	Current international dollar	Billions	6.925	6.590	6.724	6.943
Montenegro	Investment	Percent of GDP		40.671	27.121	22.000	22.000
Montenegro	Gross national savings	Percent of GDP		-9.977	-3.138	-3.625	-2.473
Montenegro	Inflation, average consumer prices	Percent change		8.500	3.400	0.500	3.100
Montenegro	Unemployment rate	Percent of total labor force					
Serbia	Gross domestic product, current prices	U.S. dollars	Billions	48.834	41.648	38.707	45.641
Serbia	Gross domestic product based on PPP valuation of country GDP	Current international dollar	Billions	79.755	77.973	80.104	83.410
Serbia	Investment	Percent of GDP		28.628	22.102	21.900	21.721
Serbia	Gross national savings	Percent of GDP		7.679	15.211	14.842	14.361
Serbia	Inflation, average consumer prices	Percent change		12.426	8.105	6.173	9.898
Serbia	Unemployment rate	Percent of total labor force		14.700	17.400	19.436	19.553

Source: http://www.imf.org/external/pubs/ft/weo/2011/01/weodata/index.aspx

Table 2 Basic economic indicators for WBCs; GDP/capita, trade, public debt, balance of payments deficit (shaded parts are IMF estimates)

Country	Subject Descriptor	Units	2008	2009	2010	2011
Albania	Gross domestic product based on purchasing-power-parity (PPP) per capita GDP	Current international dollar	6,911.287	7,168.955	7,453.474	7,752.534
Albania	Import volume of goods and services	Percent change	6.512	0.703	-1.337	2.077
Albania	Export volume of goods and services	Percent change	15.963	-9.372	30.979	-10.112
Albania	General government net debt	Percent of GDP	55.157	60.170	59.731	59.892
Albania	General government gross debt	Percent of GDP	55.157	60.170	59.731	59.892
Albania	Current account balance	Percent of GDP	-15.206	-14.030	-10.110	-11.183
Bosnia and Herzegovina	Gross domestic product based on purchasing-power-parity (PPP) per capita GDP	Current international dollar	7,791.098	7,633.924	7,782.261	8,063.111
Bosnia and Herzegovina	Import volume of goods and services	Percent change	2.888	-10.304	-0.668	2.229
Bosnia and Herzegovina	Export volume of goods and services	Percent change	8.814	-3.843	1.218	5.956
Bosnia and Herzegovina	General government net debt	Percent of GDP	21.432	26.805	29.913	32.485

Country	Subject Descriptor	Units	2008	2009	2010	2011
Bosnia and Herzegovina	General government gross debt	Percent of GDP	30.851	35.398	36.889	41.383
Bosnia and Herzegovina	Current account balance	Percent of GDP	-14.470	-6.865	-6.037	-6.037
Croatia	Gross domestic product based on purchasing-power-parity (PPP) per capita GDP	Current international dollar	18,604.559	17,707.870	17,683.516	18,103.275
Croatia	Import volume of goods and services	Percent change	5.351	-21.741	-2.346	1.516
Croatia	Export volume of goods and services	Percent change	2.117	-17.486	4.482	2.390
Croatia	General government net debt	Percent of GDP				
Croatia	General government gross debt	Percent of GDP	29.269	35.409	40.038	44.121
Croatia	Current account balance	Percent of GDP	-9.157	-5.458	-1.925	-3.554
Kosovo	Gross domestic product based on purchasing-power-parity (PPP) per capita GDP	Current international dollar				
Kosovo	Import volume of goods and services	Percent change	27.098	-5.819	10.809	24.033
Kosovo	Export volume of goods and services	Percent change	19.303	1.742	22.046	26.918
Kosovo	General government net debt	Percent of GDP				
Kosovo	General government gross debt	Percent of GDP				
Kosovo	Current account balance	Percent of GDP	-15.206	-16.848	-17.269	-23.080
FYR of Macedonia	Gross domestic product based on purchasing-power-parity (PPP) per capita GDP	Current international dollar	9,600.311	9,584.983	9,727.900	10,112.345
FYR of Macedonia	Import volume of goods and services	Percent change	0.800	-11.100	10.700	12.900

Country	Subject Descriptor	Units	2008	2009	2010	2011
FYR of Macedonia	Export volume of goods and services	Percent change	-6.300	-10.700	22.700	18.715
FYR of Macedonia	General government net debt	Percent of GDP	18.576	21.167	24.016	25.518
FYR of Macedonia	General government gross debt	Percent of GDP	20.641	23.921	24.812	26.801
FYR of Macedonia	Current account balance	Percent of GDP	-13.860	-6.420	-2.783	-4.188
Montenegro	Gross domestic product based on purchasing-power-parity (PPP) per capita GDP	Current international dollar	11,062.582	10,527.636	10,741.982	11,090.315
Montenegro	Import volume of goods and services	Percent change	17.615	-22.893	-3.668	-1.047
Montenegro	Export volume of goods and services	Percent change	-5.801	-12.978	9.004	8.177
Montenegro	General government net debt	Percent of GDP	26.534	32.378	38.617	39.790
Montenegro	General government gross debt	Percent of GDP	31.876	40.691	44.069	43.073
Montenegro	Current account balance	Percent of GDP	-50.648	-30.259	-25.625	-24.473
Serbia	Gross domestic product based on purchasing-power-parity (PPP) per capita GDP	Current international dollar	10,804.616	10,563.100	10,830.192	11,254.681
Serbia	Import volume of goods and services	Percent change	10.756	-22.956	4.058	6.966
Serbia	Export volume of goods and services	Percent change	6.236	-14.972	19.066	16.591
Serbia	General government net debt	Percent of GDP	30.003	31.496	39.235	36.206
Serbia	General government gross debt	Percent of GDP	33.418	36.783	44.049	40.459

Source: http://www.imf.org/external/pubs/ft/weo/2011/01/weodata/index.aspx

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QUASI-MACROECONOMIC STABILITY AND INCERTITUDE OF REAL CONVERGENCE OF BOSNIA AND HERZEGOVINA TOWARDS EUROPEAN UNION

ABSTRACT

International policy of economic reconstruction of B&H have provided a substantial nominal convergence of B&H to the other SEE countries, and to some extent to the countries of EU, because it has a stable and convertible currency, a fixed currency exchange rate and a low inflation. The author shows that nominal convergence has contributed to macroeconomic stabilization, but that, does not imply neither realization of real convergence nor sustainability of stabilization by itself, and that is the reason why the overall economic growth in the post-war period was relinquished to economy backed by donations (aid driven-economy). The neo-liberal form of stabilization as the dominant economic goal was introduced in B&H more completely than in other countries, in which the stability is constantly reduced to the monetary sector, i.e. in which the monetary policy is given two impossible tasks: stability and development.
The policies on which the concept of such a quasi- macroeconomic equilibrium rests provide only short-term stability, but not the long term growth, and therefore do not meet the economic requirements for joining EU. The author proves this fact by the simulation of convergence indicators: total improvised pre-recession total DCEI for B&H is less than for the minimally converged countries: Bulgaria, Romania and Croatia (at the time of the last enlargement of EU), of which B&H lags the most in the institutional convergence, and it has highly uncertain real convergence (according to the rate of pre-recession growth, in order to reach of average GDP p.c. of the EU-27 countries, B&H would take 32 years).

Thus, the convergence of B&H to the EU requires higher economic growth than it was until now, especially because relatively high rates of economic growth, above the average in the region, did not provide a remotely significant competitiveness to B&H, even among Western Balkan countries. In comparison to the other countries in the region, B&H is rapidly falling behind, and the indicators of global indices competitiveness of countries and businesses in them are noticeable even divergence trends in relation to, for example, Bulgaria and Romania, and even Albania. This shows that the long term growth is primarily determined by the initial conditions, by the rate of increase of a physical capital (i.e. by the participation of investment in GDP), by the rate of growth of social capital (by the level of education, contemporary management and by encouraging innovation and social trust) and general political-legal environment.

In recession and post-recession period (from 2009 onwards), B&H is facing the ultimate uncertainty of convergence: on the one hand, B&H enters an unfavourable period of expansion fatigue and a discomfort from recession, on the other hand, decrease of the foreign aid and uncertainty of revival led only by modest export growth. The author based improvement of conditions for real convergence in post-recession perspective on a short-term anti-cyclic fiscal policy and medium-term structural reforms.

Key words: Bosnia and Herzegovina, real convergence, economic growth, macroeconomic stability.

JEL classification: E0, O1

1. INTRODUCTION - Significance of the macroeconomic convergence and settlement of accounts of the effects of joinig the European Union

Macroeconomic convergence towards the European Union has not yet gained a serious attention of the public and politicians in Bosnia and Herzegovina, and in the same time the domestic economic thought is divided into (Euro) optimists and (Euro) pessimists.

Such division of thought in the European environment reflects different views on the time required for the accession of new members, while domestic divisions reflect more or less ideological matrix of division between the neoliberal optimists and pessimistic critics of neoliberalism.

Neoliberals find the causes of the slowing down of the reforms, the slow convergence and the non-implemented liberal reforms in the domestic political factor. Critics of the (neo) liberalism find the causes for these delays and slowing down in the imposed development patterns and the wrong international policies of support to the economic reconstruction and restructuring of Bosnia and Herzegovina.

Aconsiderable numbers of Bosnian entrepreneurs are pessimists. They fear of the country's market opening and the universal trade liberalization which would subject them to foreign competition, for which they are not ready yet.

In the atmosphere of a European perspective, the country is characterized by the absence of real structural convergence, especially when it comes to the existence of a functioning market economy and its competitive ability.

Since the market transformation of Bosnia and Herzegovina is reduced to macroeconomic stabilization, the country enjoys only the stability of the so-called nominal economic indicators (stability and convertibility of the local currency, a fixed exchange rate and low inflation).

However, even this kind of stability is still, on one hand, handicapped by the entity structure which deprives the state of Bosnia and Herzegovina to conduct macroeconomic policies, and on the other hand, it does not correspond with the actual economic progress.

Contrary to the nominal, the actual economic indicators show the economic backwardness of the country. The country has a constantly high unemployment rate, a high trade and balance of payments deficit, sustainability of the debt to foreign countries through international assistance and transfers from abroad, and, above all, the rate of economic growth is insufficient, not only for closing down the economic gap between Bosnia and Herzegovina and European Union, but also for reaching the income levels of the countries of the last, the fifth EU enlargement.

Removal of the existing barriers and stimulating the economic growth in Bosnia and Herzegovina is at the same time a long-term prerequisite fulfilment for joining the EU.

To order this now, it should the question of assessment and calculation of the possible macroeconomic effects of accession and membership of Bosnia and Herzegovina in the European Union. Since the European Union set Maastricht and Copenhagen criteria for membership can only have benefits, and macroeconomic convergence of key economic priority of applicants. Know the effects of joining in the first stage of preparation for accession, to determine how Bosnia and Herzegovina lags behind with regard to the criteria for EU membership, as there are real degree of stability, and the main constraints that Bosnia and Herzegovina has to meet these criteria, they become the basic tasks for the professional and political nomenclature in Bosnia and Herzegovina. These are essential requirements for understanding the criteria for accession, and that, in order to facilitate the preparation of argumentation to achieve political and economic-ideological consensus of the Association, and winning over public opinion, and for effective coordination of economic policies during the actual process of accession to the European Union. Especially as the costs associated with the convergence, and the uncertain and undefined time limit for joining the European Union could further slow the flow of economic reforms as conditions for economic integration.

2. THE FRAGILITY OF NOMINAL CONVERGENCE

Macroeconomic stability, structural reforms and economic growth throughout the transition process are closely related and important in the process of creating self-sustaining development, while at the same time, and the convergence of the European Union.

The economic criteria for membership in the European Union, the simplified statement, include achieving "functional marcet economy" and deal with competitive pressures within the Union. " The progress of the negotiations depends on meeting these criteria, with the necessary reforms must be achieved before accession, which, among others, relating to: the ability of a minimum level of competitiveness in major sectors of the candidate, including compliance with criteria such as those on New to which government policy and legislation influence competitiveness (trade policy, competition, government support, support to small and medium enterprises) and the level and pace of trade integration with the EU before enlargement (the volume and types of goods that are exchanged with member states). In relation to the 10 +2 previously associated with the transition countries, the remaining countries that have not yet started negotiations, including Bosnia and Herzegovina, will face the ultimate dugoročnonim and uncertain process of joining the EU: on the one hand waiting for them over the acquis in relation to countries which, in 2004th (10 countries) and 2007 (2 countries), joined with the EU until 2003, on the other hand, you should count on more than a certain enlargement fatigue.

Therefore, fulfilling the criteria for membership of Bosnia and Herzegovina in the European Union should be regarded as a goal of transition, not just the condition for membership in the European Union (Ott, K., Boromisa, A-M, 2005), which is therefore necessary to concentrate on "the process of joining as a key (market) transformation." On meeting these criteria should be viewed as a process of long-term 'Europeanisation', in which Bosnia and Herzegovina will most likely stay long, so it should deal with structural and institutional reforms, regardless of the eventual accession to the European Union. Achieved macroeconomic stabilization shows that Bosnia and Herzegovina has made the first prerequisite for the realization of its transition process, which is also, translated into the language Maastricht criteria, and the transition condition for the convergence of European Union support. In this context, Bosnia and Herzegovina has made significant nominal convergence with other countries in transition, and to some extent with the EU, because it has: convertible and stable currency, a stable exchange value and low inflation. Nominal convergence is further contributed to macroeconomic stability, but, by itself, does not imply any real achievement of sustainable convergence or stabilization. In conditions that are characterized by the beginning of the transitional process and the post-war economic and the financial instability in Bosnia and Herzegovina, macroeconomic stabilization is a necessary prerequisite for radical systemic change, but still insufficient due to lag more complete institutional changes. On the forcing of stabilization, but its shape is reduce its short-term developmental effects, and with almost exclusively quantitative side forced rapid ownership transformation, creation and development of capitalism in Bosnia and Herzegovina, and could not, as expressed Sekretery of the UN Economic Commission for Europe for instritucionalno unprepared post-communist countries, not to be "fast...immature (infatile) and problematic." (IDS Bulletin, Vol. 29, No. 3, 1998, 10).

In fact in Bosnia is more complete than in other countries can enter (neoliberal) form of stabilization as the dominant economic goal, in which monetary policy given simultaneously or alternatively two tasks: the development and stability. Supported by other measures, monetary policy gives some results in overcoming the recession and curb inflation, but experience shows that success does not eliminate another problem: when overcomes recession than checking inflation and if inflation moderates, not providing enough development (Perišin, I., Šokman, A., 1982, 94). The latter case was confirmed in the case of Bosnia and Herzegovina, where each macro-economic stability, if not fragile and more dynamic economy and increasing productivity and hence competitiveness.

Providing a high and sustainable economic growth in the infrastructure sector, but also the interior of the real convergence of the EU. In the process of transition, for this is necessary previously to establish a macroeconomic stabilization, establishing a transitional, intermediate objectives: low inflation, stable exchange rate and financial stability, which, therefore, should provide a steady growth in GDP and living standards, which are the real prerequisites for inclusion in the EU. Isolated intermedial achieved the first two goals; however, indicate that the Bosnian post-war macroeconomic stability steadily reduced the monetary sector. This form is imposed literally everywhere intrenational community has produced establishing macroeconomic stabilization as the goal of transition, not its first assumptions. Although the Bosnian macroeconomic stability and economic development explicitly prevented and prevent local failure (discrepancy ongoing political and ethno-national divergence on the reintegration of the country), the implicit economic weakness it follows from the transitional package from the IMF and World Bank applied the principles of the Washington consensus, derived from the characteristics of a strong state and by applying a weak country such as Dayton Bosnia and Herzegovina. Moreover, some economists believe that, "forcing the Washington consensus, namely shok therapy and persistent accelerated privatization of a particular threat to the future of Society of Bosnia and Herzegovina (Babić, M., 2008, 6).

With the axiomatic view that macroeconomic stability is a prerequisite for sustainable economic growth, the application of neo-liberal concept, however, has contributed to the establishment of well quasi makroekonomomske balance in the country, the alarming rate of registered unemployment. Forgotten is that the Okun's Law (1964), the percentage reduction in unemployment contributions increasing GDP and employment growth that leads to an increase in labor productivity and consequently the employment effects of the accumulated growth in GDP. Thus, the percentage of unemployment contributes to the fall of GDP! Okun's Law has led to widespread acceptance of active stabilization of economic policies that became the key that opened the door for expansion into the world economy (Keynesian) 1960. In Bosnia and Herzegovina was thinking of doing the following: privatization will lead to an increase in economic efficiency, and thanks to her will in the long run and increase employment. "It is so. Trickle down effect that the rule does not work. In addition, he wrote Keynes, in the long run we are all dead (Stojanov, D, 2000, 54).

The failure of reform in the maladjusted conditions, as the critics of neoliberal transition (Stigltz, J., Kolodko, G.Z., Horvat, B. and others) declared, is a logical consequence of "not understanding the basis of market economy and the basis for institutional reform." This approach, on the one hand, it follows from "excessive reliance on school neoclassical models of economics," the general liberalization and privatization understood "as a sign of success" rather than "a means for achieving development perspective." I, on the other hand, the reduction of economic neo-liberalism on a small number of instruments (macroeconomic stability, trade liberalization and price with an open economy and privatization), which will express to create the market, which will quickly reallocate resources and allocate them efficiently owners. Accordingly Stiglitzevim analysis, the model neglects the instructions of neoclassical theory in which the functioning of a market economy (in terms of Pareto efficiency) as necessary competition and private ownership. Shok therapeutic transfer (distribution) of state property is easily doable, but such privatization is not conducive to creating the basis for a market economy. Hence, "to which privatization has failed to hit the market based economy is not a coincidence but a logical consequence of the way it is implemented.

The ultimate outcome of this approach, as was suggested critical thought, which is manifested in the case of Bosnia, is as follows:

1. "Private market, without adekvane institutional structures, can provide incentives only by the process of selling off state assets";
2. If markets open to competition too soon, before the establishment of strong financial institutions, the current unemployment rate will be further deepened;
3. The policy underlying the Washington Consensus can provide only short-term stability, but not long-term growth.

In contrast, the World Bank's stance on the model of macroeconomic policy in Bosnia and Herzegovina talks about its positive effects on the consolidation of stability of Bosnia and Herzegovina, since it was established price stability and exchange rate on the strict respect for the currency board regime. On prednodne criticism somewhat acknowledges that such macro-economic policies "may be an exaggerated form of limiting the potential of Bosnia and Herzegovina", but "continued focus on maintaining stability is the best option for promoting competitiveness and sustainable growth in the medium term." In addition, there are claims that such macroeconomic policy of limiting the potential of the economy of BiH will be solved "by speeding up the key structural reforms, including improving the business environment and increasing the degree of labor market flexibility (The World Bank, 2005, 1-2). However, what is overlooked here is that to achieve long-term and sustainable growth, according to Stiglitz, it is necessary to ensure the functioning of the (complete - additions K.H) market, which requires much more than low inflation and rapid privatization. This requires a strong financial regulation, competition and incentives for technology transfer, the transparency of the whole transitional process (Stiglitz, J., 1998, 20).

2.1. Enlargement Fatigue

In reference to the ten + two (10 + 2) previously associated transition countries, the remaining countries, including Bosnia and Herzegovina, will face the ultimate long-term and precarious process of joining the EU: on one hand, they have more Acquis waiting for them, in comparison with the countries that have joined the EU with Acquis accepted until 2003, that is, 10 countries in 2004 and 2 countries in 2007. On the other hand, we should count on more than a certain enlargement fatigue.

The fatigue was first felt after the last EU enlargement (2004), and then it intensified as a result of the of recession effects (2008-2011).

The first fatigue implied a lack of political climate for further enlargement, and, more importantly, the European imperative for putting things in order after this enlargement. Then, after that, the fatigue implied continuing the process of revision of the constitution from 2005. It's already left the countries of the Western Balkans "in a kind of utmost uncertainty and a state of black holes abandoned for a very long time." The global recession produced another, perhaps even worse fatigue. The relevant sources say that “expansion is no longer an EU priority” because, after the anticipated entry of Croatia into EU in 2012, “nothing will be happening for a long time”. (This is the recent statement of Tanja Fajol, European representative).

That is why the fulfilment of criteria for membership of Bosnia and Herzegovina in the European Union should be regarded as a goal of transition, not just a prerequisite for membership in the European Union. Therefore, it is necessary to concentrate on "the process of joining as a key for the (market) transformation."

Meeting these criteria should be viewed as a process of long-term 'Europeanization', in which Bosnia and Herzegovina is likely to stay for a long time. That is why Bosnia and Herzegovina should face the structural and institutional reforms, regardless of possible EU accession.

2.2. Comparison with some of the countries from the last round of EU enlargement at the time of their accession in 2004 and 2007

I will point out below the success with which Bosnia and Herzegovina converges towards European Union, and I will make comparisons with other countries, EU members and countries candidates for EU accession.

Bosnia and Herzegovina has, to a certain extent, reached the nominal convergence with the EU countries, especially with the countries from the last EU accession. However, it is still far from the actual convergence not just towards EU countries, but towards the most successful countries in the region as well. Moreover, the success of the nominal convergence is actually one of the obstacles for a realistic, actual convergence.

Comparison with the candidate countries at the time of their accession to the EU (2004 and 2007), including Croatia as well, confirms that Bosnia and Herzegovina has been quite equalized in meeting the Maastricht criteria.

Bosnia and Herzegovina has even had some advantage (Table 1 presents this situation) according to some Maastricht criteria (for example, on the basis of inflation and public debt as% of GDP).

Table 1 Indicators for 2004

Country	Inflation	Long-term interest rates	Budget deficit (as% of GDP)	Public debt (as% of GDP)
Czech Republic	2,9	5,7	5,9	40,7
Poland	2,4	6,5	6,2	48,1
Slovenia	4,6	8,5	1,6	24,7
Hungary	6,8	7,6	4,6	57,6
Slovakia	7,6	5,5	3,0	42,9
Bulgaria	4,8	6,3	0,7	43,2
Romania	12,7	18,0	3,0	26,4
Croatia	2,3	9,5	3,9	66,0
BH	**0,4**	**8,9**	**2,8**	**25,5**

Source: Adapted from the Central Bank data, Annual Report 2006

We can see that BiH had 0,4% inflation rate at that time; 8,9% long-term interest rates, budget deficit 2,8% and public debt 25%. In comparison with other countries, these are successful indicators.

The Maastricht criteria presented, although not a prerequisite for entry into the EU, but for the later phase of the euro introduction, are important to indicate the level of their fulfilment.

However, the precise degree of convergence accomplished, and a possibility of comparison with other countries is achieved by measurable indicators. For the period before recession, simulations will be made on the basis of DCEI - Deka Convergence European Indicators, which take into account four different types of convergence: the monetary, fiscal, real (actual) and institutional convergence (DCEI has a maximum value of 100 points, which is, in fact, the average value of a certain indicator for the EU).

In this table, to the analysis of the monetary and fiscal convergence in reference to the DCEI selected countries from the last, fifth round of accession (the ten countries in 2004, Bulgaria and Romania in early 2007), including Croatia as well, we have joined our own calculation of monetary and fiscal indicators for Bosnia and Herzegovina (Table 2).

Table 2 Monetary and fiscal convergence in selected countries

Country	DCEI for 2004			DCEI for 2006		
	Monetary	**Fiscal**	**Total**	**Monetary**	**Fiscal**	**Total**
Czech Republic	95	65	82	100	75	85
Poland	85	75	76	90	80	79
Slovenia	80	75	83	75	85	83
Hungary	65	60	73	75	60	75
Slovakia	85	70	73	90	80	81
Bulgaria	75	80	59	75	85	65
Romania	10	80	42	40	90	63
Croatia	75	40	47	80	70	59
BiH	**86**	**45**	**40**	**86**	**48**	**42**

Source: Data from DekaBank. For BH, the author's calculation by which the improvised sum of monetary and fiscal indicators for 2006 one gets on the basis of the following points: inflation 90 points, 70 interest rates, exchange rate 100 and the rate of growth of loans 80 points.

Comparison of DCEI for monetary convergence (which measures the rate of inflation, interest rate, exchange rate and the rate of credit growth) shows that all of the countries at that time, except for Romania, achieved a high degree of monetary convergence to the European Union, and a significant improvement of the fiscal convergence (measure of the share of the budget balance in GDP, of the private consumption, of the public debt and external debt in GDP). All of the countries, two years after accession, with the exception of Slovenia, increased their monetary convergence to the European Union.

The Czech Republic has perfectly converged and her DCEI monetary convergence amounts a maximum of 100 points. Most of these countries have had an extreme reduction in the general price level during the last decade, stabilization of the exchange rate, balanced interest rates and credit growth rates. BiH, however, enters the group of transition economies with lower rates of domestic inflation. In 2004, Bosnia and Herzegovina had 0.4% inflation, long-term interest rates 8.9% and a fixed rate of the domestic currency against the euro.

Consequently, the indicators of monetary convergence were, on average, at the level of the three most successful countries from the above analysis – Czech Republic, Poland and Slovenia, while the indicator of fiscal convergence of BiH has been ranked lower, but not the last. Bosnia and Herzegovina greeted the year 2006 with favourable indicators of monetary convergence, which again settles Bosnia and Herzegovina in the leading half of these upper countries.

Table 3 Indicators for the assessment of monetary and fiscal convergence, 2002-2006

	2002	**2003**	**2004**	**2005**	**2006**
Inflation	0,3 %	0,6 %	0,4 %	3,7 %	7,4 %
Long-term interest rates	10,6 %	9,2 %	8,9 %	8,2 %	7,3 %
Exchange currency rate	unchanged	unchanged	unchanged	unchanged	unchanged
General public expenditure, % GDP	53,9 %	51,3 %	50,8 %	47,7 %	50,3 %
The current account deficit,% GDP	19,1 %	19,4 %	17,9 %	19,8 %	10,7 %
Foreign debt, % GD	33,4 %	27,7 %	25,5 %	25,6 %	21,3 %
Gross foreign currency (million BAM)	2.484,1	2.792,9	3.479,0	4.224,5	5.451,7
Net free reserves (million BAM)	137,7	164,1	174,4	213,4	268,1

Source: adapted from the Central Bank data, Annual Report 2006

For a successful joining up the EU and adoption of a common monetary policy by which a member state is enabled to enter the third stage of EMU, i.e. the introduction of euro as the national currency, prior to that it is necessary to achieve a high and sustainable level of an overall convergence, that is, to achieve a total DCEI.

However, even at that point, there is a setback in the monetary convergence development. In this context, the Bosnia and Herzegovina expresses its weakness:

1. While all other countries improve monetary convergence, increasing the monetary and the overall DCEI at the same time;
2. Bosnia and Herzegovina is not only stagnant (an indicator of monetary convergence is unchanged but the country has a problem to maintain monetary stability built on the basis of a functioning *Currency board* and a stable and fixed exchange rate under the supervision of the international community.

The problem of real convergence is stressed particularly at the time of global recession, since Bosnia and Herzegovina shows the tendency of divergence.

The slowing down of real convergence has already begun at the time before the recession. In comparison with the countries from the last wave of accession, including Croatia, the situation was as follows:

Table 4 The real and institutional convergence of the chosen countries

Country	DCEI for 2004			DCEI for 2006		
	Real	**Institutional.**	**Total**	**Real**	**Institutional.**	**Total**
Czech Republic	90	80	82	85	80	85
Poland	60	85	76	65	85	79
Slovenia	100	80	83	95	80	83
Hungary	85	85	73	90	85	75
Slovakia	60	80	73	75	80	81
Bulgaria	25	80	59	35	80	65
Romania	50	75	42	55	80	63
Croatia	30	55	47	35	60	59
BiH	**43**	20	45	43	25	42

Source: Data from DekaBank. For BiH the author's calculation by which the improvised sum of real, actual convergence indicators for 2006 one gets on the basis of the following points: economic growth 90 points, 5 unemployment, the share of trade with EU in total trade 25 points.

If we compare the situation in 2004 and 2006, we can see that unlike in the most of the countries (except Slovenia and Czech Republic), the real convergence in Bosnia and Herzegovina stagnates.

In the period after Dayton Agreement, the economic growth has been mostly the result of international financial and technical assistance (5.1 billion US $) and transfers by diasporas (approximately EUR 2 billion annually). These financial inputs have encouraged the accentuated trend growth in GDP p.c. (average growth rate from 2000 to 2007, i.e. until the effects of global recession had been felt, was close to 6%). In spite of the fact that in comparison with neighbouring countries, and especially the Euro zone countries, Bosnia and Herzegovina has very high growth rates, it would take three generations to get closer to the average income in the European Union.

In this tabular overview, we simulate the convergence of selected countries to the average GDP in EU, based on the situation before recession, in 2007.

Table 5 GDP p.c. (PPP) of selected countries and time required to close the Gap with the EU GDP p.c.

Country	GDP p.c. (PPP) in int. dollars (2007)	Growth rate GDP p.c.	% of the average EU GDP p.c. (PPP)	Number of years required to close the gap in GDP p.c. with EU	
				Reaching 75 % of the EU average	Reaching 100 % % of the EU average
1	2	3	4	5	6
EU	**33.400**	**2,6 %**	**100 %**		
Slovenia	27.300	5,7 %	81,73 %	3 (2010)	7 (2014)
Bulgaria	11.800	6,1 %	35,33 %	22 (2030)	32 (2040)
Romania	11.100	5,5 %	35,30 %	29 (2036)	41 (2047)
Candidate countries					
Croatia	15.500	5,6 %	46,41 %	21 (2028)	28 (2034)
Macedonia	8.400	4,6 %	25,15 %	64 (2071)	85 (2093)
Turkey	12.300				
B&H	**6,600**	**6,8 %**	**19,76 %**	**32 (2039)**	**41 (2049)**

Source: IMF, World Economic Outlook, from my own calculation of time required to close down the gap in GDP p.c. between BiH and EU;;** The author's assessment

If the EU is developing at the rate of 2.6%, then Slovenia would need three years to reach 75%, and 7 years to reach 100% of average EU GDP p.c.
The countries waiting for admission to the EU are having a very long period of convergence ahead of them (on average about 30 years to reach 75% of EU average)

At the same time, Bosnia and Herzegovina would need 32 years to reach 75% and 41 years to reach 100% of average EU GDP p.c.

Well, regardless of the "dynamism", the rate of economic growth in the period before the recession was not sufficient to comply with the EU members, even for the period of three working generations ahead.

2.3. The capacity of convergence in post-recession period

The effects of the recession continue to deepen the consequences of the permanent structural (transitional) crisis, with even greater uncertainty in the process of convergence towards the European Union.
In the post-recession period, Bosnia and Herzegovina, almost in its entirety, can meet the nominal Maastricht convergence criteria, except the criteria of long-term interest rates. The level of inflation, budget deficits and public debt, as well as the independence of the Central Bank of BiH, are the sub-criteria which are already within the defined limits of convergence.

Table 6 Indicators of selected countries, 2010

	Inflation (end year)	Government balance/ GDP	Current accounting balance/GDP	External debt/GDP	Gross Reserves/GDP
Albania	8.7	-5,2	-9,2	34,1*	19,1*
B&H	2.0	-5,0	-5,5	46,6*	16,7*
Bulgaria	5.2	-3,8	-3,0	107,6	35,2
Croatia	2.8	-4,7	-3,8	101,9*	23,6*
Hungary	3.5	-3,9	1,0	140,4*	32,8*
Macedonia, FYR	2.5	-2,5	-3,9	58,8*	24,5*
Montenegro	2.0	-7,1	-17,0	96,9*	13,8*
Poland	2.5	-7,5	-2,2	65,1*	17,7*
Romania	7.9	-6,8	-5,1	48,8*	14,3*
Serbia	7.7	-4,8	-9,6	73,6*	34,4*
Slovak Republic	1.0	-7,5	-1,5	74,3*	0,8*
Slovenia	2.1	-5,7	-1,0	113.4*	14.4*
Turkey	8.2	-4,1	-6,8	43,6*	12,2*

Source: EBRD, Transition Report 2010, Recovery and Reform, London, 2011, pp 10.
*State of affairs in 2009.

On the other hand, the real convergence is satisfactory when it comes to the exchange rate stability, but the level of GDP p/c is far below the level of the least developed EU countries and it would be possible only with long-term sustainable rates of the economic growth.

However, further actual convergence of Bosnia and Herzegovina towards the EU remains uncertain, because from 2010 divergent flows are possible for Bosnia and Herzegovina, what we can see from this table.

Table 7 GDP growth of selected countries

	% GDP growth						
	2005	**2006**	**2007**	**2008**	**2009**	**2010**	**2005-2010**
European Union	2.0	3.2	3.0	0.5	−4.2	1.8	**6,2**
Euro zone	1.7	3.0	2.9	0.5	−4.1	1.7	**5,6**
Bulgaria	6.4	6.5	6.4	6.2	−5.5	0.2	**21,2**
Romania	4.2	7.9	6.3	7.3	−7.1	-1.3	**17,5**
Slovenia	4.5	5.9	6.9	3.7	−8.1	1.2	**14,0**
Croatia	4,2		2,6	2,4	-5,8	-1,2	
B&H	**3,9**	**6,0**	**6,2**	**5,7**	**-3,0**	**0,9**	**19,7**

Source: EBRD, 2010.

3. CONCLUSION

Macroeconomic convergence towards the European Union has not yet gained a serious attention of the public and politicians in Bosnia and Herzegovina. The European prospects of Bosnia and Herzegovina have proven to be the result of the political evaluation and the good will of the European officials, rather than the result of the merits of the current political authorities. In such a climate, the issue of macro-economic convergence towards European Union cannot be given a serious consideration and attention, although it is very important to know the effects as early as when the country holds the status of a potential candidate, which Bosnia and Herzegovina already holds towards EU. Spreading and strengthening of the awareness of the importance of macro-economic convergence, could, to some extent, build up the lacking ethno-national trust in the country, with reference to gaining a widespread, mutual, public confidence of citizens in future prosperity of Bosnia and Herzegovina within EU. Although relations of political stability and legal security seem to be of a crucial importance at the moment, the economic issues will gain a prevalent importance in the long run.

The achieved macroeconomic stabilization shows that Bosnia and Herzegovina has made the first prerequisite for the realization of its transition process, which is also, translated into the language of Maastricht criteria, a transitive prerequisite for the support of the convergence to the European Union.

In this context, Bosnia and Herzegovina has made a significant nominal convergence towards the European Union. The nominal convergence has further contributed to macroeconomic stability, but, by itself, it neither implies any realization of a real convergence, nor the sustainability of the macroeconomic stabilization in the long run. It is obvious that an alternative approach is unavoidable for: a) the real convergence, b) for the country to survive in the economic and social sense. Otherwise, Bosnia and Herzegovina could become politically unsustainable.

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A TRADING S.T.O.R.M.P.A.T.H. ACROSS AN UNFINISHED CONTINENT; THE EU ASSOCIATION OF CROATIA AND GEOGRAPHICAL PERSPECTIVES FOR B&H

ABSTRACT

*The pending EU-accession of Croatia invites other land-locked West Balkan economies to improve EU-trade within a Mediterranean TEN setting (trans European network). On the one hand, the Spanish corredor mediterraneo aims to link the Algeciras-hub with Barcelona and France, emphasizing a missing-link issue in a multiple-gauge setting. On the other hand, the Italian corridoio meridiano and corridoio adriatico address sea-land intermodality by maximizing passages through Italy. Also, the maritime milkrounds in global deep-sea shipping routes offer blueprints for equivalent port co-operation in the Adriatic-Ionian port area, as they are now operating in the Black Sea, the North Sea and the Far East. Then, the Balkan transport infrastructure is assessed within the TEN corridors, such as 4, 5, 7 (the Danube), 8, 9 and 10 (the trail of the Orient Express). Their joint traffic potential is implemented by Eurostat data and concludes that relevant corridors between Danube and Adriatic total a traffic equivalent of at least one contemporary Alp crossing, at the condition that improved coastwise port co-operation optimizes due **hub-based milkrounds** of deep-sea shipping companies. The **Stormpath** acronym suggests an asymmetric location of well known free-trade zones (zone franches). They should not only act at seaports at the benefit of landlocked countries. Newborn multi-modal zones at land-locked locations are bound to boost inward processing (IP) activities, and may already provide the trade-based value added, accelerating an eventual EU accession. The acronym **Stormpath** lists Adriatic ports and suggests inland locations such as **S**arajevo, **T**uzla, **O**sijek, **R**ijeka, **M**ostar and **P**loce, whereas 'ATH' stands for the sections 5/b and 5/c in the TEN corridor 5 by the acronym '**A**driatic To **H**ungary'. The paper concludes by suggesting a comparative-cost methodology for assessing both an initial fact-finding mission and, eventually, a detailed cost-benefit analysis.*

Key words: TENs, transport, EU accesión

JEL classification: L9

1. INTRODUCTION

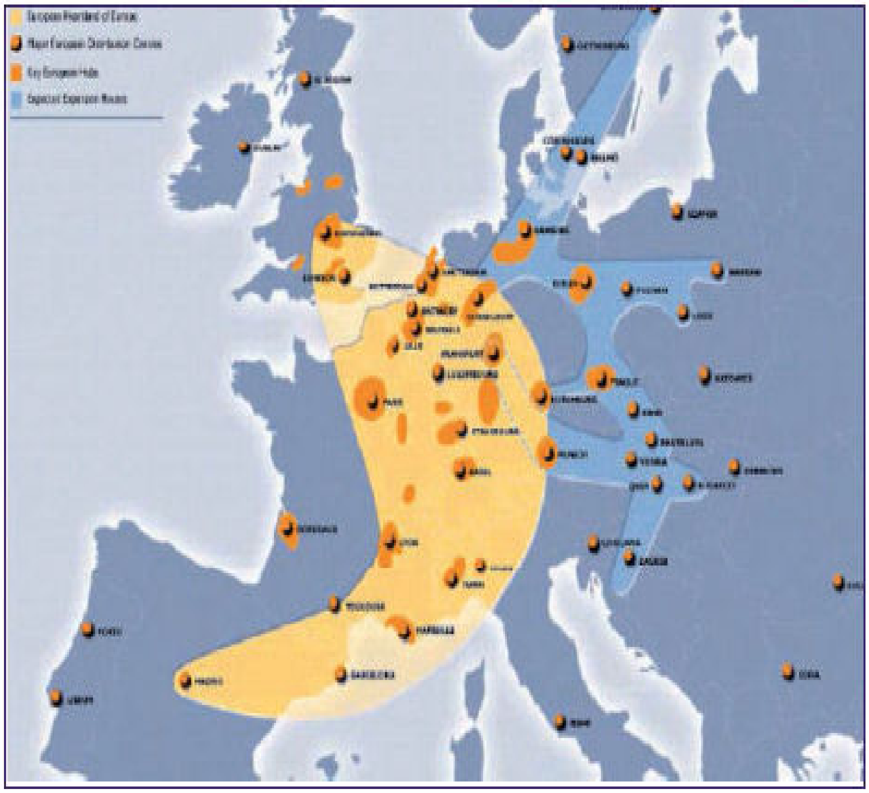
The pending EU-accession of Croatia invites other land-locked West Balkan economies to improve EU-trade within a Mediterranean TEN setting *(trans European network)*. On the one hand, the Spanish *corredor mediterraneo* aims to link the Algeciras-hub with Barcelona and France, emphasizing a missing-link issue in a multiple-gauge setting. On the other hand, the Italian *corridoio meridiano* and *corridoio adriatico* address sea-land intermodality by maximizing passages through Italy. Also, the *maritime milkrounds* in global deep-sea shipping routes offer blueprints for equivalent port co-operation in the Adriatic-Ionian port area, as they are now operating in the Black Sea, the North Sea and the Far East.

2. EU TRANSITION CORRIDORS

2.1. The Blue banana in transition

Traditional European geography claims that economic prosperity clusters in a kind of *banana shaped* region from London to Madrid touching the *Iron Curtain* and the *Riviera*. Older versions even reached the best journals *(NELSON, 1968)* and claim that the geography of rich and poor goes back to the split of Charlemagne's empire (A.D. 843). The 2004 EU enlargement amended these theories with new corridors, such as the ***Vindobona*** (Berlin-Prague-Vienna) and the ***Vogelfluglinie*** *(bird's flight)* from Hamburg to Stockholm over Copenhagen. Eventually, the new TEN link the capitals of the EU enlargement, but often neglect regional needs and side lines. To a certain extent, the banana geo-masterminds follow a GDP/capita thesis with top regions ranking a few thousand € higher, compared to the more isolated areas in the periphery.

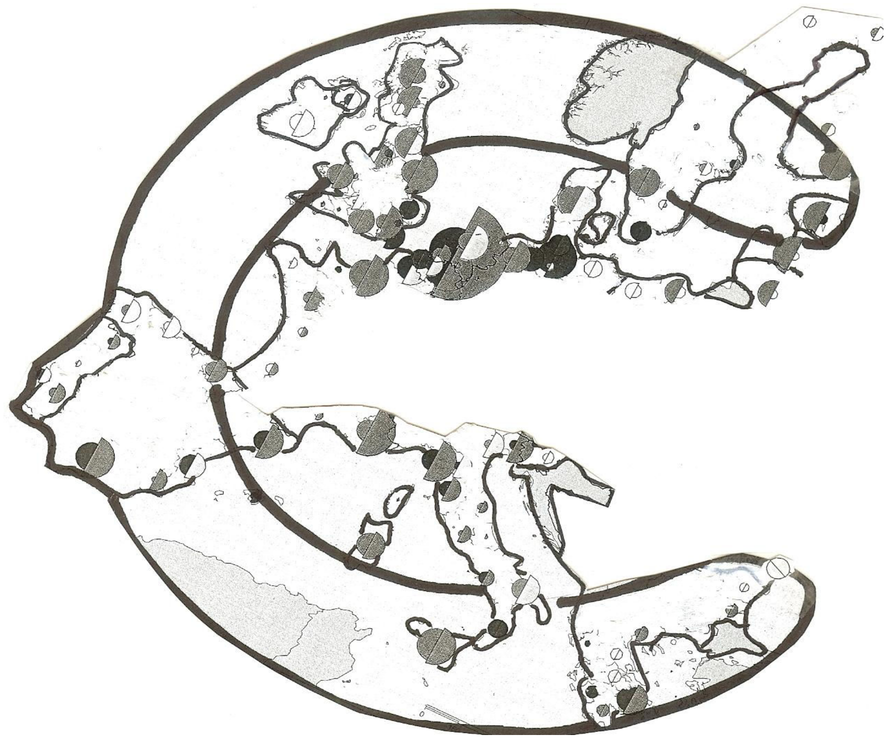
Figure 1 One of the typical maps of the blue banana



2.2. The horseshoe syndrome

The European coasts portray a kind of *horseshoe* from the Baltic *(Helsinki/Talinn)* down to the Black Sea *(Contanza)*. Nevertheless, the port throughputs by NUTS-2 region mark two major concentrations. On the one hand, the Hamburg-Le Havre range *(including Antwerp & Rotterdam)* still concentrates most EU inbound trade, especially in the *neo bulk* area. On the other hand, the Mediterranean basin gains momentum, both by its Northern coast, switching from inbound energy bulk to neo bulk, and some newborn hubs between Gibraltar and the entry of the Suez-Canal (e.g. Algeciras, Gioia Tauro, Malta, etc.). Adriatic ports appear to be left with the choice between smaller mother ships or feeders to the hubs, including asymmetric *milkrounds*, loading and unloading within a regional loop (Fig.6/c).

Figure 2 Port throughput by NUTS 2, portaying a horseshoe

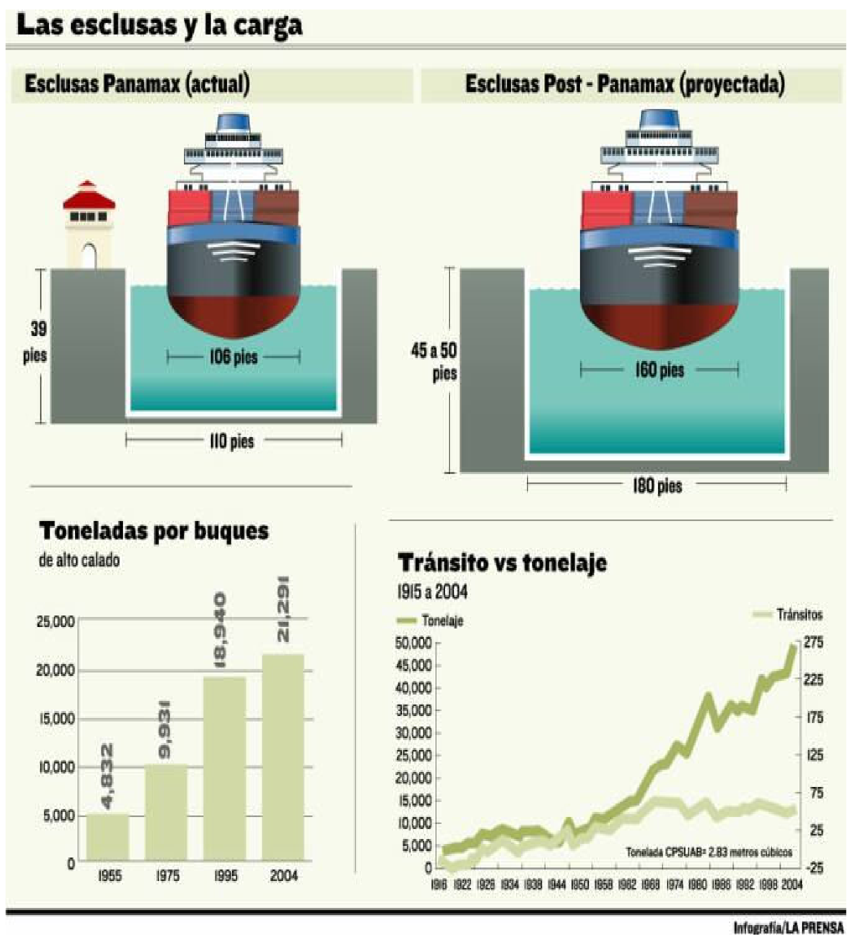


Source: Eurostat data base 'regio' with left half circle = loadings, right unloadings, port data are recorded for dry and liquid bulk, containers, RoRo and others. Source ISBN 92-894-9030-6, publications.eu.int.

2.3. From Panamax to Panamaix

The Panama Canal was designed for the Titanic *(33 m beam by 173 m length)*. A century ago, the ill-fated candidate never crossed the isthmus but she still claims the ***Panamax*** label of size restrictions. Figure 3 portrays the rising average draft by stagnating crossings. The pending centennial soon celebrates a draft to 50 feet by a 160ft-beam with a 15,000 TEU capacity or 12,500 FCL. This ***Post Panamax size*** *(almost cape-size)* exceeds the logic of a normal ***milkround*** with ships calling at successive ports between the deep-sea legs. Especially round-the-world orbits tend to call only at main hubs ***(e.g. by crossing the Mediterranean only)*** with limited feeders serving the outlaying areas. Smaller ports will struggle for mother ships in specialized point-to-point trades or they will be left with costly feeders.

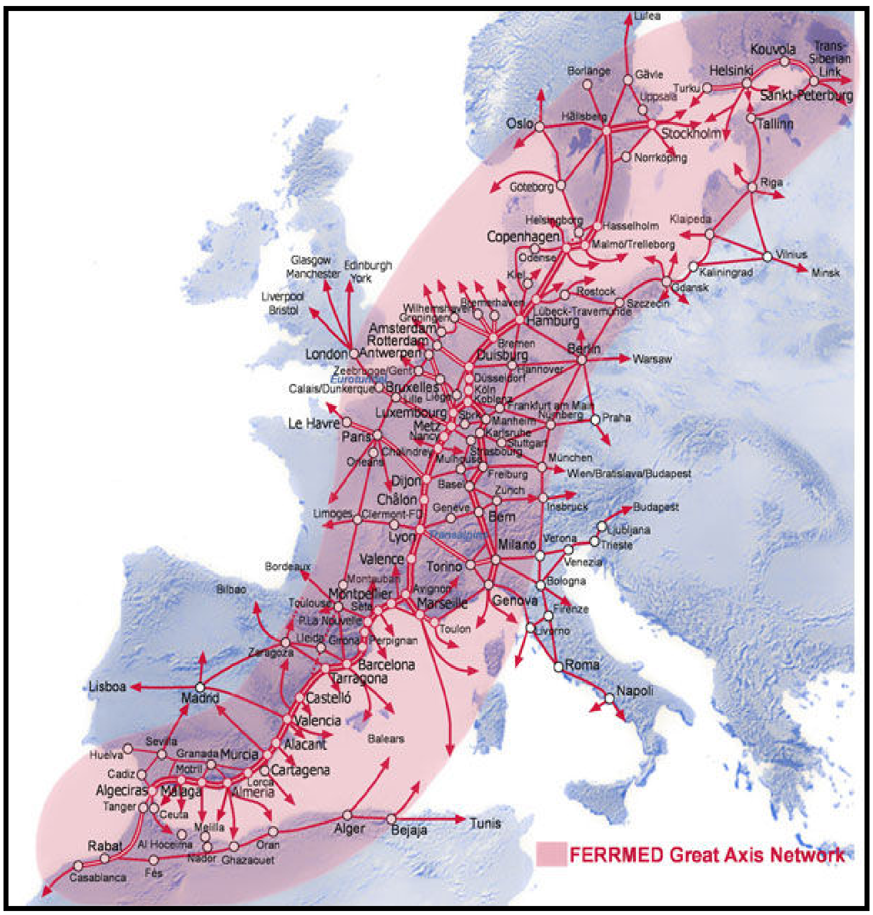
Figure 3 The old new Panama canal with traffic & transit evolution



2.4. El “corridor mediterraneo” and *Ferrmed*

Spain replies to the *Post-Panamax* scale by port development, such as Algeciras, of which poor hinterland coverage restricts its ambitions to act as a hub. The radial star of Spanish transport still features a Madrid-based structure and is hampered by a rail gauge of 6 Castilian feet *(i.e. 1.6+ m compared to the standard UIC 1,435 mm UIC gauge)*. ***El corredor mediterraneo*** aims to complete a Mediterranean coastal rail by adding missing links at the standard UIC gauge and re-engineering existing sections by a ***triple gauge***, some in connection with the high-speed AVE *(Madrid-Barcelona-France)*. Figure 4 portrays the new ***Ferrmed*** transcontinental axis to the German industrial centers and beyond. The ***corredor*** has not yet an official EU labeled TEN-status, and rather seems a national answer to the TEN..

Figure 4 The Spanish corridor mediterraneo and Ferrmed network

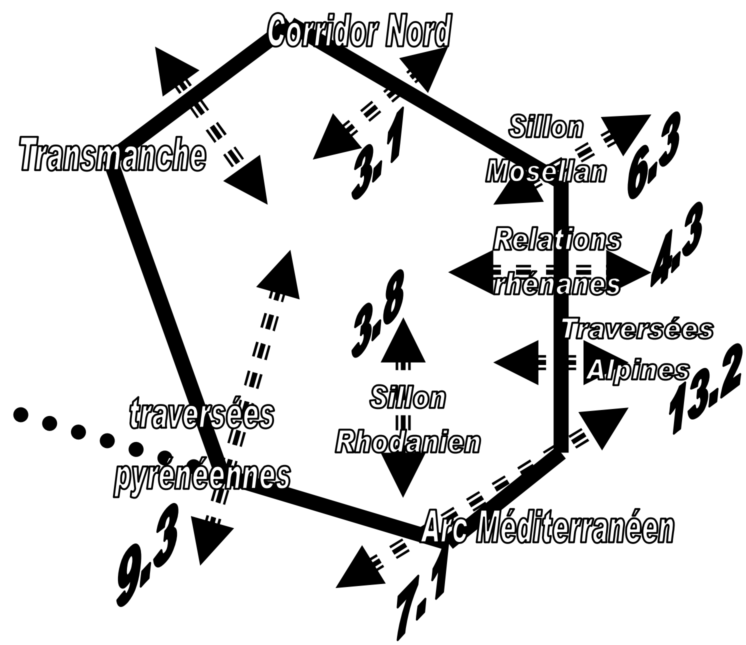


Source: www.ferrmed.com

2.5. The French *hexagone*

French geography is often nicknamed as the ***hexagone***. Government policy aims to counter the shifting ***blue banana*** by transport projects totaling € 142 billion over two decades (2000-2020). The EU sponsors about one third of major border links, of which € 32 billion for rail and only € 8 billion for roads. The completion of the new high-speed lines is bound to boosts freight capacity on the old *arteries,* especially on the connections with Germany and the Rhône *(Sillon Rhodanien)*. The French-Riviera is relieved by a new Alp tunnel *(Lyon Turin)* with joins a new mixed *(TGV plus freight)* connection with the Spanish border and the ***corredor***. In the Nord, the ***façade atlantique*** is served by new feeding lines to the Channel tunnel and an inland logistical network, backing the *Port 2000* project at Le Havre with a high-capacity canal ***(Seine Nord),*** parallel to the Channel coast. When all works are completed, France will dispose of two major deep-sea seaports at both the Atlantic *(Le Havre)* and in the Mediterranean *(Marseilles)*, which may operate in a real competition to the ***corridoio de due mari*** *(Rotterdam-Genoa)*.

Figure 5 Transport investments in the French 'hexagone' (in € billion)

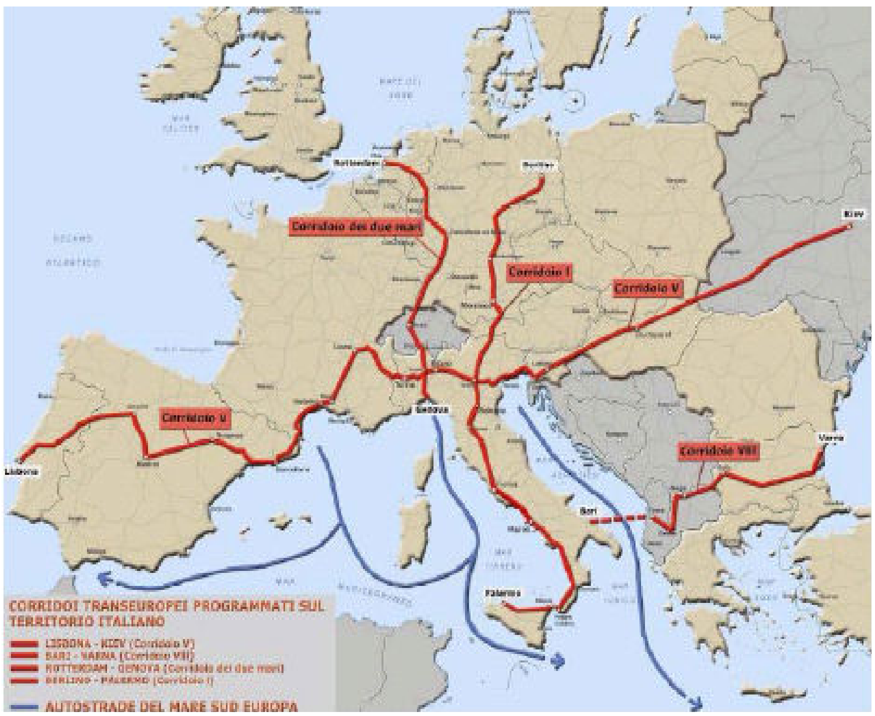


2.6. Il “corridoio Meridiano” *(Cargnello E. , 2002)*

The Italian transport policy seems to maximize the use of the ***corridors of the sea (autostrade del mare)***, in connection with four main TEN connections (Fig. 6/a):

1. *Il corridoio dei due mare*: Rotterdam-*Loetschberg*-*Simplon*-Genova*;*
2. corridor 1: Berlin-*Brenner*-Palermo *(and the Hub Gioia Tauro);*
3. corridor 5: Lisbon-Lyon-Turin-Milan-Ljubljana-Budapest-Lvov-Kiev;
   Often, the sideshows to Rijeka and Ploce are not shown as in Figure 6/a!
4. corridor 8: Bari⇔ferry⇔Durres-Skopje-Varna

Figure 6/a The Italian TEN passages with motorways of the sea



Especially, the concept of the ***corrodoio Merridiano*** emphasizes the sea passages through the Mediterranean from the Spanish coast to the entry of the Suez Canal in which the Adriatic Sea, by its very geographical shape, suffers a larger detour on global trading routes, compared to Marseilles, Genoa and the Spanish coast. In the deep Italian South, the port-hub of Gioia Tauro gains momentum, together with Malta, Tanger Med and the main ports of the Black Sea since the latest 2007 EU enlargement (Fig. 6/b/c).

Figure 6/b The 'corridoio Merridiano' with major European transport axes

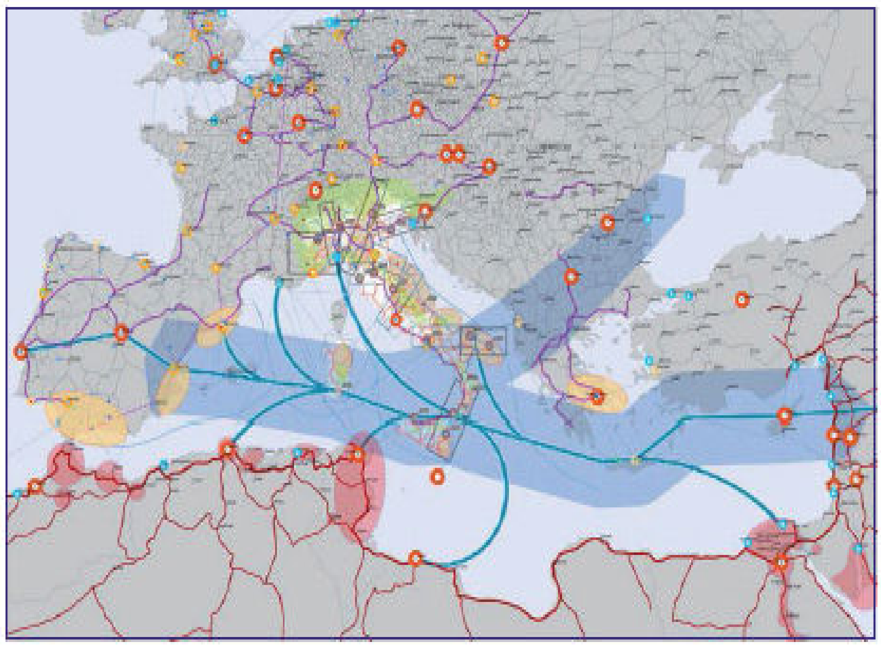


Figure 6/c Typical CGM/CMA milkrounds with Malta and in the Black Sea

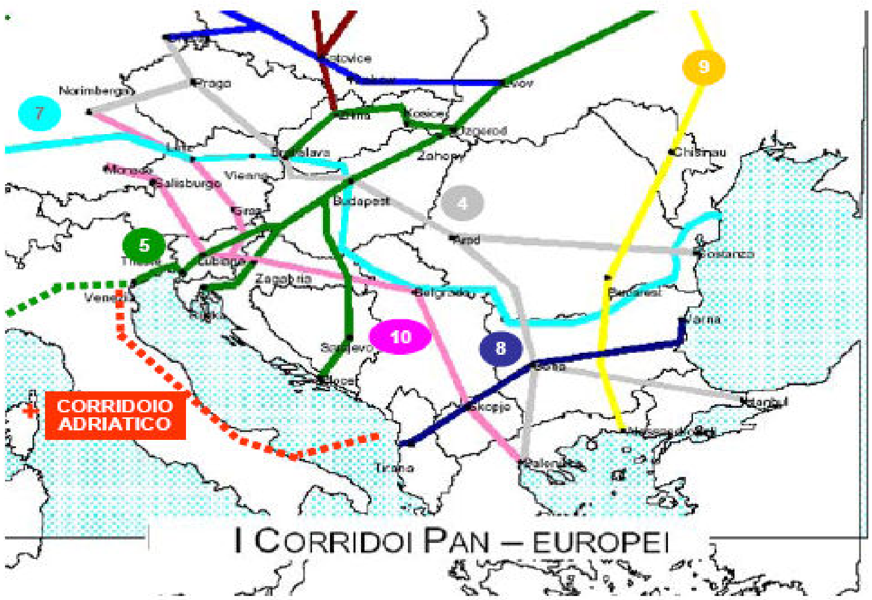
Source: http://www.cma-cgm.com

The hubs often substitute for milkrounds at both ends of a deep-sea voyage. Those local calls may eventually decide upon the net trade balances of the reporting EU members, since some dominate the inbound unlaodings, other the outbound loads.

2.7. Il "corridoio Adriatico"

The TEN aim to connect the Black Sea, the Danube and the Adriatic. The main corridor number 5 features two additional links to Rijeka and Ploce, such that land-locked Hungary obtains a triple access to the Dalmatian coast, each with its own border crossing *(H-SLO, H-HR and H-HR-BiH-HR)*. Now, Italy draws a coastal non-TEN corridor linking the North to Bari and there the ferry to Durres-Albania, after which corridor 8 links land-locked Skopje further to Varna. Finally, the Balkan part of corridor 7 is nothing less than the Danube, whereas numbers 4 and 10 follow the former trails of the *Orient express*. More important is the emphasis on capital cities which tend to dismiss some lateral connections. On the one hand, there is no mentioning of an inter-port corridor along the Dalmatian coast. On the other hand, Hungary is served by a star-hub through Budapest which under-evaluates some lateral links, such as between West Romania *(Arad-Timisoara)*, the Danube-port of Baja (Hungary) and the Croatian mouth of the Drava *(Osijek/Vukovar)*.

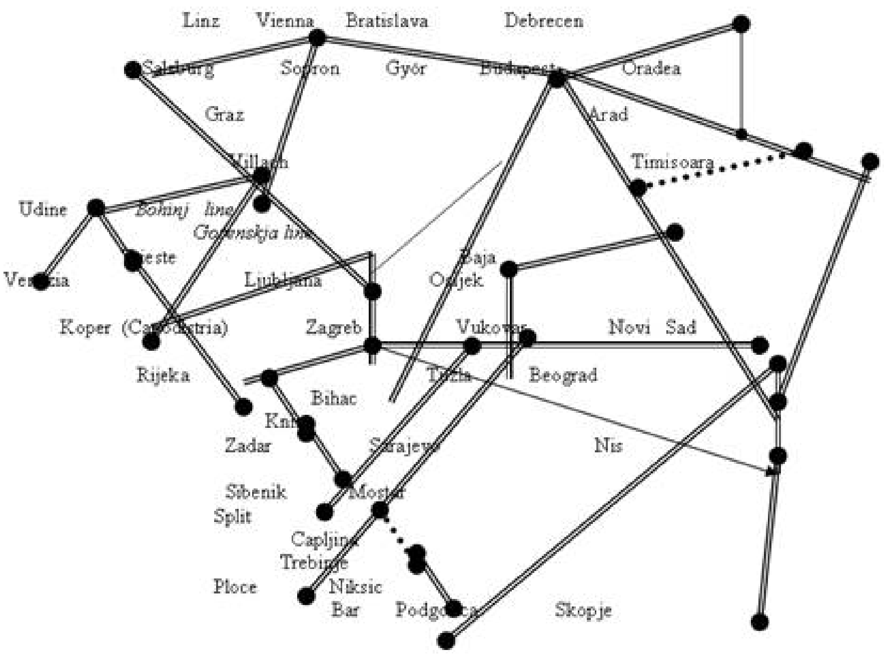
Figure 7 TEN corridors between the Adriatic and the Black Sea



2.8. Danube –Adriatic, a new "STORMPath"

The network between Danube and Adriatic is fairly complete though in a fairly obsolete state. The military aspirations of the former Habsburg Empire innovated in overland routes to the Adriatic by the old *Südbahn (Vienna-Koper/Pula)* with the first Alp *Semmering* tunnel to be complemented by the *Karavanke (now the **Gorenskja line** at 3kV dc)*. The scenic ***Bohinj*** route countered the *Südbahn* monopoly position by a dedicated engineering along the Isonzo/Soca valley. It is known by WWI battles, the Hemmingway saga and the impressive Redipuglia *sacrario*, close to the Isonzo mouth. The port of Rijeka fuels a direct connection to Hungary which runs soon at a standard 25 kV ac current. Ploce has place left for expansion but feeders have to cross BiH. Bar links Montenegro to Serbia, with a planned link to the Ploce line at Capljina, for which the EU supported a € 0.5 million study. Most lines are single track with a circuitous routing, which need inter-line co-ordination.

Figure 8 Main railway networks between Danube and the Adriatic ports



2.9. EU trade & traffic (2009/2010)

Visible EU exports to the West Balkan exceed € 25 billion but imports score below € 12 billion. The volume trade exceeds 18 million tons both ways, which is mostly hauled by national carriers. Cross trade amounts to 1.5 million tons outbound and 0.5 inbound. Croatian trucks specialize in BiH traffic and Slovenians dominate the cross trade with Croatia. The average value of EU exports to the West Balkan amounts to € 1.43 and EU imports average € 0.65. These volumes hardly reach EU standards of shifting road transit to other eco-modes *(which is about 500 million tkm in current Marco Polo entries)* but specific links may seem worth the effort to follow up.

Table 1 Current EU-27 transport with the *(non-EU)* West Balkan countries

Country/2008	Import *(billion €)* export		Import *(million tons)* export	
Croatia	4.3 4.9	10.6 10.2	9.5 8.9	6.5 6.7
B&H	1.5 2.0	2.0 3.1	2.1 2.6	2.4 2.6
Serbia	3.2 4.0	6.5 7.3	4.4 4.6	4.1 4.6
Fyrom	1.2 1.6	2.1 2.4	1.0 1.2	2.0 1.8
Kosovo	0.1 0.1	0.6 0.6	0.1 0.1	0.5 0.5
Albania	0.7 0.9	2.0 2.1	0.6 1.0	2.8 2.6
Totals	11.0 11.9	23.8 25.7	17.7 18.4	18.3 18.8

Source: Eurostat transport statistics (note the differences with trade statistics, cf. infra)

A more informative exercise establishes a scenario of the internal market with the West Balkan countries included. Table 2 estimates the internal market at € 2.1 trillion which stagnates after the 2004 enlargement but keeps accelerating in the *Hanseatic* region (Benelux, Germany and Visegrad), such that the mentioned *horseshoe syndrome* tends to consolidate. It is not easy to implement the Balkan because of changing national accounts, but tables 2/b and 2/c suggest a future upgrade of the last row and column of Table 2/a.

For EU departures, the new members (RO + BG) take more than 2/3 and they tend to consolidate the Danube dominance, such that the West Balkan is left with less than one third. For arrivals, the *pure* West Balkan *(i.e. without Croatia)* drops even from one third (32%) to almost a quart (26%).

Table 2/a Intra-EU origin-destination flows by main region in billion €

From ⇔ to	F = France	D= Germany	BNL:Benelux	Iberia	AT-Lantic	Scan Baltic	ViseGrad	DunaAdria	ClubMed	Bal-Kan	TotalDepart
2001	Na	**50.1**	**41.1**	*34.9*	*33.0*	*9.2*	**6.4**	6.5	*32.3*	*4.1*	*218*
Fr05	tio	**54.3**	**44.2**	*36.6*	*31.3*	*7.3*	**8.2**	8.0	*33.0*	*7.7*	*232*
2009	nal	**56.0**	**45.0**	*30.8*	*25.1*	*9.0*	**9.4**	6.7	*29.1*	*3.0*	*214*
2001	**68.6**	National	**75.7**	34.3	*48.8*	30.7	**31.1**	49.3	51.9	10.1	401
D 05	**75.4**		**96.0**	40.2	*59.7*	39.7	**52.7**	66.2	57.9	20.1	508
2009	**77.9**		**102.2**	37.3	*47.5*	38.0	**59.7**	63.4	56.0	8.8	491
2001	**61.0**	**95.3**	**60.9**	18.3	*45.2*	**16.2**	**6.1**	**8.6**	32.0	3..9	**348**
Bnl05	**71.1**	**122.4**	**80.6**	23.7	*52.0*	**21.5**	**15.2**	**11.4**	36.0	8.2	**442**
2009	**77.4**	**137.6**	**81.2**	23.0	*41.4*	**21.8**	**18.2**	**11.5**	35.0	3.1	**454**
2001	29.7	**20.0**	12.1	**16.9**	*14.1*	3.3	**2.9**	2.3	13.8	1.5	117
IB 05	31.6	**21.3**	12.6	**21.5**	*17.5*	4.3	**3.5**	3.0	16.1	3.9	135
2009	30.4	**22.7**	12.5	**23.2**	*12.4*	3.6	**4.4**	2.9	16.0	1.2	129
2001	*33.8*	*52.5*	42.3	17.1	*37.0*	*14.7*	**5.0**	*4.3*	*19.5*	*3.0*	*229*
AT05	*29.6*	*46.4*	54.9	18.7	*34.8*	*12.4*	**5.3**	*4.7*	*19.0*	*5.3*	*231*
2009	*25.2*	*38.5*	50.4	15.3	*29.7*	*10.1*	**7.7**	*3.8*	*15.8*	*1.4*	*198*
2001	10.3	**24.8**	15.9	6.1	*18.8*	29.9	**5.2**	3.7	*8.8*	*1.4*	125
SB 05	11.1	**28.3**	19.1	7.2	*20.1*	43.1	**7.7**	4.6	*9.5*	*2.6*	154
2009	9.9	**29.1**	18.1	6.6	*15.0*	39.4	**8.4**	3.7	*8.4*	*1.0*	140
2001	**3.7**	**31.9**	**4.2**	**2.0**	**4.2**	**4.3**	**9.6**	**7.5**	**5.2**	1.3	**75**
VI05	**7.3**	**40.4**	**8.6**	**3.2**	**6.3**	**7.9**	**18.4**	**12.1**	**8.6**	4.2	**117**
2009	**12.9**	**57.4**	**14.1**	**5.4**	**11.2**	**11.1**	**26.4**	**14.8**	**13.3**	3.9	**170**
2001	**6.1**	**35.8**	**6.3**	**2.9**	5.0	2.9	**6.4**	*12.6*	11.3	2.7	**92**
DA05	**6.8**	**43.1**	**6.2**	**3.6**	6.5	4.7	**12.7**	*15.2*	13.9	6.9	**119**
2009	**7.8**	**47.9**	**6.6**	**4.2**	6.1	4.1	**16.1**	*10.4*	12.7	6.8	**123**
2001	*32.9*	37.1	**15.8**	*19.3*	18.5	6.5	**8.2**	12.5	**6.8**	*9.5*	167
CM05	*33.6*	36.5	**16.0**	*22.2*	20.1	8.0	**9.8**	15.3	**9.8**	*14.6*	186
2009	*32.8*	42.3	**16.2**	*18.1*	15.4	7.2	**12.0**	12.6	**10.2**	*7.6*	174
2001	*4.0*	*9.2*	*3.3*	*1.8*	*4.0*	*1.1*	1.1	2.1	*8.8*	*NA*	*35*
Bal05	*5.5*	*12.1*	*5.8*	*4.0*	*7.3*	*2.0*	2.1	5.1	*12.2*	*NA*	*56*
2009	*2.6*	*6.3*	*2.4*	*1.2*	*1.1.*	*1.0*	1.3	2.3	*6.2*	*1.8*	*26*
2001	**250**	**357**	**278**	154	*229*	119	**82**	109	190	38	1899
ARR.5	**272**	**405**	**344**	180	*256 209*	153	**136**	146	216	73	2181
2009	**277**	**438**	**349**	165		145	**164**	132	203	39	2119

Key: **bold = 2009 is highest ;** *italic = 2009 is lowest ;* standard = 2001<2009<2005

Table 2/b EU arrivals (imports) from Balkan countries in million Euro

EU region	2009 totals	2010	Id without Romania / Bulgaria	
France	2 822	3 530	186	195
Germany	7 835	9 616	1 185	1 658
Atlantic	1 216	1 925	124	160
Iberia	1 549	1 581	250	189
Nordic (Scan)	420	611	52	61
Visegrad Baltic	1 653	2 641	303	477
Baltic	87	118	6	10
Club Med	7 883	9 545	1 618	1 991
Danube Adria	*3 935*	*5 496*	*1 603*	*2 209*
Dan-Adria+HR	4 816	6 479	2 381	3 011
Totals	28 281	36 046	5 919	7 752

Table 2/c EU departures (exports) to Balkan countries in million Euro

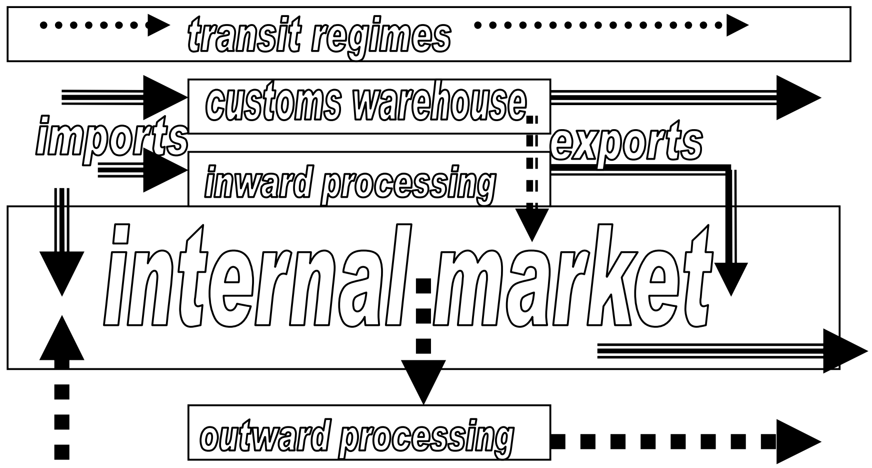
EU region	2009 totals	2010	Id without Romania / Bulgaria	
France	3 008	3 546	331	359
Germany	10 776	12 223	2 476	2 595
Atlantic(Uk+Ir)	1 533	1 936	239	475
Iberia (E + P)	1 453	1 761	200	204
Nordic (Scan)	1 053	1 002	168	175
Visegrad Baltic	4 928	6 014	712	738
Baltic(Lt,Lv,Lt)	85	135	12	17
Club Med	9 590	10 666	2 576	2 517
Danube Adria	*10 101*	*11 340*	*3 712*	*3 995*
Dan-Adria+HR	12 886	12 909	7 450	6 046
Totals	45 312	50 072	14 603	13 126

3. THE IP DEBATE ON LANDLOCKED COUNTRIES (Kishor Uprety, 2005)

There is a fierce discussion on the status of landlocked countries and their legitimate search for access to deep-sea trading routes. The literature stresses the need of servitudes, offered by so-called transit states, such as in the last Kampala declaration (1974), the New York convention (1965), the Teheran resolution (1964) and the initial Barcelona Statute (1921). The main point of discussion is pinched between territorial sovereignty and the need of free access and it is eventually bound to remain a conflict between moral versus juridical rights. Also the transit type differs for roads, navigable rivers and railways, as history proves. Most arrangements imply transit agreements, ancillary rights or port-storage facilities under (mostly) bi-lateral reciprocity agreements. The recent Balkan history has little added to the discussion.

The point is why the opposite could not be more effective with the pending accession of Croatia in 2013. At that moment BiH features a *Swiss kind* of transit regime. The point is that then, some ICD *(inland clearing depots)* could be active, awarding an IP (inward processing) status at a limited number of locations with a multimodal access (Danube, road, rail). IP trade still features a value added at about 5% of total EU trade (Schroeter, 2007).

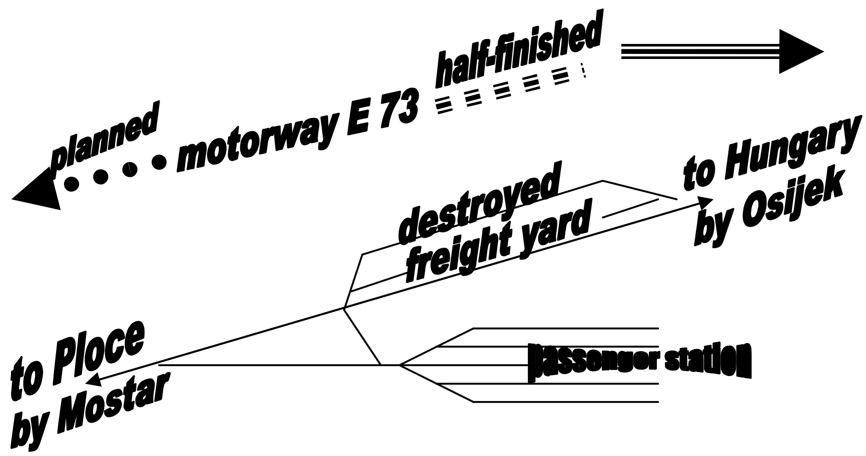
Figure 9 Simplified scheme of the EU trading regimes (IP & OP)



4. THE WAREHOUSE MODEL REVISITED FOR COMBINED TRANSPORTATION

The pending urgencies dictate a practical approach which follows two series of restrictions; On the one hand, the motorway is still restricted to a pre-war status at Sarajevo where the access to the city freight yard could be finished without excessive costs *(existing roadbed & tunnel)*. The E73 highway could link up to the Croatian border and Hungary, such that a self-supporting toll road may warrant a reasonable pay-back period. On the other hand, the circuitous road to the sea *(Ploce-Metkovic-Gabela)* requires more time and money. Therefore, combined-transport solutions (road-rail) ought to relieve the current traffic jams for some decades. In view of the combination with clearing customs warehouses the (maritime) containers or *swap-body* technology seems best solutions though others *(piggy-backing, roadrailer, etc.)* may be used in combination to the pure container traffic as well.

Figure 10 A simplified map of rail and road infrastructure in Sarajevo

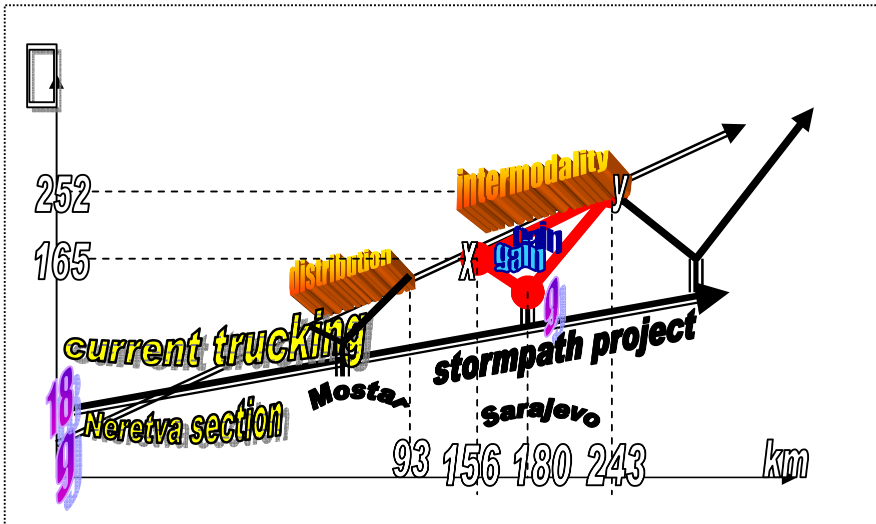


Say, that the crippled freight yard is remodeled into an ICD freight station in which maritime containers can be cleared for customs, or inbound trade and traffic under EU-IP status. The road to the sea at 180 km has a fixed costs of 9 € and trucking costs 1 €/km for a TEU with a net load of 20 tons. Volume train shipments cost twice another € 9 for loading and unloading. The higher total fixed cost of € 27 is off-set by a cheaper mileage *(½ €/km instead of 1 €)* but also requires additional local deliveries at € 2 per km. Thus, Figure 11 locates the break-even (x) at 156 km where a standard service cost (1€/km) equals a volume service at 0.5€/km and a local delivery at 2€/km with the next equation: $9 + x = 27 + 180 (.5) + 2 (180 - x)$, or $x = 156$ km.

The advantage of volume services against a higher cost of local deliveries lasts up to y=243 km by the formula: $9 + y = 18 + 180 (0.5) + 2 (y-180)$. In between the triangle suggest a track section of 87 km (243-156), of which the area visualizes the total € gain at the hypothesis of one ton per km.

The method can be repeated at other intermediate locations, such as Mostar at 80 km (port A) where the distribution area will be smaller up to 93 ($y = -27-40+160 = 93$ km). Between 93 and 156 km the stretch along the Neretva has no clear cost advantage. Nevertheless, this could be solved by other means of combined transport than customs cleared sealed containers. Then, the relation between fixed and variable costs may be different as well.

Figure 11 The standard warehousing model, as applied to IP transport



Source: Reworked from Claessens (1989) Port & Jetty location, o.c.

All this means that a proposed inter-modality from the Sarajevo rail yard may produce the next shift from road to rail for one train set of 20 wagons:

1. 40 (return trips of 20 wagons) x 180km x 300days = 2.16 million truck km;
2. -3 locomotives at € 2 million = 6 million;
3. -50 piggy backs at € 50 000 = 2.5 million (20 up, 20 down plus 10 reserve).

This € 8.5 million capital costs *(0.85 p.a.)* averages 39 eurocent per saved truck km, or up twice the German motorway toll *(Maut)*. With ten to twenty trips a day with a net 20 ton load per truck *(TEU)*, some 50 million tkm can switch from road to rail, which is still below current *Leonardo* benchmarks.

5. CONCLUSION: the silk roads, the spice route and the incense trail

Europe and Turkey renew ancient strategic projects which soon link the EU rail system and motorways to the Gulf. Now, the Bosporus is linked to the Rhine in only 80 hours, and the new rail tunnel in Istanbul re-opens the old aspirations of the *Bagdad Bahn*. Yet, the possibilities of the TEN-Balkan land-bridges remain below evident benchmarks and need caution, care and considerate statements which can be summarized in a SWOT table:

1. All Balkan railways are electrified at 25 Hz (50 Hz), a legacy of the old ***Ganz*** company, which eases the modernization of a crippled but unified network, that may be cheaper than Western inter-operability stories with four current

systems *(1.5 & 3 kV dc and 15 kV/16²/³ Hz & 25 kV 50 Hz)* and a variety of ECTS security systems;

2. Nevertheless; more than 90% are bumpy tracks and 85% single track:
3. Half the road network is in good shape; new *greenfield* investments tend to be cheaper in flatlands, than the congestion mark-ups in the West. Mountain passages, though, may still cause *missing link* issues, such that methods of combined transportation remain inevitable, in this case, upstream the Neretva valley up to Konjic and Sarajevo;
4. The geographical setting of the closeness to the Suez entry and the new *Panamax* saga mark a Mediterranean corridor inevitable. Only port co-operation schemes ought to optimize Dalmatian milkrounds.
5. The historical tradition of a CEEC mechanical engineering warrants technological solutions to specific local demands and problems;
6. In between a low salary advantage may attract defensive investments by switching to offensive investments if market potential grows;
7. for both the local economy and transit transport flows.

Table 3 summary of Balkan infrastructure project roadmaps

Crux	*Strengths*	*Weakness*	*Summary*
Opportunities in rail landbridges	One 25 kV/50Hz Silk roads	Rights-of-way = 85% single track	Effectivity is urgent
Treaths	Greenfield = new may be cheaper !	Late arrivals in Infrastructure	Back-logs, now 7% RL/46% RD
Summary	Fresh restart for conglomeration	Lack-of-capital = tight efficiency	**SEQUENCING in region setting**

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THE EUROPE 2020, KNOWLEDGE BASED ECONOMY AND CREATING INTEGRATION PROJECTS IN SLOVENIA

ABSTRACT

Slovenia is a member of European Union and it is important to understand what it means »knowledge based economy« within the framework of Lisbon Agenda which is to implement for sustainable growth, social inclusion and employment. There are namely important the economic points of view of the knowledge that are intellectual and social capital.
The paper stresses why especially it is to turn to the integration projects, creating EU projects and partnership. What is important in capitalism, it is ownership of intellectual capital and its results. That is why it is to prepare measures, to intervene and educate, in enterprise and in policy but also when intervene with EU funds and instruments. It is important that politics and management understand EU functioning, EU policies and instruments, to prepare right measures, to attain results and added value.

Key words: Europe 2020, EU instruments, policy, measure.

JEL classification: F15, I25

1. »KNOWLEDGE BASED ECONOMY« WITHIN THE FRAMEWORK OF LISBON AGENDA AND EUROPE 2020

Knowledge based economy, the slogan from Lisbon 2000 (Lisbon European Council Conclusions, 2000, 23-24 March) are not only words, because the truth is and data show that in XXI century most part of added value derives from intellectual capital. The truth is also the fact that intellectual capital is an economic cathegory and it should be treated as such. (But in most cases it is not. In most cases owners of enterprises and of businesses and projects exploit results of intellectual capital, but intellectual capital in their balance sheet is not treated as economic cathegory, i.e. as intangibles. It is a property and it gives a benefit.)

Lisbon 2000 meant a great millennium reform: it was planned to attain planned results mainly by capital that the knowledge. The knowledge can be an individual one, a social capital, an intellectual capital or an intellectual property. It is very important who is the

real owner of knowledge: the individual who possess knowledge whether the owner of an enterprise who employs the individual, as it is a capital resource and as such the knowledge (in whatever form it is functioning) produces to his owner an added value.
That is why it is also important branding, to sell products it own name and not to be a supplier in a chain. In XXI century, it is very hard to sell a product and not to produce it. To be competitive it is to be a leader of a business.

A large part of economic growth is due to new and better knowledge. EU investment in knowledge and learning requires concerted policy efforts focusing on three different, interrelated levels:

1. For individuals, the main issues are education-and-training-system reform to raise literacy levels and foster true lifelong learning;
2. For organizations, the challenges are to better exploit the productivity and efficiency gains of external networking and internal knowledge management;
3. For a Learning Europe the diversity of knowledge and learning traditions of citizens, organizations, regions and nations must be preserved, deepened, but also harnessed for the greater and shared prosperity of all Europeans. This must reflect in both specific learning-policy actions and a policy learning process itself;
4. To raise GDP is not just to invest in R&D – the products must be sold at a good price: this was a message of corrected Lisbon in 2005. But as it is hard to be competitive in the market in 2010 it was declared that Lisbon strategy was not good.

2. EUROPE 2020

Nowadays we have Europe 2020 strategy, with mainly same targets as they were in Lisbon Agenda.

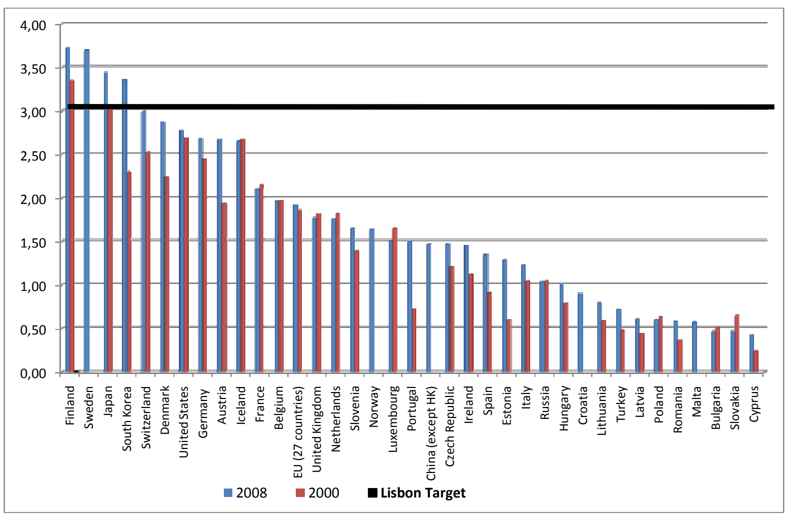
Europe 2020 is nowadays within EU countries following Lisbon priorities. So Lisbon priorities and Europe 2020 are basic instruments for all policies and their measures for national strategic plans as a framework to intervene in all of EU countries. National The EU 2020 program aims at smart, sustainable and inclusive growth, with the objective of investing 3% of the EU's GDP in R&D. This target is well founded (Europe has an average R&D investment level below those of other developed countries, including the US), but in the future, it should also cover a wider set of intangible capital assets.

Strategic report on the renewed Lisbon strategy for growth and jobs which is launching the new cycle (2008-2010) is keeping up the pace of change exposed. It is an essential part of the Union's response to globalisation – intellectual capital. Strategic report (page 3) stressed that »intellectual capital should be of help to Europeans to shape this new set of challenges and opportunities« (Strategic report, 2010, p. 3). But it is not. »Too many Europeans are still unemployed and unemployment is rising. …Europe is still fragmented when it comes to fostering innovation and research and development; the contribution from the private sector is still insufficient« (Strategic report, 2010, p.5). It

was not understood what it means to allow Europe to capitalise on its creative potential of knowledge. Reforms are mainly tackling labour market segmentation, but not the most important part – knowledge as an economic category in all its forms. »There should be *efforts to improve the intellectual and industrial property framework and to speed up standardisation as they have not borne fruit« (Strategic report, 2010, p.7).*
Member States have set targets committing themselves to significantly increasing R&D investments which would help the EU approach its 3% of GDP target by 2010, the evidence does not yet reflect this ambition, as it was said before, can not.

With globalisation, R&D is increasingly outsourced to other parts of the world. In Europe, costs of protecting and enforcing innovations remain too high and the things are not doing in the right way. Universities, research institutes, companies and researchers are working in several projects, with the creativity and inventiveness of its people.

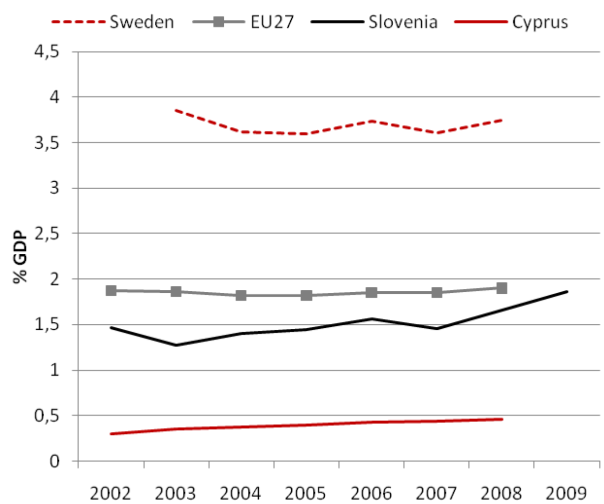
Graph 1: Gross domestic expenditure on R&D (GERD) in percentage of GDP



Source: http://epp.eurostat.ec.europa.eu/portal/page/portal/science_technology_innovation/data/database

The graph above shows the Nordic countries (Finland, Sweden and Denmark), Japan, South Korea, Switzerland plus United States had maximum average annual investment in 2008. World Academy of Science, Engineering and Technology means investment in knowledge in these countries is well programmed and there exit a parallel relationship between average annual growth and average annual investment.
Slovenia invests in R&D relatively high, nearly 2%, but results are still not obtained. Everybody says, there is a lot of intellectual capital, but there are no results, in GDP e.g.

Graph 2: Investments in research and development, in %GDP



Source: National Reform programme 2011-2012, Government of the Republic of Slovenia, p. 29

3. THE IMPORTANCE OF R&D AND INNOVATION FOR INTANGIBLES

In the 2002-2007 period the share of Slovenian expenditure on research and development in GDP stagnated (ranged between 1.3 % and 1.6 % GDP). During the last two years (2008 and 2009) the value of the indicator rose substantially and thus in 2009 reached 1,9 % GDP which is the level of the 2008 EU average. Partially, the increase in this share was a result of the GDP drop and partially the result of nominal expenditure growth. Besides the amount of investments made into research and development, it is also important to point out their efficiency – this is where Slovenia's past results were under the average (Development Report 2010), "especially due to insufficient transfer of knowledge from the research and development sphere to companies and insufficient harmonisation of measures aimed at boosting innovation capacities." (National Reform programme 2011-2012, Government of the Republic of Slovenia, p. 29)

The importance of R&D and innovation is explicitly recognised in the ''Lisbon process'' and in EU2020. A new Lisbon strategy should has a more comprehensive target than R&D intensity alone, encompassing several key inputs to the knowledge economy. At the same time, through fiscal policies and public private co-financing, it should be easier for researchers, engineers and entrepreneurs to find the cash needed to get their ideas to market. The EU is spending about €143bn in the 2007-2013 period to fund research and innovation projects. Focus is toward projects that tackle current challenges, such as health and an aging population, climate change, food security, and diminishing natural resources.

To have results from R&D and innovation there must be in business following the concept of marketing and branding.

Science and invention cannot be performed in isolation. Throughout the world, the dominant mode of research and innovation is through open collaboration – among small and large companies, university and industry, public and private sector, clusters and trading blocs. This requires an open environment for knowledge, talent and services to flow, and for critical mass to build where needed. Results must be obtained.

The knowledge became in globalisation the concept. Investment in people became a crucial growth factor in globalisation. That is why it is of crucial importance to be aware what is happening with this capital and by Lisbon, contribute to development of region and social cohesion (Lisbon European Council Conclusions, 2000, 23-24 March; follow up every year European Councils: Nice, December 7-9 in 2000, Goteborg, June 15-16 in 2001, Barcelone March 2002, Bruxelles March 2003).

By OECD investment in knowledge is defined and calculated as the sum of expenditure on R&D, on total higher education (public and private) and on software. Investment has a broader connotation of investment than its usual meaning in economic statistics. It includes current expenditures, such as on education and R&D, as well as capital outlays, such as purchases of software and construction of school buildings.

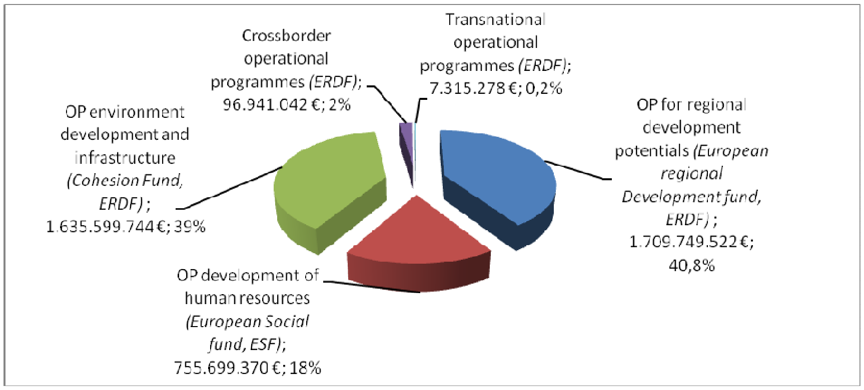
Investment in people is investment in knowledge and knowledge is in the context of added value first of all an economic category. That is why economic points of view of the knowledge are to be understood, to identified, to measure and to evaluate, in business and also within every project. The knowledge namely became in globalisation the concept, to do carefully with and in a systematic, a qualitative way.

4. EU COHESION POLICY

Cohesion policy should bring EU countries together and all to be even better. That is why it is in the financial perspective 2007-2012 a great investment in measures for cohesion policy. National Strategic Reference Framework within a country is a base for operational programmes (OP) to which numerous and various EU projects are applying to implement EU priorities and goals.

The EU Cohesion policy before 2010 was directed too much at improving the life condition of inhabitants and supporting their revenues. It did not sufficiently create long term impulses for economic growth. International experience indicates that the most efficient method of catching up to the most developed countries and regions is to initiate development based on innovation and modern technologies. Under the new cohesion policy programmes, more than € 85 billion will be in EU made available for investments in knowledge and innovation.

Picture 1 Cohesion policy and operational programmes within NSFR 2007- 2013, Republic of Slovenia



Source: Governmental Agency of Republic Slovenia for Local self-government and regional policy, 2008, www.eu-skladi.si.

Significant sum of euros is to be spent in this financial perspective 2007-2013. It is in European Union 347 billion euros that will be available for cohesion in the period 2007-2013. This will be complemented by national public and private co-financing of some 160 billion euros. Stakeholder involvement in projects is intense, they exchange experience, ideas and best practice.

Actions in the priority areas are:

1. Investing in people and modernising labour markets;
2. Unlocking the business potential, especially of SMEs;
3. Investing in knowledge and innovation.

There is not enough investing in people in Slovenia and even more attention should be paid to the measures for key priorities for action.

Like the business intelligence also a project intelligence mostly depends on intelligence of cognitive capability of management skills and management to work as a system. System management's due care is a knowledge management: management of knowledge or intangible capital in all of its forms (know how, technical assistance, intellectual capital, etc).

Project management is not only to take leadership, but to plan and programme, to organise and coordinate business functions within a project. Management has to take care about human resources and to have all business linked actions under control. Every project develops its choice of activities to implement and attain a project aim. It is to be understood why the intellectual capital is important content also in the context of EU projects.

5. MEASURES AND PROJECTS

The *European Area of Lifelong Learning* Communication namely identified six key priorities for action:

1. New basic skills for all;
2. More investment in human resources;
3. Innovation in teaching and learning;
4. Valuing learning;
5. Rethinking guidance and counselling;
6. Bringing learning closer to home.

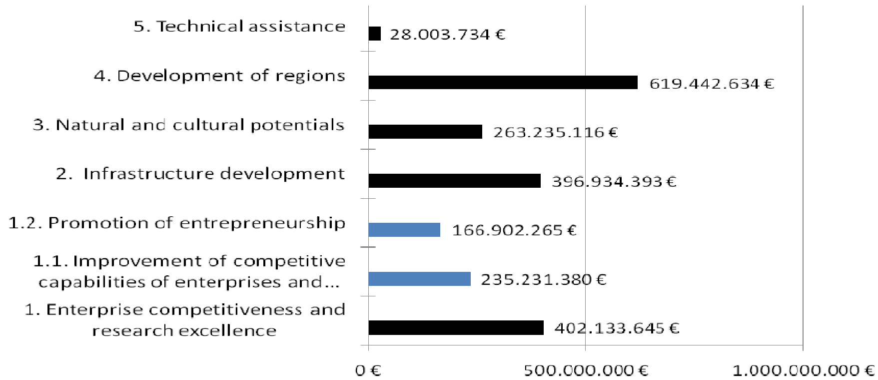
As we turned attention before, there is a lot of room for projects of knowledge in all forms.

However, the document Evaluation of the Integrated Guideline Package for Growth and Jobs (Draft Final Report, October 2007, Eureval and Rambøll Management and Ecofin Council conclusions (13.11.2007) did not expose important fact regarding the full benefits of intellectual capital that can be reaped, why there is not the empowerment of small businesses and improving EU competitiveness.

But there are other documents that do expose and turn their attention regarding knowledge: »EU projects need to protect its knowledge, as its openness allows lower cost inputs for industry, lower prices and investment. Particular attention will be paid to improving access to procurement markets and enforcement of intellectual property rights, fair competition, as well as to market access for SMEs« (Strategic report, p. 10)

In Slovenia concrete project are following these key national priorities named in the picture 2.

Picture 2 Operational programme for regional development potentials, OP RD, 2007-2013



Source: Governmental Agency of Republic Slovenia for Local self-government and regional policy, 2008, www.eu-skladi.si.

6. THE ECONOMIC POINTS OF VIEW OF THE KNOWLEDGE

It is widely recognised that intangibles are a major determinant of innovation, growth and employment in the knowledge economy. Business valuation of intangibles recognizes identifiable intangible assets such as patents, copyrights, trademarks, trade secrets, research and development, and computer software code, and unidentifiable intangible assets such as goodwill and human capital. It is proposed that the knowledge as an economic category appear more and more even in accountancy.
It is the concept of International Accountancy Standard, IAS 38. It is the economic point of view of intellectual properties.

The knowledge embodied as an intangible asset can be following International Accounting Standards, IAS 38, as follows:

1. The human capital embodied in the skills, knowledge and experience of the management and workforce;
2. Organisational (or infrastructure) capital in the form of organization-specific structures, procedures and business or operational routines;
3. Relational (or market) capital, the established set of relationships with suppliers, customers, partners and business associates;
4. Intellectual property, comprising assets like patents and trademarks, design titles, copyright and plant and seed breeders' rights, with a legal ownership embodied in the company.

Especially in the former socialist countries intangibles commodities such as training and staff development, innovation, marketing, management expertise are neglected. What was put in balance sheets, in most cases there is a value of software computer programmes. Project managers even do not think about economic value of intellectual resources, most do not know how to reveal the value of these resources and how to give direction to future value creation.

7. CONCLUSION

The EU's transition to an innovative, creative knowledge economy will be successful, when all EU countries will develop a system managerial access to intellectual capital. That means that managers have to identify intellectual capital as intangible property, to measure and to evaluate it. It is on management to solve problems of operating activities of intellectual capital. A system and its property are important, especially when it is universities and businesses co-operate, and students, academics, researchers and skill workers move around freely and cooperate easily with the worldwide community.

"Knowledge based economy", slogan from Lisbon 2000, are not only words, but also must - to turn words in the action. Human capital, intellectual capital, social capital, business intelligence and corporate strategy are these resources and key instruments that as knowledge in people should produce more added value. Because of factors such as globalization, increasing competition, the growing impact of information and communications technology, and the high scientific and technological change, firms must innovate more rapidly than ever before. So one of basic questions which appear nowadays, especially in a transition country, it seems to be: how to develop capability and skills to perceive and to activate various type of knowledge for development.

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ACCESSION OF SERBIA TO THE EUROPEAN UNION

ABSTRACT

The European Union is now preparing to expand through the accession of countries of former Yugoslavia. The process of Serbia's accession to the European Union began by signing of the Association Agreement. Serbia has to meet political, economic and legal criteria. The accession process itself is also based on the transposition of the EU secondary law acts in Serbia, i.e. on the approximation of law systems. Serbia will have to change the legal environment and remove legal barriers to create suitable conditions for proper functioning of the European Union's internal market. This paper analyzes Serbia's preparation process for EU membership with regards to the commitments contained in the Association Agreement and to the positive and negative aspects of the future membership. Serbia belongs to the countries of the European continent, and welcomes the fact that it fully becomes a part of the European Union in the near future.

Key words: European Union, accession process, association agreements, internal market.

JEL classification: F15

1. INTRODUCTION

The European Union (EU) is an international organization of regional type, as only European countries can become EU Member States. "The current form of European Union is the result of more than 50 years of development that occurred in various historical and socio-political conditions."[1]

The number of Member States has extended since the establishment of the European Coal and Steel Community from original 6 states to today's European Union with 27 Member States. Currently, several European countries are preparing for EU membership, including Serbia. "The accession possibility for Middle and Eastern European countries arose not earlier than on the European Council in Copenhagen in 1993. At that time, the European Council drew up a set of requirements that candidate countries have to meet. These conditions stress stability of institutions ensuring

[1] Nováčková D.: Organizácia a manažment Európskej únie, Eurounion, Bratislava 2008, s.77, ISBN 978-80-89374-03-8s.31

democracy, rule of law, human rights protection, respect for and protection of minorities, existence of functioning market economy, as well as ability to deal with competition pressure and market forces within the Union."[2]
States applying for EU membership are bound to fulfill first of all the membership criteria, which are:

1. Political;
2. Economic and
3. Legal.

When certain conditions are met, a candidate country submits its request for the European Union membership to the Council and when accession negotiations are completed, EU bodies and Member States express their opinion on the candidate country's membership. By ratification of The Treaty of Accession to the European Union and its entrance into force the candidate state becomes a Member State of the European Union.

Serbia and the European Union have already signed a Stabilization and Association Agreement whose main goal is that Serbia becomes a member of the European Union. "European Accession Agreements belong to important sources of the European law, because they establish a basic framework for coordination and cooperation of contracting"[3]. The agreement regulates the process of Serbia's preparation for EU membership and specific forms of cooperation. Legislative approximation and fulfilment of political criteria are considered to be an important field of cooperation. From the foreign-political point of view, Serbia is regarded as an unstable country. Therefore, the agreement is called "stabilization agreement", as it is supposed that the preparation process for EU accession is to be coordinated in such a way, that Serbia becomes a stable country.

There are several institutional and jurisdictional changes related to the process of Serbia's preparation for joining the European Union. The Serbian government sees joining the EU a priority and that's why it adjusts also the institutional mechanisms. Special workplaces have been constituted within the state administration bodies to deal with these questions. The Ministry of Foreign Affairs of Serbia has become a coordination institution in this process.

2. THE LEGAL FRAMEWORK OF EU MEMEBERSHIP

Any state at the European continent can become an EU Member State while it meets certain conditions. A state that applies for EU membership addresses a request for a membership to the Council. The Council resolves upon the request unanimously after consultations with Commission and having obtained an approval by the European Parliament, which decides by a majority of deputies voices (Article 49 of the Treaty on

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[2] Stachová, P.: Bulharsko a jeho vstup do EÚ. In: *Manažment podnikania a vecí veřejných*. Slovenská akadémia manažmentu. Roč. 2, č. 3 (2007), s. 71. ISSN 1337-0510.
[3] Nováčková D.: Základy európskeho práva a vnútorný trh Európskej únie, Eurounion, Bratislava 2004, s.292 ISBN 80-88984-58-0, s.61

the Functioning of the European Union - TFEU). Once the membership of a given state has been approved by the European Parliament, the concerned parties sign a so called Treaty of Accession to the EU, which establishes rights and obligations of a new Member State. In this respect it is necessary to underline, that any “European stat” can become a Member State.

2.1. Criteria for the EU memership

The European Commission is a part of the institutional system of the European Union and it is responsible for the enlargement process. It submits regular Reports on progress achieved by the Western Balkan countries to the Council and to the European Parliament. It also suggests recommendations to states that are preparing for admission to the European Union in order to improve the accession strategy. The Commission has developed also strategic documents, standpoint to requests for membership by Montenegro and Albania and by potential candidate countries including Serbia. Serbia was added to those countries that need to fulfil, apart from the standard criteria, the criterion of international cooperation with the Hague Tribunal (ICTY).

Conditions for the European Union membership are as follows:

1. **Political -** stable institutions guaranteeing democracy, rule of law, human rights and respect for the rights concerning national minorities protection;
2. **Economic -** market economy and the ability to withstand competitive pressures and market forces that act within the Union;
3. **Legal –** the ability to accept obligations arising from the acquis communautaire and from the EU membership.

2.1.1. Political criteria

From the European Commission’s viewpoint, Serbia has attained progress in the achievement of political criteria. The European Commission recommends Serbia to implement public administration and to take measures to fight organized crime and corruption. Consequently, it suggested that Serbia continues to actively cooperate with the International Criminal Tribunal for the former Yugoslavia (ICTY). On September 9, 2010, the UN General Assembly accepted a resolution proposed by Serbia and by the EU in response to the International Court of Justice in Kosovo. The main objective of the solution is to open opportunities for dialogue between Pristine and Belgrade and to support the development of cooperation; to make a progress towards the European Union and to improve the lives of citizens. The political criteria have not only a national, but also an international dimension.

2.1.2. Economic criteria

The economic criteria are related to the economy of Serbia, whereby market liberalization and economic competition are regarded as important factors. Serbia needs to make considerable efforts to restructure its economy, so that in the medium-term horizon it can deal with competitive pressures and market forces within the European Union. The implementation process of the liberalization measures itself implies an openness of economy and a renewal of macroeconomic stability. Due to the fact that Serbia was impacted by war and its economic situation is not the best, the reconstruction and restructuralization of the economy progress slowly. Based on the given facts, the process of achievement of economic criteria lags behind the accession process strategy and the scope of structural changes is not as expected. Apart from other facts, workers‘status on the labor market is worsening.

Putting into effects any new reforms is connected also with privatization of state enterprises. Many sales of state enterprises that were prepared, did not occur finally and, what‘s more, privatization of state enterprises is still lagging behind. The legal environment for healthy entrepreneurship does not reach European standards and that’s why legal regulations concerning business, especially commercial code, tax laws and accounting law, will have to be modified and will have to reach a high degree of compatibility with relevant EU legislation. Healthy competition is at the core of market economy and therefore, Serbia will also need to adapt the national competition framework to EU requirements. The economic criterion applies also to various sectoral policies.

2.1.3. Approximation of law

Legal approximation is a process of elimination of differences in legislation aimed at the achievement of a complete accordance of a legislative proposal with relevant EU legislation. Compatible Serbian regulations should form such a legal environment that would enable appropriate functioning of the internal market. The internal market is an economic instrument of the European Integration that connects Member States’ national economies and so it turns also into a political tool of the unification of the European continent.[4]

The process of legal approximation will be implemented by the central bodies of the state administration that dispose of a legislative authority. The approximation of law affects a broad spectrum of economic and social policies.
Serbia aims at progress in adjustment of its legal regulations to the European norms. Serbia also continues implementing measures of the temporary agreement and it strives for progress in meeting the requirements of the Stabilization and Association Agreement (SAA) in many areas including agriculture, science and research and statistics. An important advancement has been made in combating organized crime. A strong performance in detection and investigation of organized criminal groups has attracted the public attention.

Fundamental changes are going to be introduced to the Serbian judicial system. Serbia has to guarantee independence of the judicial power and transparency in the way judges are selected for these posts. The reform process is about to affect not only judges, but also other parts of the judicial system, public prosecution and prison service.

[4] Nováčková, D.: Ekonomické slobody vnútorného trhu EÚ, Eurounion, 2010, s. 152, ISBN 978-80-89374-090-0, s. 9

3. GENERAL CHARACTERISTICS OF THE STABILIZATION AND ASSOCIATION AGREEMENT

The Stabilization and Association Agreement between Serbia and the European Union is an international agreement creating a framework for cooperation with the provision for future EU membership. On the basis of the agreement the two parties hold political dialogue about the preparation of Serbia to accession to the European Union. From the point of view of international law, the agreement is a political document.

Major objectives of the Stabilization and Association Agreement are:

1. Support Serbia in strengthening democracy and the rule of law;
2. Contribute to the political, economic, and institutional stability of Serbia, as well as to the stability of the region;
3. Provide a framework for political dialogue that enables development of tight political ties between the two parties;
4. Support Serbia in developing economy and international partnerships via harmonization of legislative acts,
5. Support Serbia's transformation to a functional market economy;
6. Support harmonic economic relations and gradually create free trade zones;
7. Support regional cooperation in all areas contained in this agreement.

Objectives of the EU that need to be achieved and that require countries' full engagement in the enlargement process include a construction of trans-European transport corridors, energy diversification, a moderation of climate change and a reduction of cross-border air and water pollution. The states involved in this enlargement process can benefit from advancements in accession negotiations and thus from grants and instruments within the Pre-Accession Assistance (IPA) and loans from the European Investment Bank or other international financial institutions. Serbia will have to change the national regulations regarding banking, customs, power industry, transportation, accounting, investments, insurance system, commercial law, state aid, competition, free movement of goods, industry products, agriculture and fishery, judicial system, freedom and security, restitution, election law, fake asylum applicants, corruption, organized crime and regulatory bodies.

During this process of enlargement, Serbia can ask the European Commission for technical assistance.

4. BODIES THAT FORM THE STABILIZATION AND ACCESSION COUNCIL

The Stabilization and Accession Council was established as a result of the Association Agreement. This Council consists on one hand side of members of the Council of the European Union and the European Commission members and, on the other hand side, of members of the Serbian government. The Stabilization and Accession Council will meet on the respective level on a regular basis and when the circumstances so dictate. It will also deal with all respective questions resulting from this agreement and all other bilateral or international questions of common interest. Another body that disposes of a competence in the European Integration is the Council for European Integration of the Republic of Serbia, which was established on September 4, 2002 as an advisory body.

Assignments for the Council for European Integration are defined as follows:

1. Monitor the implementation of Serbia's strategy for EU accession;
2. Suggest recommendations for Serbia's improvement so that conditions for the country's accession to the EU can be met;
3. Propose measures for establishment of a general national consensus about Serbia's accession to the EU;
4. Accomplish other professional and advisory activities that enforce the effectiveness of governmental and state bodies in the accession process.

In institution of the new coordinatory structure of Serbian institutions, experience from EU negotiations and proven practices were taken into account.

It prescribes institution of these bodies or a redefinition of some of the bodies that already exist to achieve the desired degree of coordination and process control. The Coordination body for EU accession process investigates all questions concerning European Integration.

The work of the Council is directed by the Prime Minister, who is an ex offo chairman of the Council. The function of vice-chairman of the Council is held by the Deputy Prime Minister who, in case of disability of the Council's chairman to conduct the Council's work, serves as its chairman.

The work of the Coordination body was first directed by Dr. Mirko Cvetković, Serbian Prime Minister, who can be substituted by Mr. Božidar Đelić, Deputy Prime Minister for European Integration or by another member of the body, if the chairman finds out that a specific question requires it. The work of the Coordination body is also represented by Milica Delević, Director of the EU Integration Office.

5. CONCLUSION

Serbia has set out on a difficult journey during which it has to implement political, economic, legislative, social and cultural changes. The current Serbian government considers the EU membership a priority and all activities of its ministries are focused on fulfilment of the strict accession criteria. The Serbia's preparation process is coordinated with other EU member countries that are regionally close. After successfully joining the European Union, the Serbian people will start to belong into the large European family, in which decisions are made close to the citizens, and in which emphasis is put on economic and social cohesion. The membership in the EU "means for the citizens of the member country especially having the possibility to use advantages of the EU's internal market, in particular the second economic freedom – free movement of persons/workers… But we need to have in mind, that „modern" migration of workers does not demand only readiness and flexibility of workers themselves, but particularly specially prepared systems of social welfare, forms of education and responsible employers in individual old and new member countries.“[5] The process of accession of Serbia to the European Union has its international importance and serves to improve the international position of Serbia.

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ECONOMIC CHALLENGES OF THE EUROPEAN UNION WITH SPECIAL EMPHASIS ON THE EUROPEAN MONETARY UNION AND THE EURO ZONE

ABSTRACT

Globalization process has marked the end of the XX century. This process has expanded international market, increased mobility of capital and instability of the currency exchange. In order to overcome these problems, countries of the EU had decided to form European Monetary Union with the single currency – EURO. Today, the level of monetary integration makes this a real economic entity. There was couple of phases that the members had to overcome in order to achieve the highest degree of regional economic integration, whereas economic policy of members is unified and monetary policy functions according to the European Central Bank.

This paper analyzes challenges that European Union faced during the creation of Economic and Monetary Union and current situation in respect to the current crisis.

Key words: EU, EMU, OCA

JEL classification: E5, E6

1. HISTORY OF THE EUROPEAN MONETARY UNION

Globalization process has marked the end of the XX century. This process has expanded international market, increased mobility of capital and instability of the currency exchange. In order to overcome these problems, countries of the EU had decided to form European Monetary Union with the single currency – EURO. Today, the level of monetary integration makes this a real economic entity. There was couple of phases that the members had to overcome in order to achieve the highest degree of regional economic integration, whereas economic policy of members is unified and monetary policy functions according to the European Central Bank. The development of the monetary union has started in 1994, when the European Monetary Institute was established to serve as predecessor to ECB. European monetary institute was established to follow and monitor convergence criteria that were set as requirements for entering monetary union.

Convergence criteria included following:

1. Annual government deficit should not exceed 3 % of GDP;
2. Public debt should not exceed 60 % of GDP;
3. Member country was required to have stable currency exchange and member country should not have depreciated its currency in past two years, and
4. Long-term interest rate could not have been higher for more than 2 % in comparison with un-weighted average of interest rates in three member countries with the lowest inflation rate.

Monetary union as we know if started to function in 1999 with Frankfurt as the headquarters for the European Central Bank (ECB). There were many motives for establishing EMU but the most obvious one included substantial economic benefits.

Other reasons were as follows:

1. Unified currency decreases the transactional costs which in turn stimulates economic integration;
2. Eliminating risks of exchange currency fluctuations creates monetary and price stability;
3. Increased transparency of pricing enabled by the use of unified currency increases competitiveness, and
4. If Euro is to become globally accepted currency all of the members of the EMU will benefit.

In theory, European Central Bank was created based on the German model. Having said so, it is useful to point out that in the second half of the 20th century; two models of central banking were developed. Those are: Anglo-Saxon and German model. These two models differ in respect to the monetary policy objectives and central bank design.

Anglo-Saxon model of central bank has few objectives: 1) price stability; 2) maintaining high levels of employment, and 3) financial stability.

As far as the German model is concerned, its primary objective is price stability.

1.1. European Central Bank

ECB is the main monetary authority of European Monetary Union as well as the Euro Zone, which, as of January 1, 2011, comprises of 17 members. Its main task is to maintain the euro's purchasing power and thus price stability in the euro area (euro zone). Starting with January 1, 1999, ECB has been responsible for designing and implementing monetary policy for the euro area. Euro area is described as the second largest economy in the world, of course, after the United States. Basically, euro area became operational when member countries transferred their monetary policy from their central banks to the European Central Bank, meaning that they had surrendered the autonomy of their monetary policy and had given up their monetary policy exclusive instruments.

„The legal basis for the single monetary policy is the Treaty establishing the European Community and the Statute of the European System of Central Banks (comprising of ECB and all the national central banks of EU members that are yet to join the euro area) and of the European Central Bank." (European Central Bank, www.ecb.int).

Both, the ECB and ESCB, were established on June 1, 1998, whereas ECB was established as the base for the Euro system and ESCB. The central bank has the sole responsibility of issuing banknotes and bank reserves. It also sets the discount rate at which banks can borrow from the central bank. This is in affect going to influence trade among the banks in the money market. Any change in the money market interest rate (discount rate) will trigger a number of different mechanisms that are going to influence the flow of the economy. Mainly, it is going to affect variables such as output or prices. This is highly complex process and it is known as the monetary policy transmission mechanism.

In the long run a change in the quantity of money in the economy will be reflected by the change in the general level of prices but no permanent change in real output or unemployment will be induced. This implies to the principle „the long-run neutrality of money". Also, central bank deals with the inflation phenomenon. Longer periods of high level of inflation are associated with high monetary growth.

When analyzing ECB, it is important to list and briefly explain monetary instruments this bank and the Euro system has at its disposal.

Those instruments include:

1. Open market operations;
2. Standing facilities, and
3. Minimum reserve requirements for banks and credit institutions.

Open market operations have a very important role in dealing with interest rates, managing liquidity in the market and signaling monetary policy standings. Euro system has five types of instruments at its disposal, and those include: 1) reverse transactions (repurchase agreements or collateralized loans), 2) outright transactions, 3) issuance of debt certificates, 4) foreign exchange swaps and 5) collection of fixed-term deposits.

Standing facilities task is to provide and absorb overnight liquidity, signal the general monetary policy standings and bound overnight market interest rates.

Minimum level of reserves is major part of the monetary policy framework regarding the euro area. The task is to ensure stable money market interest rates, create structural liquidity shortage and possibly aid in control of monetary expansion.

2. WHY EUROPEAN MONETARY UNION (EMU)?

This question will be best answered after we examine advantages and disadvantages of the EMU.

2.1. Advantages and disadvantages

There are many advantages and disadvantages and some of the most important ones will be listed and briefly explained here.

2.1.1. Advantages

1. Transactions costs will be eliminated (buying and selling currencies to do business in the EU used to add to the cost of doing business but with the existence of the EMU, all of that has been eliminated);
2. Price transparency (prior to the establishment of the EMU, it was pretty difficult to compare prices of goods and services across the EU because of the effect of exchange rate differences);
3. Exchange rate fluctuations uncertainty will be eliminated (flow of the investments has been decreased because of the uncertainty of the exchange rate fluctuations);
4. Single market with single currency is logical solution (trade and everything else operates more efficiently with the use of single currency – EURO);
5. Yen, US dollar and EURO (EURO has become one of the most powerful and stable currencies in the world covering one of the biggest markets);
6. Step toward even closer economic integration (EMU has created one of the closest regional economic blocks and presents very successful economic integration);
7. Increased trade (the volume of trade had increased due to elimination of problems caused by fluctuating exchange rates; proponents also argue that this elimination of exchange rate fluctuations had also lowered costs to the industry);
8. The Political Agenda (it is political issue that the autonomy of monetary policy of members had been transferred onto a European Central Bank; basically all the national control over monetary policy had been removed);
9. Inflation control (it is argued that surrendering autonomy of their monetary policies to ECB had enabled members not to worry about the inflation rates, meaning that the ECB, under the influence of Germany, would keep fairly low and stable rates of inflation).

2.1.2. Disadvantages

1. System instability (there is a fear of potential system instability due to set/controlled inflation rates that may work in favor of some members but not in favor of others);
2. Trade benefits may be overestimated (opponents argue that not much was gained by establishing the EMU, meaning that the trade and cost benefits have been overestimated);
3. Loss of Monetary Policy Sovereignty (opponents also feel that giving up its monetary policy autonomy is too costly because members have to rely on the decision-making based at the ECB headquarters);

4. Increased tendency of deflationary pressures (problem with one member having higher inflation rates than other members and trying to deflate the economy that is not going to work in favor of other members).

When analyzing all of this, we conclude that there are more advantages than disadvantages but it is up to countries to decide if they are willing to give up their monetary policy autonomy and if the benefits of joining EMU outweigh the costs.

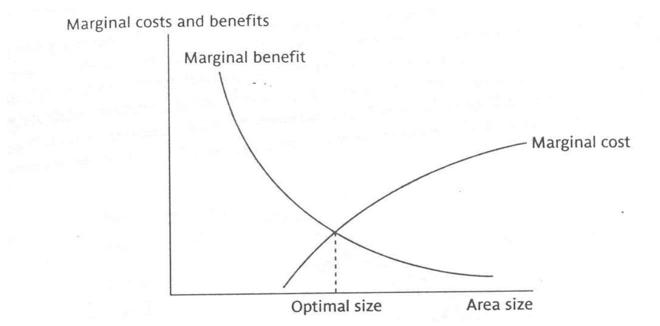
2.2. Optimum Currency Areas

In this chapter we will attempt to answer the concern whether it makes sense for group of countries to give up their monetary policy autonomy and to abandon their national currencies. Even though, most of us do not spend too much time thinking about this issue, but national currency is country's trademark such as the national anthem or the flag.

2.2.1. Is a large currency area desirable?

Using the same currency makes commercial and financial transactions much simpler. It can be argued that when more people accept the currency, the more useful that currency becomes. It would be great to have one currency that is recognized and accepted everywhere. Currency exchanges are costly as well as risky due to fluctuating exchange rates. These facts clearly point out that small currency zones or areas are definitely not optimum. As the size of the currency area grows, its marginal benefit is positive. However, the principle of diminishing returns also applies here, because as we expand already large area by adding one more country, extra benefit is smaller than when the initial area was small.

Figure 1: Represents the logic of the optimum currency area theory[1]



We ask ourselves, if the marginal benefit was always positive, would the world be the optimal currency area? The answer is YES, but only if there were no costs of any kind. The larger the area is, the more diversity it has. When sharing common currency, the

[1] Baldwin, R. & Wyplosz, C. (2009), The Economics of European Integration, 3rd edition, McGraw-Hill Higher Education, p. 317

more diversity means more costs. The marginal costs are positive and the same increase as the size of area increases. On the Figure 1, this is shown by the upward-sloping marginal cost schedule. This figure shows the existence of trade-offs, meaning that the large area is desirable but it has its downfalls as well. The OCA represents the situation where the marginal costs and benefits from having the same currency balance each other. Diversity also adds to the costs because having the same currency requires a single central bank, in this case European Central Bank, and this single monetary authority cannot react to each local deficiency.

One of the basic ideas states that diversity translates into asymmetric shocks and that the exchange rate can be used in order to deal with these shocks.

2.2.1.1. Adverse shocks

Imagine a situation where the demand for one country's exports declines because of a cheaper alternative from somewhere else. As a result, there is going to be a deficiency in the balance of trade. IN order to fix this de-balance, country will have taken steps to make its exports cheaper. This would be an attempt to restore competitiveness. The simplest measure in this particular case would be to depreciate the currency. Of course, this can only take place if the country has its own currency and it is not a part of the rigid fixed exchange regime of some kind. But if the country is a member of larger currency area, this is not an alternative. An obvious choice would be lowering prices but this will cause many negative effects for the economy, such as slowdown of the same.

2.2.1.2. Asymmetric shocks

The diversity means that different countries face different shocks. Let’s assume that we are dealing with the monetary union of only two members. If both of them are exposed to the same adverse shock, they both have to undergo a real depreciation in order to restore balance, competitiveness. In this particular instance, the loss of the exchange rate due to entrance of the currency union causes no consequences, meaning that as long as all members are exposed to symmetric shocks, the response from the single monetary authority will favor every member. But in the presence of asymmetric shocks, the membership in the monetary union becomes a serious problem. This is basic and unavoidable cost of forming a monetary union. The reasoning behind this is as follows:

1. With sticky prices, the nominal exchange rate is the way to restore country's competitiveness, and
2. If an asymmetric shock occurs, the common exchange rate cannot assist all member countries.

2.2.1.3. Symmetric shocks causing asymmetric effects

For numerous reasons, different countries react differently to the same shock. Those reasons are mainly related to different socio-economic establishment. When a common central bank undertakes measures against a symmetric shock, the effect of those actions will not be the same for every member of the currency union. Differences in the structure of financial markets or even in the size of the firms may result in asymmetric effects.

2.2.1.4. Criteria for the Optimum Currency Area

There is no simple answer in regards to the formation of the monetary union. There are many factors that need to be taken into consideration when trying to make the decision of joining the monetary union.

The optimum currency area theory considers benefits as given and according to those proposes criteria which are to be used when judging the costs of sharing the same currency (Baldwin & Wyplosz, 2009).

When deciding on the OCA, we have to consider three classic economic and additional three political criteria. First economic criteria attempts for find the way to minimize the costs of an asymmetric shock within a currency area. Other two economic criteria aid at identifying economic areas that are likely to be hit by asymmetric shocks infrequently or moderately enough not to be a big concern. Three political criteria deal with political aspects such as, whether some countries would aid other countries when faced with asymmetric shocks.

1. Acording to Mundell criterion – OCAs are those within which people move easily.

This first criterion was proposed by Robert Mundell and the idea was that the cost of sharing the same currency would be eliminated if all the factors of production such as capital and labor were completely mobile across borders. The process of globalization has worked for the benefit of full capital mobility, so the concern at stake here is the lack of labor mobility.

2. According to Kenen criterion – countries whose production and exports are widely diversified and of similar structure form an optimum currency area.

If major asymmetric shocks do not occur often, the overall, everyday benefits will by out-large exceed the overall costs. According to Kenen, most of the shocks are associated with spending patterns, so the country's most likely to be affected by major shocks are those that specialize in the production of only limited range of goods.

3. According to McKinnon criterion – countries open to trade and trading heavily with each other form an optimum currency area.

This criterion recognizes that even when the economy is very small and highly open to trade, it has very limited ability to change the prices of its goods on the international markets. If this is the case, than giving up the exchange rate by leaving its national currency and adopting the common currency does not entail much of a loss.
The above were economic criteria for the optimum currency area, but as we have stated, there are three criteria that are more politically oriented.

Those are as follows:

1. Transfer criterion – countries that agree to compensate each other for adverse shocks form an optimum currency area;
2. Homogeneity of preferences criterion – monetary union members must share a wide consensus on the way to deal with shocks, and
3. Solidarity criterion – common monetary policy will sometimes give incentive for conflicts of national interests among the members, but the monetary union members must rise above those and accept the costs in the name of a common destiny of „higher good“.

3. FINANCIAL CRISIS AND ECONOMIC DOWNTURNS IN THE EURO AREA (EURO ZONE)

Financial crisis of 2008 was the most severe one since the „Great Depression "and it has greatly affected the EU, but mainly Euro Area (Euro Zone).

3.1. Problems of selected Euro zone – 17 Members

We will briefly outline major problems and the data concerning couple of Euro Zone members with big debt issues.

3.1.1. Greece – current debt crisis (brief overview)

Greece is still in the hardest position, basically on the verge of declaring bankruptcy. Austerity measures are not resulting with the desired results, nor are requirements prescribed in the stabilization package from the EU and the IMF fulfilled by Greece. The data regarding the debt-to-GDP ratio is as follows:

1. Debt-to-GDP Ratio: 144% (est. 2010); forecast to rise to over 160% by end of 2012;
2. Deficit-to-GDP Ratio: 10.5% (est. 2010) (www.imf.org, 2011).

This debt crisis is a result of massive spending and consumption, coupled with increased wages and government benefits, in the years following its adoption of the euro. Moreover, at the end of 2009, it was revealed that Greece had manipulated its balance sheets prior to the crisis to hide its debt. This triggers another concern of necessity of establishing supranational institution or revising an existing one in order to ensure that no member-country will ever attempt manipulating its balance sheets. Basically, new or the existing institution of supranational character should be equipped with legal framework to ensure that all members of the Euro Zone – 17 comply with all the regulations. Greece has had its share of problems even before entering the EMU.
"The roots of Greece's fiscal calamity lie in prolonged deficit spending, economic mismanagement, government misreporting, and tax evasion."(The European Sovereign Debt Crisis: Responses to the Financial Crisis, 2011)

Just a quick reminder, in May 2010, the European Commission (EC), European Central Bank (ECB), and IMF held an emergency meeting to address Greece's burgeoning debt crisis, which resulted in the creation of a €750 billion temporary bailout fund called the European Financial Stability Facility(EFSF). Following its establishment, the EFSF provided Greece with a €110 billion loan in exchange the agreed structural program including the assurances that the country would implement rigid austerity measures to bring it deficit below 3 % of GDP by 2014. To that end, the agreement called for €28 billion in spending cuts and tax hikes. (www.imf.org)

By early 2011, after it was clear that Greece was struggling to implement the austerity measures including budget cuts and privatization plans mandated by the EU and IMF, and could be headed towards a debt restructuring or default. By the spring, it became evident that Greece had not reduced its deficit enough to be able to borrow on the capital markets by the end of 2011--as it was specified in the May 2010 bailout. It was obvious that second EU-IMF bailout was necessary to allow Greece to meet its debt obligations through 2014.

3.1.2. Italy – current debt crisis (brief overview)

The debt problems of two other big EU and Euro Zone nations are getting worse. Italy and Spain are also bothersome to EU decision-makers and investors as well. Both countries have huge debts and it is more and more likely that both countries will not be able to make all the payments. Both countries have passed legislation that calls for rigid austerity measures but both are faced with strikes and demonstration over the same. The main issue with these two countries is that both are considered too big for bailout packages and not many other European and Euro Zone members are financial big enough to assist Spain and Italy.
Italy continues with its budget deficit problems and high public debt of 4.6 % and 119 % of GDP for 2010, respectively. Italy, just like every other member of EMU is obliged to keep its budget deficit under 3 % but as many other members of the EMU, Italy has also failed to accomplish the same. The Italian government has had difficulties bringing the deficit down to a level that would allow a rapid decrease of the debt. Due to economic downturn caused by the financial crisis of 2008, Italian deficit grew to 5.4 % in 2009, and 4.5 % in 2010, respectively. The desired objective of austerity measures is to bring deficit down to 3.9 % in 2011 and below the ceiling of 3 % in 2012 (OECD, www.oecd.org).

Economic growth averaged only 0.8 % in the period 2001 – 2008. As the Euro Zone and the world economies slowed down due to financial and later economic crisis, GDP decreased to 1.3 % in 2008 and 5.2 % in 2009. In 2010, GDP recovered only for about 1.3 %, and in 2011, GDP of Italy is expected to grow at lower pace than the average for EMU countries. Italy's GDP rose 0.1 % in the first quarter of 2011, and 0.3 % in the second quarter. GDP is still about 5 % below its pre-recession climax, this is not promising. (International Monetary Fund, www.imf.org) This is the slowest growth rate recorded after the first quarter of 2010. If this trend keeps on and if rigid austerity measures do not come up with the targeted results, Italian government will have no choice but to consider debt restructuring.

3.1.3. Portugal – current debt crisis (brief overview)

The Portuguese economy experienced boosts when they joined the European Union in 1986 and the European Monetary Union (EMU) in 1999. However, lately it has suffered from sluggish to negative growth, a ballooning budget deficit, and low productivity and competitiveness, which, exacerbated by the onset of the Euro Zone debt crisis. All of this resulted in record-high debt, downgrades in credit ratings, and build-up pressure to seek an EU or IMF assistance for bailout. In May, 2011, Portugal's government reached an agreement with the European Commission, European Central Bank, and IMF on a €78 billion, 3-year bailout package that will require Portugal to implement comprehensive measures and reforms such as privatization of state-owned enterprises and reform of its labor market as well as the justice sector.

On May 5, 2011, the government had signed a memorandum of understanding on conditionality for the structural/bailout package. Portugal's government was able to keep the deficit level under 3 % which is in accordance with the Euro Zone's criteria but in 2005 Portugal's budget deficit increased to a high of 5.9%. In the years to follow, 2006 – 2008, government was able to somewhat keep the deficit under control – 2006 – 4.1 %, and in 2007 – 3.1 %. But, in 2010, budget deficit "exploded" to 10.1 % of GDP and their public debt leveled at 93 % of GDP in 2011. (www.imf.org)

3.2. Debt crisis in the Euro zone

In the previous section we have provided a brief overview of the problems related to debt crisis in some countries belonging to the monetary union – Euro Zone – 17. On a side from those countries, some other members such as Ireland and Spain are not in too favorable positions. We have witnessed that the EU, ECB, and the IMF have been undertaking different measures providing bailout packages to members in need but we cannot escape the concern of the future of Euro Zone – 17. Even proponents of the EMU admit that this debt crisis is the biggest challenge for the Euro Zone but for the EU in general. An example of "PIGS" countries (Portugal, Ireland, Greece, and Spain) provides us with incentive that there is a possibility of not being able to bailout all the members that are facing severe economic troubles. Greece has received €110 billion bailout from the EU and the IMF. Ireland has seen €67.5 billion loan in November, yet both countries have seen very little, if any, progress towards the recovery. All of the austerity measures in these countries have led to greater problems including business failures and increased unemployment rates. Prescribed austerity measures must be undertaken in order to slow down debt increase but obviously, as far as Greece and Ireland are concerned, the same measures are not providing the desired outcome. Decision-makers fear that the crisis from Portugal, Ireland and Greece do not get carried over to Spain because the Spain is much stronger and bigger economy so any possible type of attempted bailout may not be as successful.

4. RESPONSE OF THE EUROPEAN CENTRAL BANK TO THE TURMOIL OF FINANCIAL CRISIS

Without going into the great detail, it is important to outline and briefly explain certain monetary approaches and activities the ECB has undertaken in order to prevent the collapse of the economic system. Of course, we will consider views of those supporting the idea of monetary union and a single monetary authority and in the section to follow we will explore opposing views in regards to the currency union.

The financial market pressure that started in late August of 2007 and developed in the financial crisis in 2008 requested well planned actions of decision-makers. Monetary authorities have faced great challenges that required great policy formulation. As far as the ECB is concerned, it has demonstrated its capacity to react flexibly and decisively to the financial crisis and its developments. During the initial phase, this single monetary authority acted quickly to provide needed liquidity to the banking sector. Also, the ECB has lowered its interest rate to the lowest levels since its establishments as well as implemented wide set of non-standard measures after the danger of the fully developed crisis was imminent, in 2008. All of the undertaken measures were aimed at achieving its main objective, maintaining price stability. Some of those non-standard measures were intended to provide assistance to the bank's transmission mechanism of monetary policy in regards with dysfunctional markets. It is the proponents' view that the ECB's response assisted in sustainment of financial intermediation in the euro area. It also helped safeguard the refinancing of solvent banks and restored confidence to many of the market actors. By being able to sustain banking sector solvency, the ECB indirectly enabled households and companies to get credits at decent interest rates and as a result achieved its main objective of maintaining the price stability. The ECB will keep on monitoring all the financial and economic developments and when appropriate undertaken non-standard measures will be gradually phased out.

5. EURO ZONE AND THE EUROPEAN CENTRAL BANK'S CRITICISM

EMU, or Euro Zone – 17 has its critics. Among those critics are famous economists such as J. Stiglitz and P. Krugman and N. Roubini.

Highly criticized aspects of the Euro Zone are pretty much directed at non-existence of the optimal currency area criteria. Some believe that the Europe has pushed too soon for the single currency. The European Central Bank is sometimes criticized on insisting on the notion that sound money and balanced budgets will somehow fix all of the fiscal problems in the Euro Zone, and EU as well.

Krugman' s misconception that European Central Bank's claim "that raising interest rates and slashing government spending in the face of mass unemployment will somehow make things better instead of worse", is not entirely correct. All of the measures that ECB has been undertaking were aimed at budget cuts but still attempted and mainly succeeded in keeping the inflation rates low. By doing that, it has succeeded in not making things worse in the Euro Zone. It is well known fact that austerity measures directly lead to economic slowdown but the intention is to restore investor's fate in markets. Also, the intention of austerity measures is to lower and eliminate public expenditures that cannot be financed or that are only increasing the debt and placing an extra burden on the country.

"A slow-motion bank run is occurring in the European periphery. Meltdown is imminent" (www.paulkrugman.com).

Most of the above mentioned opponents of the EMU promote the idea that the only reason that the Greek, Irish, Portuguese and Spanish banking systems are being sustained is by extra borrowing from the German Bundesbank. The common notion among the opponents is that the Euro Zone has failed, meaning that the set of principles was proven unworkable as soon as the first major financial crisis had occurred.

Government insolvencies currently threaten the solvency of debtor country (ex. Greece) central banks. This would impose large losses on creditor country (ex. Germany) central banks, which national taxpayers would have to make good. (Martin Wolf, Financial Times, June, 2011).

One of the main concerns surrounding the Euro Zone stability revolves around the question: "What would have happened if the ECB would refuse to lend against the debt of defaulting countries?" Of course, considering that debt restructuring becomes only way out. Without the support of the ECB, many banks would have collapsed. This scenario would continue with governments pulling out of the currency union, freezing of the bank accounts and trying to redenominated debt in a new currency.
J. Stiglitz believes that the ECB, with the use of its monetary instruments, seems to be putting its own balance sheet and those of European banks above the well-being of the citizens of the concerned countries. According to him, the debt had to be restructured and the banks should have never been allowed to leverage themselves beyond any level of prudence (www.project-syndicate.org).

Higher level of regulation should have been put in place in order to prevent banks from becoming so vulnerable. In his view, ECB should do everything to protect people, even at the expense of the shareholders and bondholders.

In his article "The Eurozone's Last Stand", N. Roubini believes that the Euro Zone is reaching its climax. Greece is approaching complete insolvency, and Portugal and Ireland have seen their bonds downgraded to junk status. Spain faces similar problems and the pressure in Italy is also building up. Euro Zone had to ensure financial stability by justifying Greece's bailout package and justifying the establishment of the European Financial Stability Facility. Fiscal aid to Greece has undermined the primary foundation of EMU, which was based on the principles of making euro a stable currency. Non-existence of the authority with power to enforce rules and regulations among its members undermines the importance of the monetary union.

There are two reasons for the absence of macroeconomic management in the Euro Zone. First reasons is that the ECB has given its double mandate a new twist: „Maintaining price stability in itself contributes to the achievement of output and employment goals", (Monthly Report, January, 1999:40) ECB has been making claims that by pursuing just one objective (price stability) it is also pursuing the second objective mandated by the Treaty. According to this argument, the ECB has narrowed down its responsibility. Secondly, ECB has interpreted its prescribed objective of price stability to mean that inflation should be held within a band of 0 % - 2 %, over the medium run. This target is lower than targeted inflation rates of most other major central banks, whereas, this pursued objective may trigger economic downturns in some member countries at the expense of keeping the low inflation rate. When the respective monetary authority pursues a low rate of inflation it is taking risks because with such a low target, the respected monetary authority, in this case European Central Bank, might not react with much leverage towards the recession forces.

6. CONCLUSION

This text has offered us brief insights into the EMU, Euro Zone – 17, as well as the reasoning for the currency union along with its pros and cons. Recent financial crisis had caused economic slowdown in the Euro Zone's.

The ECB has responded to the crisis but results are yet to be seen. The crisis itself had placed great deal of pressure on the achieved monetary policy consensus among the EMU members. Different central banks had undertaken similar monetary measures even though the framework of monetary policy differed to a certain extent from one central bank to another. However, for all of them, the primary objective was price stability. Playing with short-term interest rates was considered to be sufficient means of achieving this objective. Central bank forecasts played a key role in monetary policy decision-making. Everyone assumed that capital markets were efficient, basically free of financial imperfections and potential macroeconomic effects of the same. Actually, those negative effects were not taken into account. Temporary inefficiencies were considered possible, but most central bankers shared an opinion that monetary policy could not do too much to counter these negative developments. Low level of supervision was regarded as a sufficient means of containing and controlling risks related to financial sector.

Even though monetary policy proved to be very successful tool in crisis prevention and elimination of the negative macroeconomic effects, the monetary policy consensus has been brought in question.

1. This past crisis has proven that monetary policy should broaden its analysis to include even financial imbalances because those can eventually spill over to the real economy sector which in effect is going to influence price stability;
2. Important lesson for the monetary policy states that the theoretical and empirical foundations of monetary policy must place more significant role on the banking sector as well as financial imperfections;
3. Euro Zone must improve institute for the macroeconomic management (establish supranational institution with authority and power to enforce rules).

As far as the Euro system's monetary policy strategy is concerned, the monetary policy already contains major elements of the above mentioned approach. (Papademos and Stark, 2010).

The objective is to identify irregularities in the patterns of a number of variables, since an unusual pattern in the development of loans and monetary aggregates could provide very important indication of excessive credit growth. In order to overcome this, monetary policy should become more symmetrical over the financial cycle and with assistance of the same can make a key contribution to financial stability. (Weber, 2010)

However, completely separate instruments are needed to ensure the financial stability, or to prevent financial system imbalances at early stages. Those instruments are individual and the same include the specific incentives within the financial system and the existing supervision. These should be directed primarily on individual institutions since they may have encouraged the growth of debt-financed imbalances. In other words, much more attention needs to be paid to macro prudential analysis and regulation.

If we add another objective (financial stability) to monetary policy, on a side from the price stability, there is fear and possibility of an increase of unrealistic expectations about the effectiveness of monetary policy instruments. Central banks can be tasked with this additional objective but they also must be provided with proper tool kits to deal with this issue.

At the end, it is important to acknowledge that the Euro Zone – 17 is the proof that close economic integration is very possible. Upon the completion of their cost-benefit analysis, it is up to the countries to decide whether or not benefits of joining the currency union exceed its costs.

Major lessons to be drawn by the central bankers in the Euro Area include the following:

1. Monetary authority must pay closer attention to the implications of financial instability on price stability;
2. The objective of financial stability requires its own set of tools whereas primary objective of the monetary policy should remain price stability;
3. In order to keep fulfilling its primary objective, stable and low inflation rate should be maintained, and
4. Without sound coordination of stability oriented fiscal policy, monetary authorities will find themselves in very difficult situation trying to ensure price stability keeping low interest rates.

But, until some reforms of the EMU are undertaken and implemented, we can only hope that the International Monetary Fund, the European Central Bank and the European Financial Stability Facility will be able to bailout whoever needs to be bailed out. I will conclude with the question of growing importance: "Should Euro Zone officials more seriously consider fiscal union?"

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NEWLY INDUSTRIALIZED COUNTRIES – THE MOVING FORCE OF ECONOMIC GROWTH

ABSTRACT

During the first decade of the 21st century, the newly industrialized countries have been the focal point of economic activities. In the last several years, the growth of these "21st century tigers" has been spectacular. The developed countries no longer dominate in international economy which raises their concern while observing the success of these newly industrialized countries and especially the way of their development.

The spectacular accumulation of the newly industrialized countries' current account balance surplus has greatly modified the allocation of monetary reserves in the world: three quarters of the foreign reserves are held by these countries. This new situation has caused a change in the internal balance of world finance. These big newly industrialized countries are, varying in degree, engaged in trade liberalization and multilateral negotiations: e.g. China joined WTO in 2001; many of them have become the regional leaders and the porte-paroles of the South.

The power of economic "giants" such as Brazil, Russia, India, China, South Africa i.e. the "BRICS" is inevitable. However, these countries are giants with feet of clay resulting in a dangerous impact in times of global economic crisis. Therefore, the vulnerability of these countries is manifested through a number of negative externalities in the world. This should convince the rich countries to fully join in the creation of new mechanisms of international governance in the future.

This paper analyzes the newly industrialized countries and their impact on economic growth through the prism of international governance and the creation of a new international economic order.

Key words: newly industrialized countries, BRICS, economic growth

JEL classification: F43

1. INTRODUCTION

The world is faced with the economic wonder of the newly industrialized countries, especially China and India. Certain figures are definitely astonishing. For example, in 2007, the gross national income (GNI) of the newly industrialized countries calculated according to the purchasing power parity (PPP) accounted for more than a half of world's GNI. Could this be foreseen 10 years ago? The rich countries no longer dominate in international economy. The dynamics of newly industrial countries is surprising: while the annual growth rate for developed countries was at an average 2.3 %, starting from 2002, the rate for the newly industrialized countries reached 7.0% in the same period.

Chine did not become a member of the WTO until 2001, when it covered for 10% of world trade (a 6% growth form 2000) and brought chaos to the world trade triangle USA, Europe and Japan.

These elements, among others, motivated the authors to analyze and project the position of the newly industrialized in the light of the new international economic relations.

2. EPOCHAL CHANGES

China started its development towards becoming a world economic force. Among other things, it holds USD 1.400 billion of foreign currency reserves[1]. For the sake of the arguement, China Investment Corp. was founded with the intention to enter global venture capital. It entered Morgan Stanley in December 2007 and today has USD 200 billion. Other sovereign wealth funds are even wealthier. Abu Dhabi Investment Authority managed more than USD 875 billion in 2009. The wealth of the newly industrialized countries represents the double amount of hedge funds. In addition to financial wealth, their great asset lies in the population: China, India and Brazil account for 40% of the world population which is quite young and very productive. In their companies they have the "industrial army reserve" migrating towards cities.

Some are concerned by this spectacular emergence of new economic powers. The financial mass held by these countries to a large extent determines the global financial market and the exchange rate of the U.S. dollar. Their "Poker" has a huge impact on international trade. The mere announcement of the USD 5 billion loan to the Democratic Republic of Congo in 2007 was characterized as a re-accelerated debt of the African countries and the Paris Club.

The big and headlong economic growth of the tigers brings into question the competitiveness of the companies from developed countries: the equally worth Brazilian, Indian and Chinese products directly compete in the market of high added value goods.

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[1] January 7th, 2008

The proof in favor of these epochal changes can be seen on the example of the successful takeover of the French Arcelor by the Indian Mittal in 2006 in spite of the great French resistance, as well as in the saving of the Swiss bank DBS by Singapore.

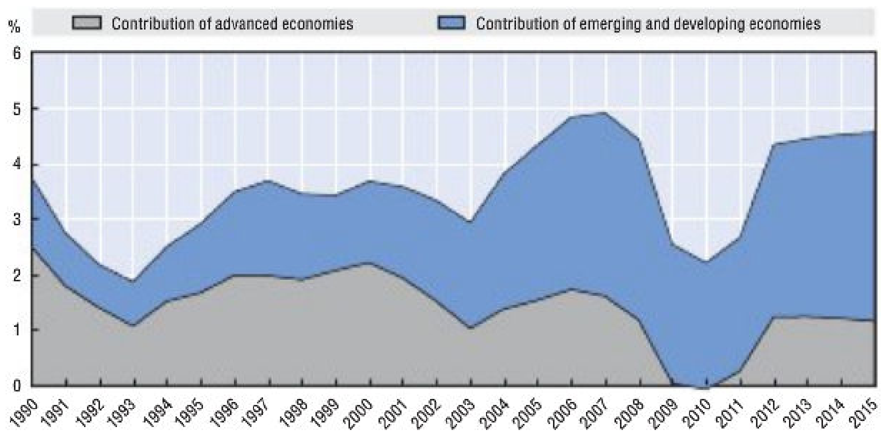
In 2010, the global economy was stronger than in 2009. However, this strength was not equal in all regions. Although the signs of the revival of economic growth were relatively strong, certain tensions remained, such as the rise in raw material prices. The liberalization in the conditions of granting/receiving bank loans, as good indicators of economic activity, made them more stable and accessible. In 2011, the world GDI growth will be strong, primarily due to the positive effects caused by the newly industrialized countries. The private sector activity will continue to show in the near future some negative results in relation to weak income growth and high unemployment rates (Table 2) in the majority of the most developed countries. However, due to the effects caused by the increase of trade in Asia and countries like Brazil, the growth of international trade has a good chance of becoming solid.

3. UNEQUAL ECONOMIC GROWTH

The preceding analysis indicates that there is an unequal contribution to economic growth. It is very dynamic in the economies of the OECD non-members, especially in Asia. The growth in world production in 2010 and 2011 ranges at around 4.5% - the rhythm is higher than in previous years (Table 1). The growth in Asia resulted from the enterprising measures taken during the financial crisis. Contrary to this, in many OECD economies, the economic problems repeat themselves despite strong external demand, stabilization of financial conditions and positive effects of the macroeconomic support programs. The annual growth rate leveled at around 2.5%, starting from the third quarter of 2009 until the third quarter of 2010, gently accelerating and reaching 2.75% in 2011. The growth in Asia and Pacific countries maintaining substantial trade relations with OECD non-member economies should remain stronger than in the U.S.

Is it really a matter of the rise of newly industrialized countries and the fall of the West? (Chart 1).

Chart 1 Contribution to world GDP (in PPP)



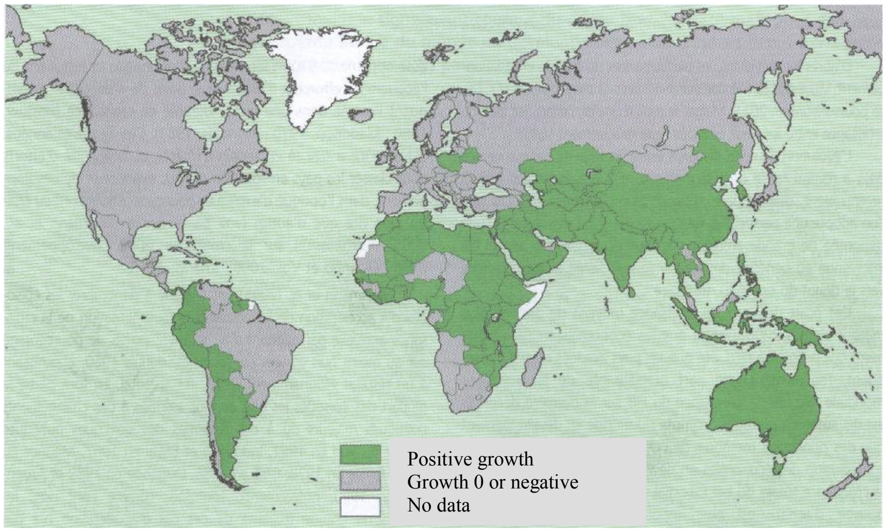
Source: OECD, (2010) Perspective on Global Development, p. 31

For over 10 years, the growth rate in developing countries has been higher than in the most developed countries. The new geography of growth is being outlined and the gravitational center of the world economy is gradually shifting towards the newly industrialized Asian countries. The traditional division between the North and South is becoming less evident in the multi-polar world, in which the South is becoming increasingly heterogeneous. For many analysts, this diversion of wealth seems as beginning of the fall of the West, where for others, the increased prosperity of the developing world will benefit both the rich countries and the poor.

The improvement in the economic performances of the newly industrialized and developing countries leads to the question whether this is the beginning of a long period of growth in developing countries. Economists and economic historians have long tried to identify the point of "secession" and beginning of the sustainable development stage (Rostow, 1960; Maddison, 1970; Reynolds, 1986). In the last years (from 2000 onwards), this question provoked a huge interest in the division of countries according to their development experience, considering why certain countries have higher growth than others (Hausmann et. al, 2005; Commission on Growth and Development, 2008, Ocampo et Vos; Kharas, 2010)

Literature reveals significant observations: the pressures on growth are common, but rarely last for long. Moreover, in the last 60 years, periods of growth have been prolonged and the transition towards those countries with high and medium income level have been extremely rare with the exception of Asia (Milanovic, 2005). For the major part of the 20th Century Asia, Africa and Latin America showed divergent tendencies, while some had great results; others were on the verge of survival (Figure 1).

Figure 1 Evolution in real GDP, 2009



Source: http://data.worldbank.org/data-catalog/world-development-indicators

Nowadays, the world economy is more complex than ever. The wealth is changing, the traditional North - South relations are no longer sufficient for the understanding of the development challenge, and traditional ties give way to new coalitions.

The world wealth changes in four speeds. In 2007, James Wolfensohn, president of the World Bank from 1995 to 2005, characterized global economy by relying on the "the 4-speed world" (Wolfensohn, 2007). He identified four groups of countries:

1. Rich countries – a group of countries that dominated the world economy from the mid-20th century. They account for only 20% of the planet's population, but 70 to 80% of world income. According to Wolfensohn, these countries can continue to improve their living standard, but their leadership is increasingly threatened by the following group;
2. Converging countries - a group of countries with lower and middle income levels, which have achieved high growth rates in the last decade;
3. Struggling countries – a group of countries that have poor performance, do not use any international assistance and have a relatively small ponder in international decision-making and
4. Poor countries - a group of countries with stagnant or declining incomes. They are mostly located in the Sub-Saharan Africa, and have little benefit and much harm from globalization due to climate changes and increasing prices of basic products.

Table 1 gives the typology of the 4-speed world.

Table 1 Main characteristics of the 4-speed world

<table>
<tr><td></td><td colspan="2">GROWTH</td></tr>
<tr><td rowspan="3">INCOME</td><td colspan="2">RICH –high income – according to WB, GDI > USD 9,265 in 2000 and GDI > USD 11,455 USD in 2007</td></tr>
<tr><td>Struggling countries – GDI between USD 755 and 9,265 in 2000 and USD 935 and 11,455 in 2007</td><td rowspan="2">Converging countries – countries whose GDI per capita shows increase twice higher than that of the OECD countries with high income</td></tr>
<tr><td>Poor countries – GDI < USD 755 in 2000 and under USD 935 in 2007</td></tr>
</table>

4. UNDERSTANDING NEWLY INDUSTRIALIZED COUNTRIES

The term *newly industrialized countries* has no standard definition. In order for a country to be considered as such, it should be at the gates entering the circle of the most developed countries and its success in the development process. If the newly industrialized countries possess these common traits, they still constitute an extremely heterogeneous group: China, Turkey, India and Mexico or Brazil and Hungary.

The industrialization of certain developing countries in 1970s, started with the development of four new industrialized countries, called the Asian Tigers: Hong Kong, Taiwan, South Korea and Singapore. Subsequently, in the 1990s a new group, called the Tiger Cubs emerges: Malaysia, Thailand, Indonesia and the Philippines. At the same time, Brazil and Mexico are denoted as the Latin American Jaguars.

The fall of the Berlin Wall is another historical event, which gave a new dimension to the process of newly industrializing countries and the transition of these countries towards a market economy: CEEC and the new Russia.

Thirdly, the spectacular rise of China as an economy with exceptional features: huge territory, population, internal market size, economic and financial activities, huge stock of raw materials. Moreover, China has certain characteristics essential to other major countries, and Goldman Sachs argues that China along with Brazil, India and Russia, the BRIC are developing rapidly and that by 2050 their combined economies could eclipse the combined economies of the current richest countries of the world. BRIC was recently joined by South Africa, changing the acronym to today's BRICS.

These countries represent the fundamental point of the newly industrialized countries and have stirred up the international economic order.

5. MULTINATIONAL COMPANIES IN NEWLY INDUSTRIALIZED COUNTRIES.

Many multinational companies originating from the newly industrialized countries are continuously growing. Mittal, Tata, Lenovo and InBev hold an enviable position and are no longer just local competitors. Multinational companies of the newly industrialized countries have a high degree of innovation. For example, Tata Motors plans to motorize India with Nano, a small and cheap car with an extremely low price at USD 2,500 a piece. However, they are not just oriented to the domestic market, but are, at the same time, selling a similar vehicle on the Western markets. Large companies in the IT industry such as Infosys or Whipro are in demand and greatly appreciated by Western clients. Moreover, a new organizational model and a new concept of activity with more performances than similar companies coming from developed countries also contribute to this. The success of multinational companies from newly industrialized countries is constant - they have actually become a relevant and unavoidable competitor to the "old" multinational companies of the Western world (Table 2).

Table 2 Multinational companies of the newly industrialized countries

MNC	Industry / sector	Country
Haier	Consumer electronics and home appliances	China
Cemex	Cement	Mexico
Embraer	Aircraft manufacturers	Brazil
Ranbaxy	Pharmaceutical company	India
Goodbaby	Children's products	China
Tetley	Food industry	India

The emergence of big multinational companies originated in the newly industrialized countries represents just one of the most noticeable manifestations of the increased growth of their economies in whole (Table 2). Having this is mind, it should be pointed out that the high growth rates resulted from the governments' orientation towards development with the aim to achieve the economic parameters of the most developed world countries. This is seen in the high rates achieved during the past years as well as in the change of their share in global economy (Table 3).

Table 3 Share in global GDP of selected countries, year 1980 and 2008

Country	Year	
	1980	2008
China	2.0	11.4
India	2.2	4.8
Turkey	0.9	1.4
Russia	-	3.2
USA	22.5	20.9
Mexico	2.5	2.0
Brazil	3.6	2.8
RSA	0.9	0.7
EU	29.8	22.4

Source: IMF, World Economic Outlook Database, April 2008

6. CONCLUSION

The Newly industrialized countries have been changing the traditional balance of forces in world economy. USA and the EU are losing their dominant positions, whereas, especially the BRICS group is becoming an equal partner. This relation is far from a tie; China and India are achieving high growth rates and are dominant in the production of certain products such as rare metals used in high technology products. In addition, many multinational companies with headquarters in the newly industrialized countries are equal competitors to MNCs from developed countries. This leads to a balancing of prosperity on global level, and is also a response to those criticizing globalization. Namely, the newly industrialized countries have become economic powers thanks to globalization and the opportunities it offers.

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MANAGING INNOVATION SYSTEMS IN TRANSITION ECONOMIES

ABSTRACT

Successfully managing innovations has become the basic precondition for the development of both companies and national economies. At the national level governments are forming innovation systems whose primary goal is to create conditions at which science and technology can flourish and then transfer their findings trough private sector into new revolutionary products and services. Unfortunately not all countries have the same preconditions for creating such systems and transition economies due to many of their characteristics face serious difficulties. The aim of this paper is to first describe the role of innovations and innovation systems in economic development e the current innovation output in transition economies are presented.

Key words: national innovation system, economic development, transition economies

JEL classification: O31, P3

1. INTRODUCTION

The terms innovation and innovativeness have become the new business "mantra" in many developed countries. It is well known that USA and in recent years EU (Lisbon Agenda) have proclaimed that their future development will be based mainly on new innovative corporate cultures and technologies. Since innovation represents the foundation of future economic development but also takes a lot of resources and can sometimes be a risky game it is logical to examine the current state of innovations in transition countries. The importance of innovations has long been recognised as can be seen from Table 1.

Table 1 Evolution process of large firms in the period 1960-2000

MARKET REQUIREMENTS	PERFORMANCE CRITERIA	IDEAL TYPE OF FIRM
1960 price	Efficiency	The efficient firm
1970 price, quality	Efficiency+quality	The quality firm
1980 price, quality, product line	Efficiency+quality+ flexibility	The flexible firm
1990 price, quality, product line, uniqueness	Efficiency+quality+ flexibility+innovative ability	The innovative firm

Source: Bolwijn & Kumpe (1990, 50)

In the last 10-15 years transition countries in Central and Eastern Europe (CEE) experienced major changes in their political and economic systems. These changes have a significant impact on organisations external environment and their competitive capabilities (Kubes & Benkovic, 1994, 125). In the transition countries, the socio-economic context influencing the innovation system includes the whole process of transition towards the fast restoration of capitalism and its primary values - private ownership and democracy. As the restoration of these values was accomplished in a technical sense by privatisation and the multiparty system, the socio-cultural context of post-socialistic semi-modernism has remained largely unchanged (Svarc, 2006, 151).

One of the problems most transition countries face in trying to expand to foreign markets is that their products are often considered "old-fashioned" and technologically poorly developed. The reasons for this phenomenon are very deep and come from the fact that years of supply driven economy made companies from transition countries very slow and rigid in dealing with their customers' expectations. In such market environment, there were no economic incentives for firms to develop the abilities such as flexibility and innovativeness. Not only that this fact disables them from concurring foreign markets but it even jeopardizes their pure domestic survival. A common characteristic of the transition countries is that the value added is stagnating at a level which is only a fraction of that in the EU, return on capital is low and does not allow investment in new technologies (Bastic, 2004, 66).

Currently, the new EU member states are losing their traditional sources of international competitiveness, such as low labour costs (caused inter alia by their integration into the EU). Also, policy makers in the CEE countries are increasingly emphasizing the importance of building knowledge-based economies (Masso & Vahter, 2008, 11).

In the first part of this paper national innovation systems and their importance are presented. The paper proceeds with short overview of current issues transition economies are facing regarding their innovation systems. Special attention is then given to the case of Croatia with emphasizing reasons that led to presently more than unsatisfactory state of innovations. The paper ends with presenting some of the measures that could help transition economies boost their innovation systems.

2. MAIN DETERMINANTS OF MANAGING INNOVATIONS

There are three basic theories in innovation theory (Sundbo, 2001, 31): (1) The entrepreneur theory, in which the entrepreneur's psychological factor is the innovation determinant and innovations are made by an entrepreneur trough the establishment of new firms. (2) The technology-economic theory, in which innovations are interpreted as technological innovations, and technicians and R&D activities are the producers of innovations. (3) The strategic innovation theory, in which innovation is a process in which the whole organization is involved and the strategy is the guideline for the process, which is steered by the top management. It emphasizes the strategic situation of the firm and sees innovation as a sociological process.

In the current scientific debate, the term "innovation" is predominantly linked to the research and development (R&D) associated with creating new products. There are many studies on innovation which reveal that the increased R&D activities lead to innovative products which enable companies to achieve competitive advantages and gain market shares (Armbruster et al, 2008, 645). By one measure innovators realized a median profit margin growth of 3,4 percent a year between 1995 and 2007, compared with 0,4 percent for the median S&P Global 1200 company (Westland, 2008, 253). The importance of innovation as a driver of competitiveness, profitability and productivity is well documented in the literature (Porter, 1998). Innovations are today considered as one of the main sources of sustainable competitive advantage which can be defined as a competitive advantage that lasts for a long period of time because competitors are not capable of imitating the firm's source of competitive advantage (Jacobson, 1988, 42).

There are two most commonly used types of innovations (Bassant & Tidd, 2007; Tidd & Bessant 2009) and they are radical and incremental innovations. The first type is associated with doing new things and they represent the true advantage of company at national level. The second type is often described as doing things better and means working on maximising the effectiveness of a system or a company. Radical innovations are often realised trough product innovation while incremental innovations in most cases take the form of process innovations.

To realize the innovation payoff, aspiring innovators must prepare to compete in not just one, but two markets - first in the consumer market for their new product or service, and second in the capital market to finance their innovation. Financial markets for funding innovations are as challenging as consumer markets. Traditionally financial analysts have looked to the past, for precedents for a particular business, in the process of trying to predict future returns. Innovation denies them that opportunity. A truly novel (radical) innovation will not have been tested before in the market, depriving the analyst of historical insight into the prospects for the innovators new business (Westland, 2008, 253).

For a long time it has been considered that innovation is a linear process and the primary goal of governments at this time was to invest heavily in public research. One of the basic assumptions of this approach was that private sector will not invest in R&D since it is risky and time consuming so this market imperfection had to be corrected. However, the view towards innovation has lately been changed since spillovers and feedback effects often play an important role in innovation making it non-linear. According to this new view the role of government is to support the interaction between science and business so that research results could be converted into new technologies and innovations.

The concept of innovation has changed dramatically in recent years as the focus of attention has shifted from the single-act philosophy of innovation to the complex mechanisms that underline the production of new products and new production processes. At the same time, the earlier reference point, the linear research-to-marketing model of innovation, has been supplanted by interactive models of innovation which emphasize the central role of feedback effects between downstream (market) and upstream (technology) phases of innovation and the many interactions of innovative activities both within firms and in cooperative agreements among them (Fischer, 2006, 1).

The role of innovations in scientific literature is proportional to their contribution in gaining competitive advantages which means one can find numerous approaches to this area of research. At the moment three areas are especially emphasized and they are: (1) creating innovation culture, (2) national innovation systems and (3) research at the network level.

A network can influence the action of its members in two ways. First, through the flow and sharing of information within the network. Secondly, through differences in the position of actors in the network, which cause power and control imbalances. Therefore the position an organization occupies in a network is a matter of great strategic importance, and reflects its power and influence in that network. Sources of power include technology, expertise, trust, economic strength and legitimacy. Networks can be tight or loose, depending on the quantity (number), quality (intensity) and type (closeness to core activities) of the interactions or links. Such links are more than individual transactions, and require significant investment in resource over time (Tidd & Bessant, 2009, 284).

De La Mothe & Paquet (1998, 2) proposed a three-tiered image of the innovation system at the regional/national level: at its core is the innovating firm embedded in a proximate environment of alliances and networks, and in a broader environment providing the legal, regulatory, economic and public support infrastructures defining the rules of the game. The coalescence of the interactions between those three levels is seen as being at the core of the innovation system.

National innovative capacity can be defined as the institutional potential of a country to sustain innovation. One of the clearest indications of innovation performance is the rate of take-up patents issued by the US Patents and Trademarks Office - USPTO (Hu & Mathews, 2008, 1466).

It has to be said that research at the network level often includes different regions such as: East Europe, North America etc. Innovative firms do not innovate alone but in the context of a network. Particularly with respect to formal forms of cooperation, the percentage of innovating firms that are involved in research and development (R&D)

collaboration with one or more partners ranges, depending on country, from about 50% to, as in the case of Denmark, 97% (Capron & Meeusen, 2000, 109).

According to Padmore & Gibson (1998, 48) science and technology cannot be researched without considering interactions between technological, economic, social and management systems. In coming to grips with this, researchers and policy makers have enlarged the context for discussion from science and technology to innovation, and now talk about "systems of innovation" or systems approach to innovation (Capron & Meeusen, 2000, 130). The true idea behind the systems approach to innovation is that the range of knowledge required for developing new products and processes is generally beyond the capacity of the individual innovating firm. In accordance with this new innovation paradigm the national innovation system itself is locally specific and determined by local socio-economic surroundings, political surroundings and other societal and historical elements (Svarc, 2009, 148).

It is clear that science and technology (S&T) and trends in S&T must, in some sense, be fundamental to the whole business of transformation. There can be no enrichment of human capital, no accretion to knowledge stocks, without S&T. But in this context S&T has to be understood in a very broad sense. It has to be understood to include education and training and all the myriad elements of design and organisation which mesh in with R&D properly at the level of the company and also in many areas of public administration (Dyker and Radosevic, 2001, 225). If massive failures are to be avoided, governments have to realise that networks and network enterprises - and not firms in the traditional sense - have become the actual operating units in the new economy (Fischer, 2006, 113).

3. THE PROBLEMS OF MANAGING INNOVATIONS IN TRANSITION ECONOMIES

The theme of technological and economic catch-up is very popular among many researchers from transition countries. From that aspect Verspagen (1999, 29) brings two main groups of factors which may inhibit catch-up through technological diffusion. They are: *technological congruence* and *social capability*. Technological congruence is defined as match between the technologies in use in the advanced country and those most fit for introduction in the backward country. This means that some technologies used in developed countries are just not suitable for transferring to transition countries due to a number of factors. Social capability is defined in terms of institutional factors such as educational systems (which supply the human capital necessary for assimilating spillovers), the banking system (which supplies financial capital for catch-up related investment), the political system etc. It is through innovation, strictly (hard) technological and (soft) organisational, that key deficiencies in social capability are made up. It seems unlikely at first sight that problems of technological congruence would present major obstacles to successful catch-up in the case of the post-socialist countries. While there is a real sense in which they are developing countries, their general levels of education are much closer to those of Western Europe and North America than those of the Third World. Literacy is virtually universal and basic engineering skills are well developed among a large proportion of their respective populations. Domestic markets are in many cases small, but regional integration schemas like the Central European Free Trade Area (CEFTA) and more important, the fact that a number of countries have realistic prospect of acceding to the EU, have ensured that this is not a major constraint on the establishment of technological congruence. A case of automotive industry and its transferring capacities to transition countries, which for them was very profitable, is a good example that while low wages provide trading opportunities, developed countries will not close off technological options in post-socialistic region. But the situation with the technological congruence is not as good as this example illustrates. While foreign car firms have met no serious obstacles in setting up state-of-the-art production systems employing mainly local people in their CEE transplants, they have found it impossible to integrate local firms into their supply networks as suppliers of complex components involving R&D and design work as well as production. Fagerberg & Srholec (2008, 1420) also point out that openness to trade and foreign direct investment (FDI) does not have to matter much for development. The conclusion is that poor countries due to lack of absorptive capacity are much less likely than other countries to benefit from FDI. According to Dyker & Radosevic (2001, 225) there are two possible scenarios for the transition countries. Not all of them have the same starting position and that factor will influence their future economic development. The most likely scenario for the transition region as a whole over the next few decades, therefore, is a group of CEE countries clamping on at a level of economic development that is fairly high but still below the EU average; while the countries of the former Soviet Union and some of the Balkan countries will continue to fall behind, as they have done over the past decade, or at best establish a trajectory of week catch-up.

The main factors that will determine which countries will fall into which categories are presented in Table 2.

Table 2 The determinants of economic development for transition countries

ASPECT	MEASURE
Science, research and innovation	Scientific publications, patents, R&D (total/business)
Openness	Openness to trade, FDI, technology licensing, immigration
Production quality/standards	ISO standards
Information and communication technology (ICT) infrastructure	Telecommunications, internet, computers
Skills	Primary, secondary and tertiary education, managerial and technical skills
Finance	Access to bank credit, stock market, venture capital
Quality of governance	Corruption, law and order, independence of courts, business friendly regulation
Social values	Civic activities, trust, tolerance
Type of political system	Democracy or autocracy

Source: Fagerberg & Srholec (2008, 1420)

The empirical analysis suggests that a well developed innovation system is essential for countries that wish to succeed in catch-up. There is a strong, significant and robust statistical relationship between (level and change of) GDP per capita on the one hand, and (level and change of) the innovation system on the other. Historical and descriptive evidence also suggests that countries that have succeeded in catch-up are given a high priority to this dimension of development (Fagerberg & Srholec, 2008, 1426).

Good governance is also critical for the ability to realise the desired economic results. Sometimes it is asserted that this is mainly a question of successfully "westernising" the political system. But research shows that a political system of the western type is shown to be conductive to growth among richer countries. For the poor countries it is, if anything, the other way around. In fact, among the countries that over the years have succeeded in catching up there are several examples of countries with institutional arrangements that differ a lot from western ideals, such as recent performance of China and Vietnam, the Asian Tigers before the 1990s or the pre-world-war-two Japan (Fagerberg & Srholec, 2008, 1434).

The involvement of private players is crucial for learning policy-making and achieving adaptability, which in turn is crucial for the overall success of an innovation policy. This is particularly important for transition economies facing important reforms in a context of accelerated globalisation and international competition (Inzelt, 2008, 82).

In transition economies the majority of the emphasis has been placed on creating the applicable political and economic environment within which organisations can develop. Much less attention has been devoted to the people side of organisations (Leskovar-Spacapan & Bastic, 2007, 534). There is also a discussion among researchers on whether internal or external factors have more impact on innovativeness. One argument for an emphasis on the internal driving forces as the core forces is that, even if the external forces are the strongest, they must be interpreted and converted into action by managers and employees. The main ideas for innovation are developed by employees when they interact with customers and observe their problems. Among internal driving forces three need to be marked as most important ones, they are: innovation-oriented culture, entrepreneurship and market orientation. Innovation-oriented culture is often mentioned as a core capability for innovation process. Creativity/innovation is truly enhanced when the entire organisation supports it. Structures in creative companies tend to be flexible, with few rules and regulations, loose job descriptions and high autonomy. The entrepreneurial firm is generally distinguished by its ability to innovate, initiate change and rapidly react in order to change flexibility and adroitly (Naman & Slevin, 1993). A market orientation is considered an important part of organisational culture. It puts the customer in the centre of the firms thinking about strategy and operation.

None of the CEE countries have a fully fledged innovation policy (IP). Hungary and Estonia stand out from the rest in terms of the range and longevity of their measures, while Poland and Slovenia have developed relatively sophisticated policy documents, but are lagging behind in terms of their implementation (European Commision, 2002).

One of the solutions transition economies tried to employ was the pure copying of developed countries innovation models and incentives. Although this approach had many opponents and did not cause significant improvements in the short term, it played its part in breaking the popular perception of the market orientation as unworthy of true science.

Although corporate policy makers in large firms might often be tempted in the short term to avoid strong competition - and to reap extra monopoly profits - by merging with their competitors, the long term costs could be considerable. Public policy makers should be persuaded by the evidence that creating gigantic national champions does not increase innovation, quite the contrary, and therefore take countervailing measures. Lack of competitive rivalry makes firms less fit to compete on global markets through innovation (Bessant & Tidd, 2007, 349).

Masso &Vahter (2008) compared the linkage between innovation inputs, outputs and productivity growth in Estonia in two different periods (1998-2000, 2002-2004). Their conclusion was that in the first period only product innovation had positive effect on productivity, while in the second only process innovation had positive effect. The explanation for this phenomenon, that can also be valid for the rest of the transition countries, was that after the loss of traditional export markets due to Russian crisis, product innovation might have been necessary to restructure and enter new export markets. In the second period, growing labour costs made it more important to reduce production costs through process innovation. Process innovation might have also been necessary to increase production in order to meet the growing demand during the period of strong macroeconomic growth.

4. THE CASE OF CROATIA

According to last European Innovation Scoreboards from 2006, Croatia was in the last fourth group of countries called trailing countries. The present state is mainly rooted in socio-economic, cultural and political surrounding causing technological and economic development and not vice versa (Svarc, 2009, 12).

Recent analyses of the CEE countries has revealed that innovation capacities confirm that growth in the transition countries has primarily been generated by defensive inter-sectoral restructuring, domestic market consumption and low-cost FDI, while technology accumulation, innovation abilities and the productive use of national research capacities have been neglected. To support the above mentioned points, four characteristics of current Croatian research system, which is the most substantive part of the innovation system in Croatia, are presented (Svarc, 2006, 145-149):

1. The weak industrial R&D sector and the low technological capabilities of companies. The overall structures of the industrial sectors of the economy and exports have not significantly changed in last 25 years, and are still dominated by low-profit "traditional Croatian industries" such as the wood and textile industries, fisheries, tobacco and shipbuilding. The total business-sector investment in R&D amounts to 0.44% of GDP, which is extremely low in

comparison to developed and fast growing countries where the business sector invests more than 1 or 2% of GDP, respectively;

2. The Croatian research paradox. Although GERD (global expenditure in research and development) in Croatia is satisfactory and creates the impression that the problems are not so much in the scientific inputs as in the outputs meaning Croatia suffers from ineffective use of research and science for technology development. The problem is much more complex and is based on a fact that Croatian research community lacks both a dynamic industrial partner whose needs could be met and a critical mass of innovative companies able to absorb the research expertise. The Croatian R&D paradox stems from inadequate and obsolete structure of the R&D sector, which is characterised by domination of the public sector over business R&D, because the latter was underdeveloped before and devastated during transition times. At the moment the ratio between public and private funding is 2:1, and it should be the opposite (Samardzija, 2009, 98). The data on human resources is even worse since 82% of researchers were employed in the public sector (Aralica, 2009, 102);

3. Inadequate science-industry cooperation. It is estimated that today only about 10% of the revenues of the institutes and 6% of the revenues of universities come from research contracted with industry;

4. The lack of a stimulating environment. As the roles that innovation and knowledge-based growth factors play in economic development were not acknowledged, the establishment of a proper environment which facilitates innovation capacities and culture was also seriously neglected.

However, as the principal pattern of socialist style innovation activities involving the suppression of entrepreneurship, innovativeness and competition, which would stimulate a variety of technological trajectories, has not been changed, the outcomes of these policies are, to a differing extent, unfavourable to R&D and innovation capacities. Some of the most striking outcomes are as follows: the further weakening of the R&D market, the serious deterioration of industrial R&D with a corresponding low-level absorption capacity of firms and finally the shrinkage of the science base in terms of both human-resource capacities and investment in R&D (Prpic, 2002, 76).

As it was mentioned earlier in this article, being open to FDI or even receiving large amounts of funds this way does not guarantee strong economic development. The way these resources are used and industries that are consuming them are far more important. In order to achieve economic convergence transition economies need not only to liberalize their financial and trade systems but also make sure these processes are followed by knowledge transfer. One of the basic indicators of this process is the R&D system convergence. Unfortunately in the case of Croatia, data for the period 2001-2003 reveal that low-tech sectors with limited spillover effects (tourism, real estate & trade) are still more important drivers of economic growth than dynamic medium- and high-tech manufacturing and services (Prasnikar et al, 2008). It is no surprise then that Aralica (2009, 113) found that almost 60% of businesses had no investment in R&D activities and were using only external knowledge.

Prasnikar et al (2008) suggest that in order to close the gap with developed countries, technology follower countries such as Croatia should use the strategy of imitation or develop incremental innovations because technological competencies may be costly and time consuming to acquire. Only after years of accumulation of resources and knowledge trough incremental innovation could Croatian companies become serious players in the technological innovation field. This strategy also does not represent something new because many Asian countries are at the moment moving away after years of imitation into seriously competing in technology markets.

5. CONCLUSION

To overcome the gap originating from their history, companies from transition economies need to be aware that internal organisational capabilities such as innovation-oriented culture, entrepreneurship and market orientation are among important drivers of wealth creation and growth. Companies have to focus not only on their existing capabilities and on exploiting existing business opportunities but also have to develop, at the same time, capabilities they will need in the future. As in other transition countries (such as Hungry, Poland, Romania, Bulgaria, etc.), the political elite in Croatia, perusing the dominant "mantra" of the liberal market economy, cut off the state support for industrial institutes and left them to market competition or the care of their parent companies. As the large industrial companies, which were the only ones capable of R&D performance and absorption, were struggling with the problems of lost markets and privatisation, all creative, educational and research activities were considered as serious liabilities rather than assets. Ironically, while "Western" states are more prepared to adopt state interventionist policies to foster innovation, post-socialist states regard intervention as a hangover from the past. It is therefore recommended to bring more control at the national level, meaning the role of government should be much bigger in stimulating certain innovation networks. On the other hand, when it comes to individual enterprises and their employees they should be given much bigger freedom to experiment with new markets and technologies. The current state is quite opposite; firms are free to pursue their own short term goals in any way while their employees suffer strict control over their actions.

At the end of the paper four measures need to be stressed as the key measures necessary for improving innovation output in transition economies. They are: (1) Creating innovation culture in all organisations trough stimulating and making people comfortable in delivering new ideas. (2) Supporting development trough small innovative companies instead of creating big national champions. (3) Further involvement of private sector in research and technology. (4) The role of the government in stimulating R&D has to be greater not lesser for all transition economies.

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THE RESPONSIBILITY AND ROLE OF THE AUDIT COMMITTEE AS A FUNCTION OF CONTROL OF INTERNAL AND EXTERNAL AUDITS IN THE DEVELOPMENT OF CORPORATE GOVERNANCE IN B&H

ABSTRACT

In nowadays corporate governance is getting more and more attention in our society, not only in the legislative and regulatory circles, but also among directors and business owners and especially among public enterprises and banks.

Not so long ago the former collective and state enterprises used a relatively simple "formula" to turn into joint stock companies or private enterprises. Today it is clear, that this newly created management system suffers from numerous difficulties and weaknesses, most of which are of „carcinogenic" character. In addition to that, competitiveness at a national level, is also one of the most pressing concerns, which equally occurs in developing and transitional societies, as well as in those that are highly developed.

The aim of this piece of work was to investigate role and responsibilities of the Audit Committee, its membership and internal organization together with relevant aspects of its cooperation with external and internal auditors, including relations with the management.

The primary functions of the Audit Committee are usually associated with the internal control and risk management, financial reporting, application of legislation and regulations as well as with the issues related to the process of external and internal audit. Committee has the responsibility to monitor the adequacy and effectiveness of internal control processes and procedures, which are instruments of risk management. This monitoring is done through inspection and examination of annual financial statements by evaluating whether financial information disclosed in financial statements are adequate and complete, prior to their presentation and public revelation. This primarily refers to the verification of application of the IAS / IFRS and of adopted accounting policies in the process of preparing financial statements, especially in the assessment or valuation of balance sheet items.

The distinctive work of the Audit Committee provides shareholders and investors with a degree of certainty, that the audited financial statements of companies, as well as other *non-financial information, are not false and that they will not be mislead. This enables high quality of financial reporting, which than contributes not only to the investors' increased confidence, but also to the accurate decision making regarding investments.*

Keywords: corporate governance, Audit Commitee, financial reporting, audit, internal audit, external audit

JEL classification: G3, M4

1. INTRODUCTION

How can the owners control those who govern? It is the question that arises from the very inception of corporate governance. In a reponse of the question, different models of corporate governance appear, but it should be noted that the superiority of one over the other can not be confirmed with certainity. Success of application of a particular model depends mostly on its adaptability to the changes that lurk in the environment. For each form of the model of corporate governance, whether if it was about Anglo-Saxon, German, Japanese or Great Britain model, their characteristic is the existence of the bodies which have the important role in corporations. The pyramid of the importance of corporation follows this scheme: stockholders meeting, Auditing Commitee, Governance and Audit Board[1].

In terms of globalization of goods, services, capital and labor, increased use of technology, the increasing complexity of business transactions, accounting systems, emphasized responsibility of management for the full and true disclosure of the financial position and performance of business enterprises, the growing public interest and concern for ethical corporate behavior, the role of Audit Committees is becoming increasingly important, and the scope of tasks performed by the responsibility is wider and deeper. Therefore, this work deals with the relevant meanings and questions about the role, organization, tasks, powers and responsibility of the Audit Commitee.

The paper will be a contemporary understanding of its role and how the constitution and functioning of those powers, which are the object of widespread attention and review by the subjects, are interested in the company's business.

2. RELEVANT MEANINGS OF CORPORATE GOVERNANCE AS BASIS FOR THE MONITORING ROLE OF THE BOARD OF AUDITORS

Conceptualization of Corporate Governance (or organizational governance) and considerations of its contents may be of different meanings and levels of observations.[2]

[1] Kodeks računovodstvenih načela i računovodstveni standardi Federacije BiH,Zavod za računovodstvo i reviziju, Sarajevo,1998.
[2] Tipurić, D.: Nadzorni odbor i korporativno upravljanje, Sinergija-nakladništvo, d.o.o, Zagreb, 2006.

According to the definition of OECD (Organisation for Economic Cooperation and Development) from 1999 which says that „corporate governance... involves a set of relationships between management, authorities, shareholders and other stakeholders.Corporate governance also represents a structure within which the company set the goals and determine the means to achieve the objectives for monitoring performance of the company. Good corporate governance should provide proper incentive for the administration and management to achieve goals that are of interest to the company and shareholders...“

According to the definition of the Institute of Internal Auditors (IIA), the process of corporate governance „includes the methods used by those who represent the stakeholders of the organization, notably management, in providing oversight over the risks and control process.

Monitoring of the risks facing the organization and a guarantee that the control adequately mitigates these risks directly contribute to achieving the goals of the organization and maintaining its values." Besides the definition of the corporate governance, another important presumption for understanding the role and tasks of the Audit Committee and its organization, membership and activities, makes understandable so-called one-ranked and two-ranked models of corporate governance.[3] One of the key internal mechanisms of corporate governance, through which shareholders influence the behaviour of managers to ensure that they manage their business enterprises in their interests are the committees. There are two ways of organization of committee of the modern corporation:

1. Establishment of a single board of directors or
2. Establishment of two committees: the supervisory board and management.

2.1. The Role of the Bord of Auditors

The role of audit committees is very complex and, according to modern concepts it should include three types of jurisdiction:

Supervision of financial reporting in order to ensure the credibility of financial statements or other information that is made public, and relating to financial performance. It is responsible for presenting a balanced and understandable assess of financial position in which the company is and in which will be in the future, so it is essential that it has the support of the audit committee. In other words, the supervisory board appoints the Audit Committee the responsibility to monitor the financial reporting system so that reports would have necessary credibility, which applies to all other information be made public, relating to financial performance of the company. Accordingly, the Audit Committee considers the accounting policies and changes to these policies, as well as the completeness and adequacy of the information the company disclose in the financial statements.

[3] Vukoja B., Katić B.: Skripta Financijsko izvještavanje, Sveučilište Vitez u Travniku 2011.

Monitoring system of internal financial control, and if there is no a special board or committee of the Supervisory Board for the risk, then the control system manages the risk. Supervision of internal control has the supervisory board, which it delegates its authority to the Audit Board, which is now considered as a normal practice. However, the audit committee, according to the nature of their primary role, usually only focuses on financial reporting, but it can also deal with other aspects of internal control. If this happens, then it is very important to make well-defined responsibilities that are not directly related to financial reporting, as the audit committee must report on them to the Supervisory Board.[4]

Monitoring procedure of internal and external audit, which involves assessment of the effectiveness of internal and external auditing, as well as other responsibilities primarily connected with the external auditor (making recommendations for appointment and change of auditors, checking the independence of auditors, reviewing the audit plan and the draft audit report, etc.). If a company has an internal audit, the audit committee should participate in the selection and dismissal of the head of internal audit and to assist in establishing relations of internal audit with supervisory board, management and organizational units within the company. The Audit Committee would also need to be involved in the process of defining the responsibilities of internal audit and the formulation of its goals and mission of supervising the control procedures. Monitoring process of external audit also includes too many different responsibilities of the audit committee, the most important are:

Establishing the communication. It is vital that the audit committee and external auditor obtain a firm and open communication, because otherwise it can be reduced by monitoring the effectiveness of external audit procedures. In other words, all the members of the board and external auditors must be very clear and defined, and their meetings constructive and productive.

Appointment. The Audit Committee proposes to the board of external auditors who should be appointed. Previously, the committee reviews and assesses the competence, independence, experience and other characteristics of audit firms proposed by the external auditors.

Checking independence. The Audit Committee should have checked the independence and objectivity of the auditors each year, or to require the audit firm information on policies and processes that ensure the independence of key members of the audit team. While reviewing the independence, the board should have in mind the code of ethics for auditors in which independence is defined.

Approval of other engagements. If an audit firm, along to external audit, the company provides other professional services; it is essential that the audit committee considers such an engagement and inform the supervisory board. This must be done in accordance with the policy formulated by the Audit Committee and adopted by the supervisory board.

[4] Kodeks računovodstvenih načela i računovodstveni standardi Federacije BiH,Zavod za računovodstvo i reviziju, Sarajevo,1998.

Consideration of the audit plan. The Audit Committee should be familiar with the audit scope and approach which will be applied. So it is useful to organize a meeting with external auditors before the audit, on which will be discussed these issues. At the meeting, the Board is also informed about significant accounts and transactions that will focus on the external auditor, as considering them especially risky.

Deliberation management. Considering that the review procedure includes various kinds of statements made by the management (the completeness of entries, the fair value of assets, events occurring after the closing of books, etc.), the audit committee should consider them and, based on their findings, assessing whether are complete and adequate.

Consideration of the findings. When the audit process comes to an end, the Audit Committee considers the findings of an external auditor, which mainly relate to the basic problems arising during the audit. Of particular interest is how they are resolved and whether there are left unresolved issues.Consideration of the findings includes the problems that the auditor noted in internal control, as well as prospective errors in the records that should be corrected.

Consideration of lette to management, eternal auditor often practice presenting their observations on the functioning of accounting and internal control systems and audit.

The question is to what extent wills the audit committee deal with each of these responsibilities? The answer depends on the decisions of the supervisory board, which again depends on the regulatory requirements. From this it is important that the role of audit committees is clearly defined by the supervisory board in a separate document.[5] The document itself should be made to the specific needs of enterprises and to contain an accurate description of the responsibilities of the audit committee, which is defined in the documenton jurisdiction, the supervisory board should take into account also the abilities to perform delegated tasks.

Namely, the audit committee should not be recognized as the only body to which the supervisory board delegated all responsibilities arising from new regulatory requirements. Also, the scope of work, which stems from the role of the audit committee, must be adequate to the abilities of board members to perform them successfully. To check whether the increased scope of responsibilities reduces the effectiveness of the audit committee, it is necessary from time to time to analyze the document on competencies. For example, an annual review of board responsibilities should include the analysis of the circumstances, in which the company operates, as well as new regulations and new elements of best practice in the work of the audit committee.

[5] Međunarodni standardi financijskog izvješćivanja (MSFI) , RRIF 2007.

2.2. Constitution of the bord of auditors

The manner in which the audit committee is constituted may have a significant impact on his work. Therefore, the supervisory board should take into account several important factors of which depend on the effectiveness of the audit committee. First of all, these are: the number of board members, their competence and independence, the way of rewards and resources needed for work.

The number of members of the audit committee typically varies depending on the characteristics and needs of the enterprise and the scope of delegated authorities. For the purpose of successful functioning of the board, the participation of all members is needed, and it is desirable that they possess different knowledge and experiences. Committees with three to six members may be suitable for achieving these goals. Board members are usually appointed for a period of three years, with possibility of reappointment, and in order maintain the accumulated knowledge necessary to carry out responsibilities, all board members are never changed at the same time, but the rotation policy is being implemented at the appointment.

Bearing in mind the delicate role of the audit committee, *competence, experience, integrity and independence* of the candidates for the board, it must be carefully evaluated by the supervisory board.

In addition to the successful operation of the audit committee, of particular importance is the activity of the committee. The President should be elected with a special attention, because for this position can properly be handled by a person who is characterized by leadership and vision and that, among all other participants in the corporate governance process, recognized as the most suitable for this role.

Although the chairman of the board is primarily responsible for preparing and conducting meetings, it is not his only involvement. He should have regular contacts with the president of the supervisory board, general manager, external auditor and the heads of internal control and internal audit, to be able to prepare the session and placed on the agenda of issues within the scope of responsibilities of the audit committee.

Members of the audit committee should be adequately rewarded for their work, while the president may have greater compensation than other members, as being given the greater degree of engagement. The basis for compensation usually does the time of engagement, but the knowledge and experience of board members should also be taken into account. In determining compensation, it is necessary to take account of their amount, because excessive amounts can impair the independence of board members.[6]

The work of the audit committee requires specific kinds of resources to the supervisory board should have in mind when planning its activities and the activities of committees and commissions that delegates certain responsibilities. These resources are mostly already available in the company, within various professional services, which calls for their partly involvement and for the purposes of the audit committee. It is generally

[6] OECD Principles of Corporate Governance

thought to assist in collecting information of interest to the Committee's work, the preparation and organization of meetings, minute taking, preparation and distribution of the report and providing all kinds of practical support. If necessary, the audit Committee should be given the opportunity to engae independent legal, accounting and other advisors.

2.3. Functioning of the Bord of Auditors

Successful functioning of the board depends mostly on the ways in which to prepare and lead the session, the report of the Committee and the evaluation of its effectiveness.

When it comes to preparing the session the most important is to define the issues that should be on the agenda of the audit committee. Therefore, you should make an annual work plan of the board, so that issues could be identified on time and ready for consideration at the individual sessions. In this way it is created a basis for quality preparation of sessions and well-timed cooperation of all stakeholders in corporate governance, without which this work can not practically be done. Flexibility is essential in terms of number of sessions, because the council would need to meet as many times as necessary to carry out its responsibilities, provided that the time interval between sessions is sufficient for their high-quality preparation.

Aside from the members of the audit committee, the meetings may attend the president and some members of the supervisory board, CEO and chief financial officer, the members of other boards and commissions or other entities that are supposed to contribute to discussions on specific topics.

The practice is that the finance director attends the meeting, because many of the questions, by the nature of things, are from the domain of financial management and accounting. Likewise, a representative of the audit firm that is an external audit attends the meeting, internal audit manager, and sometimes the general manager (his presence, however, can affect the discussion not being sufficiently open and constructive because of restraint for board members to eventually confront their opinions Managing Director).

Chairman of the audit committee may decide that of a certain moment the session continues only in the presence of board members and external auditor. This happens when the external auditor informs the board about confidential matters, and when given feedback of management, especially the CFO, as well as the functioning of financial reporting and internal controls.

The Audit Committee shall adopt the formal record of their meetings, before they, along with other supporting documents (agenda, materials in individual counts) submit to the board, and if required, to external auditor and service dealing with internal audit. President of the Board has an obligation to inform the supervisory board of the conclusions from each session, in a way that will enable members of the supervisory board to perform its part of responsibility concerning the supervision of the company. Information on the work of the audit committee should be made available to shareholders. Therefore, the supervisory board should approve the publication of important information on the work of the audit committee in its annual report on operations.

It would be desirable to the Audit Committee to evaluate their work by themselves, so that all aspects of their work done with the best practice applied in the work of these committees. The Committee should analyze the degree of realization of their responsibilities and to collect opinions about all those who have been in constant communication (supervisory board, management, internal and external auditors, etc.).

2.4. Membership and organization of the Bord of Auditors

One of the key factors for good performance of the audit committee is certainly the appointment of competent members of the committee. The most common of all members of the audit committee is expected to be „accounting literate", respectively that they can read and understand financial statements of the enterprise. It is good for the audit commitee that at least one member has accounting and/or auditing skills, respectively to be able to ask questions about: financial risks, internal controls, audit process, accounting and other similar subjects. Each appointed member of the audit committee should have:

1. Integrity;
2. Willingness to devote time and energy to the company;
3. Understanding of business, product and services of the company;
4. Knowledge of risks and internal controls of the company;
5. Examining and independent judgments;
6. The ability to offer new or different perspectives and constructive suggestions.

In terms of office of the members of the audit committee, or the period to which they are appointed, some pre-established rules do not exist. The practice in the world shows that when determining the period of office of the members of the audit committee, it is important to take into account the need for continuity of Managment Board, but also the need to constantly provide new ideas.The usual terms are from one to three years. Active participants in the meetings of the audit committee are board members, but depending on the agenda of each session, and other participants, for example, the director of internal audit, external auditor, senior management, director of finances and others who are responsible for issues and topics that are on the agenda.

2.5. Responsabilites and tasks of the Bord of Auditors

Members of the audit committee must be adequately informed, committed to their work and an examination-oriented in meeting their surveillance duties in several areas especially in[7]:

[7] According to, Audit Committeess – Good practices for meeting market expectations, PricewaterhouseCoopers, 1999., 1st edition,www.pwc.comi Shaping the Irish Audit Committee Agenda, KPMG & Audit Committee Institute Ireland, May 2005.

1. Internal control and risk management;
2. Financial reporting;
3. Application of laws and regulations, and
4. the process of external and internal audit.

The Audit Committee has the responsibility to monitor the adequacy and effectiveness of internal control processes and procedures as an instrument of risk management which makes analyzing corresponding reports and maintainging these meetings and discussions with management, internal audit department and external auditor. The Audit Committee should be familiar with the nature, scope, timelines and results of the corresponding control tests conducted by internal and external audit and with the reports where the results of these tests are sent to management including the management response to the same reports.

The Audit Committee has expressed particular responsibility for monitoring and reviewing financial disclosures in the financial statements prior to their presentation and annunciation publicly. The Audit Committee shall examine the annual financial statements and assess whether they are complete and in accordance with the information and knowledge of board members. This refers primarily to check the implementation of accounting policies adopted in preparing the financial statements, especially in the assessment and evaluation of balance sheet items. To fulfil its responsibilities and duties, the audit committee must establish communication with the external auditors and internal audit department. Some of the most important aspects of cooperation and communication of the audit committee with external and internal auditors are processed in the sequel.[8]

3. COOPERATION OF THE BOARD OF AUDITORS WITH EXTERNAL AND INTERNAL AUDITORS

Cooperation of the audit committee and external auditors typically includes the following four areas[9]:

1. The importance of audit services;
2. Risk and control;
3. Financial reporting;
4. Other issues related to governance.

In the context of the importance of audit services that the external auditor provides for a firm and its clients, it is necessary to discuss the formal qualifications and reference audit projects of external auditor, its audit resources and capacities (personnel, location, technical equipment, etc.), knowledge of the business industry and the importance of activities of the company (client).

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[8] OECD Principles of Corporate Governance

[9] According to, Audit Committeess – Good practices for meeting market expectations, Pricewaterhouse Coopers, 2003.,2nd edition,www.pwc.com, str. 35

The Audit Committee should hold a special meeting with the external auditors to discuss the business risks facing the company and internal control processes and procedures that act preventively. The Audit Committee, management and external auditor will meet and work for viewing and examination of financial reports and findings of the audit of financial statements. In addition, members of the audit committee and external auditors can critically discuss the acceptability and quality of the accounting policies adopted by management, their aggressiveness or isolation in the context of the overall business policy.

The Audit Committee must be aware of and fully understand the activities of the internal audit department and its internal organizational structure. Some of the questions the audit committee in this regard should set are listed below[10]:

1. Is the internal audit engagement appropriate?
2. Does it keep up the pace with the activities of enterprises, information systems and systems of control?
3. Does the internal audit have appropriate resources in terms of professional skills and finance?
4. Would the objectives and tasks of internal audit be realized well if outsourcing of internal audit is carried out?
5. How it is defined the internal audit program?
6. Does the internal audit investigate the areas of significant financial and operational risks in the business of the company?
7. Does the company act according to the recommendations of internal audit and monitor the changes?
8. Do the internal auditors have acceptable relationship with external auditors and persons in the company that are included in the risk management process?

3.1. Communication with management and reporting

Relevant issues for which the audit committee should regularly receive information include[11]:

1. Management's assessments of business risks that the firm faces and the planned responses to those risks and information risk management strategy which establishes management;
2. Current issues affecting the business in which the company (eg: regulatory issues or information on the competitive environment);
3. The effect of the new tax regulations or other relevant legislation may have on the company's business;
4. The legal environment, including the status of any pending lawsuits or administrative proceedings and charged with the associated liabilities, if any, and the status of product and obligations relating to the environment and the funds provided for possible complaints;

[10] Audit Committeess – Good practices for meeting market expectations, Pricewaterhouse Coopers, 2003., 2ndedition,www.pwc.com, str. 43.
[11] According to, Audit Committeess – Good practices for meeting market expectations, Pricewaterhouse Coopers, 2003.,2nd edition,www.pwc.com, str. 44.

5. Activities of the Treasury, including cash management, bridging risk in a foreign currency transactions and the use of new and unusual financial instruments;
6. Dealing with foreign countries, including the location and local controls over financial reporting;
7. Human resources and compensation policies, procedures for examining the costs and facility of employee andcontrol of contracts with temporary and permanent employees;
8. Insurance for directors and senior perpetrators.

4. CONCLUSION

If we look at the scandals and financial crisis, whose repercussions are felt even now in developed countries (ENRON, WORD COM and others) one can say that the role of the Audit Committee in corporate governance and corporate governance in the Federation of Bosnia and Heregovina should be taken seriously and given full attention to strengthening the role and expansion of responsibilities of the Audit Committee. To commit to achieving the above mentioned is very important because as the role of audit committees' protection against any unlawful or harmful business activities that may adversely affect the business performance and reputation of the company. The role of the Audit Committee is also significant because because it not only suggests and proposes the ways to improve the success of the companies, it evaluates the internal control system as a realistic assumption of presentation of financial data.

The Audit Committee is one of the specialized sub-committees that delegates appropriate supervisory functions. In continental formations of corporate governanc the audit committee is a specialized sub-committee of the supervisory board, while in the Anglo-American systems of corporate governance audit committee is specialized sub-committee to which they delegate some supervisory functions of the board of directors. The main task of the Audit Committee in public enterprises and joint stock companies in Bosnia and Herzegovina are defined by the Act on public enterprises in the Federation of Bosnia and Herzegovina. The Audit Committee shall report to the founder. The Audit Committee has a duty to take into account the valid legal requirements, standing at the disposal to founder submitting them expert reports and opinions.

The primary functions of the audit committee are usually associated with individual areas of internal control and risk management, financial reporting, implementation of legal regulations and with relevant areas and issues concerning the process of external and internal audit. Responsibilities and authorities of audit committees are usually established and recorded in the form of rules of audit committees. With the clear and precise definition of responsibilities, powers and duties of the audit commitee, an important assumption of its work in by concrete situations in the appropriate appointment of members of the audit committee, determination of its internal organization, and particularly the issue of cooperation with exsternal and internal auditors, and communication with management.

In the years to come when Bosnia and Herzegovina starts its way in the EU the role of audit committees will be strengthened as the increasing importance attached to improving of corporate governance in general.

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COMPETITIVE PROCESS AND FOREIGN FIRM ENTRY IN LIGHT OF EU ACCESSION: THE CASE OF SLOVENIAN RETAIL TRADE SECTOR

ABSTRACT

The aim of this paper is to investigate the changes in the competitive process and their concurrence with the entry of foreign firms. We do that by exploring market structure developments in the Slovenian oligopolistic retail trade sector NACE Rev. 2 47.110 in the 2002-2007 period to encompass the changes in the economic situation caused by the Slovenian accession to the EU in May 2004. We find that although the Slovenian EU accession cannot be directly linked to higher foreign firm entry rate, our analysis suggests that 2004 was associated with more intensive activity of foreign-owned competitors. The results are in accordance with theoretical predictions about the impact of foreign competition on firm selection process within a particular industry. We find that in the analysed period the decreasing number of firms in the market led to larger scale, higher labour productivity and lower unit cost of operation of an average firm. Most efficient firms gained larger market shares at expense of their less efficient rivals, which resulted in increased market concentration. We find inverse relationship between the concentration and competition level since despite the higher market concentration, the average markup of the retailer decreased. Based on our findings we may infer that the price level in the retail trade sector also decreased throughout the analysed period.

Key words: competition effect, foreign competition, firm selection, Slovenia, retail trade

JEL classification: L11, L13, F12, F21, L81

1. INTRODUCTION

One of the important factors of the market structure and industry evolution in small open economies is foreign competition. The internationalisation of markets and growing liberalisation of the world trade have led many empirical studies to investigate the role of international competition in connection to the changes in the competitive process. Industrial restructuring process triggered by liberalisation and economic integration is driven by the pro-competitive effects of increased internationalisation of firms' operations.

The aim of this paper is to investigate the changes in the competitive process and their concurrence with the entry of foreign firms. We do that by exploring market structure developments in the Slovenian retail trade sector, more specifically Retail sale in non-specialized stores with food, beverages or tobacco predominating (NACE Rev. 2 47.110), that carries the characteristics of the typical oligopolistic industry. We place our analysis in the 2002-2007 period to encompass the changes in the economic situation caused by the Slovenian accession to the EU in May 2004. At that point Slovenian economy became an integral part of the European internal market, characterised by four freedoms: free movement of goods, persons, services and capital. This was consequently expected to foster the entry of foreign firms into Slovenian market. We test the theoretical predictions about the industry evolution (changes in the number of firms in an industry, firm entry and exit rates and market concentration) associated with the increased level of foreign competition upon the Slovenian EU accession. Further, we aim to investigate the implications of such changes on the average performing firm in the industry with respect to the firms' turnover, labour productivity, markup size and performance ratios.

The remainder of the paper is organised as follows. The next section discusses the theoretical background together with the research hypotheses. The third section presents our empirical analysis, while the last section concludes.

2. THEORETICAL BACKGROUND AND RESEARCH HYPOTHESES

2.1. Pro-competitive effect of foreign competition

The effects of foreign competition associated with trade entry mode of foreign firms (trade liberalisation) have been much more extensively studied than the effects of foreign competition via FDI entry mode of foreign firms (investment liberalisation). Following the 'trade literature', the additional source of gains from trade, besides those proposed by classical and neo-classical trade theories, is the pro-competitive effect (the disciplinary effect of increased foreign competition on domestic firms). Within the monopolistic competition setting, the pro-competitive effect results in an increase in firms' scale, a decrease in average costs and prices and an increase in product diversity (Helpman 1981; Krugman 1979), while under the assumption of an oligopolistic interaction between firms, by affecting the market power of firms trade liberalisation causes a decrease in price cost mark-ups and an increase in the firms' scale (Dixit and Norman 1980; Brander 1981; Venables 1985; Baldwin and Venables 1995). In the presence of asymmetrical firms within the same industry, the pro-competitive effect of trade (trade liberalisation) results in a firm-selection process within an industry. Several models demonstrate that trade liberalisation forces the least efficient firms to contract or exit while promoting the growth and success of more efficient ones. Aggregate productivity rises as employment shifts from low productivity firms driven out by import competition to high productivity firms turning toward export markets (the first key contributors include Melitz (2003) and Bernard, Eaton, Jensen, and Kortum (2003)[1].

It can be expected that these effects are, at least to some extent, also present in the case of inward FDI as both the exports and local sales of a foreign affiliate involve an increase in market competition in the host country. On the other hand, FDI involves several specific characteristics leading us to expect there are some important differences between trade and investment liberalisation impacts from the host-country perspective.

As pointed out by Markusen and Venables (1999), in the absence of any micro-economic imperfections a small FDI project will have no effect on host-economy welfare so if a case is to be made for gains or losses it must rest on the possibility that FDI interacts with, or creates, distortions in the host economy such as technological externalities, interaction between multinational activity and fixed distortions in the economy and changes in the structure of imperfectly competitive industries. Three main channels of influence of inward FDI are usually discussed in literature: technology transfer, productivity spilllovers and competition effect.

Firstly, in compliance with Dunning's eclectic paradigm, MNEs usually possess some kind of 'technological' advantage that is transferred to their local affiliates and which allows them to compete successfully with other MNEs and local firms despite the disadvantages related to the higher costs of doing business abroad. The subsidiary may speed up the transfer of technology and innovation causing them to be disseminated faster than otherwise among the domestic firms that compete with it, supply it or otherwise enjoy some point of economic contact. For the host country to derive a net benefit via this channel, the transfer must occur more swiftly (or cheaply, or both) through the multinational firm than through competing channels – the free flow of non-proprietary discoveries, licensing of patents and know-how, embodiment in internationally traded capital goods etc. Productivity comparisons between foreign-owned and domestically-owned firms or establishments almost always find that the foreign-owned firms have higher productivity levels in both developed and developing countries. Some of that higher productivity, but not all in most comparisons, can be attributed to the higher capital intensity or larger scale of production in the foreign-owned plants.[2]

[1] Peretto (2003) distinguishes between two driving forces behind the industrial restructuring process, namely specialisation and the scale effect. In two-sector models of inter-industry trade, firms' entry/exit is driven by a specialisation effect: as a country specialises in one sector there is the entry of firms to that sector and an exit from the other sector. In one-sector models of intra-industry trade, by contrast, entry/exit is driven purely by a scale effect: as a country trades with another the market becomes larger and induces the entry/exit of firms. Specialisation and scale effects are not independent. In two-sector models of inter-industry trade, specialisation affects the market structure within each sector precisely because it changes the relative and absolute size of the two sectors and thereby triggers an entry/exit within each sector. In one-sector models of intra-industry trade, the inter-industry specialisation effect is absent and what is left is the pure scale effect based on market size.

[2] See Lipsey (2002) for a comprehensive review of these empirical studies.

Secondly, foreign subsidiary may induce a higher level of technical or 'X-efficiency' in domestic firms that compete with it, supply to it or purchase from it. Generally, productivity spillovers are said to take place 'when entry or presence of a MNE affiliates lead to productivity or efficiency benefits in the host country's local firms, and the MNEs are not able to internalize the full value of these benefits' (Blomström and Kokko, 1998, p. 8). These effects may take place either in the foreign affiliate's own industry (intra-industry), in other industries – among the affiliate's suppliers and customers (inter-industry) – or as a result of geographical proximity to MNEs' affiliates (agglomeration spillovers). However, MNEs have a strong incentive to prevent information leakages that would enhance the performance of their local competitors but at the same time might want to transfer knowledge to their local suppliers. Therefore, it is expected that spillovers from FDI are more likely to be vertical rather than horizontal in nature. Several potential channels of productivity spillovers are discussed in the literature (Blomström and Kokko (1998), Saggi (2002), Lipsey (2002)). Intra-industry spillover effects may occur mostly through demonstration effects or labour market turnover, while inter-industry spillovers occur through backward and forward (intermediate buyer-seller) linkages between foreign affiliates and domestic firms.

Thirdly, the MNE may provide a significant boost to competition in the host-country market. It tends to populate industries where barriers to entry by new firms are high. Thus it may pare down monopolistic distortions and raise the productivity of the host country's resources by improving their allocation. As stated by Caves (1971, p. 15), 'whatever the market structure that results from the influence of FDI, it can be argued that entry by a foreign subsidiary is likely to produce more active rivalrous behaviour and improvement in market performance than would a domestic entry at the same initial scale.' However, as far as domestically-owned firms are concerned a foreign firm entry can also reduce their productivity as demonstrated by Aitken and Harrison (1999). The entry of a foreign firm with lower marginal costs draws demand away from domestic firms as the foreign firm has an incentive to increase production relative to its domestic competitors. Domestic firms are then forced to cut production and the least productive ones even to exit the market. This is the so-called 'crowding-out' effect or 'business stealing' effect. In imperfectly competitive markets where firms face fixed production costs the productivity of surviving domestic firms would fall in this case as they would then spread their fixed costs over a smaller market, forcing them to back up their average cost curves. In addition to the product market, the crowding-out effect associated with inward FDI may also take place in the factor markets where foreign firms may increase demand and thus the equilibrium price of the factor of production.

Taking into an account competition and the vertical linkage effect of MNE entry presence for the host economy[3] Markusen and Venables (1999) demonstrate within a monopolistic-competition setting that the necessary and sufficient condition for the price index of consumer good to fall is that the ratio of the MNE's demand for

[3] First, there is the competition effect. An increase in the number of MNEs reduces the price index in the consumption industry, and hence also domestic firms' sales which leads to the exit of some domestic firms to restore the sales of remaining firms to their zero-profit level. Second, there is a linkage effect as MNEs create additional demand for domestically produced intermediate goods (this may, however, be offset by an indirect competition effect) and thus expand intermediate industry's output.

intermediates to their impact on the domestic supply should exceed this ratio for domestic firms. Further they show that when in the initial equilibrium there is no local production, a multinational entry can push the economy over to equilibrium with local production in both the intermediate and final-goods industries, with a resulting welfare improvement. Here the multinational entry acts as a kind of catalyst for the development of local industry. Further, Barrios, Görg and Strobl (2005) found within similar general equilibrium monopolistic competition setting, that the number of domestic firms as a function of the presence of foreign firms follows a U-shaped curve where the competition effect first dominates but is gradually outweighed by positive externalities from backward linkages. The entry of new foreign firms provokes the exit of a determined number of local firms through competitive pressure. However, with further increases in the number of foreign firms the equilibrium number of local firms starts to increase as a result of the dominance of the positive externalities effect.

2.2. Foreign competition and market concentration changes

Traditionally, given the predominance of the Structure-Conduct-Performance (SCP) paradigm the market structure effects of increased foreign competition that have attracted most attention have been that of market concentration changes. According to the transaction-cost theories of MNEs, it is expected that MNEs prevail in industries with a relatively high market concentration because the influences giving rise to MNEs are identical to the bases of several barriers to entry to industries[4], and entry barriers cause higher market concentration. Therefore, the height of entry barriers and the presence of MNEs should be highly correlated. On the other hand, entry barriers strongly affect the market concentration; we then expect FDI and concentration to be closely associated. However, not all types of entry barriers seem to be equally important for an MNE entry. Shapiro (1983) found that MNE entrants tend to be deterred by capital-cost entry barriers while they are actually encouraged by barriers related to advertising and R&D.

Several studies indeed confirm a strong positive correlation between MNE activity (entry and presence) and market concentration (see Dunning (1993), Caves (1996), Blomström and Kokko (1997, 1998), World Investment Report 1997 for a review of these studies). However, there are several difficulties in measuring market concentrations. In fact, some of this evidence relates to industry rather than market concentration as production-concentration ratios often apply to industries as a whole and not to individual product markets. Moreover, measures of 'market concentration' often only consider domestic producers and disregard the share and dispersion of imports.

Although there is strong empirical evidence of a high correlation between MNEs' presence and market concentration, no firm conclusion can be drawn regarding the causal relationship between FDI (MNE entrance) and market concentration in the host

[4] Among barriers that limit the number of firms operating in the market, the following are usually recognised (Caves, 1996, pp. 83-85): advertising expenditures, capital-cost barriers, scale economies, research and development expenditures, and organisational complexity.

economy. As follows from empirical studies[5], MNEs mainly enter industries where barriers to entry and concentration are relatively high, and initially add to the number of firms in the market (at least when MNEs enter via greenfield investments). While the immediate impact on market concentration upon entry is thus generally negative, the impact on post-entry market concentration is not so clear. Over the medium- and long-term, MNE participation and conduct may contribute to increasing or decreasing concentration. On the one hand, MNEs are the most favoured potential entrant to those national markets that are likely to be highly concentrated and profitable, implying that in equilibrium these markets will be less concentrated if MNEs enter than otherwise. On the other hand, MNEs may contribute to some increase in market concentration as the scale economies inherent in their firm-specific assets and their productivity advantages over single-nation competitors can force the least efficient local companies out of business (or into a fringe corner of it). However, welfare may still increase (see Zajc Kejžar, 2011). According to Caves (1996, pp. 87-88), the pro-concentration potential of MNEs' activity can also be regarded as the outcome of random processes. Investments in building proprietary assets have highly variable outcomes which tend to increase concentration if the big winners greatly increase their market shares and are not systematically pulled back by any subsequent reverses.

The risk that an MNE's entry leads to increased concentration seems to be higher for developing countries than for developed ones, at least based on empirical studies. In one of the latest studies for developed countries, Driffield (2001) finds for the UK that inward FDI acts not only to reduce concentration at the industry level but also to increase the rate at which an industry adjusts towards its equilibrium (speeds up the rate at which concentration is reduced).

2.3. Foreign competition and competitive process

Merely showing the relationship between foreign competition and concentration on domestic markets, however, does not satisfactory explain how foreign competition affects the competitive process, efficiency and welfare. There is, namely, no simple relationship between competition, efficiency and concentration. Sutton (1991) showed that tougher competition between incumbent firms may itself cause higher concentration because competition leads to lower prices, ultimately forcing out marginal producers, while offering less favourable prospects for new entrants. In this case, higher concentration would be accompanied by lower prices and concentration would not necessarily imply a lack of competition. The more relevant questions to ask here are, therefore, how the entry of foreign firms affects the price, product variety and dynamic efficiency in an industry.

There is also the classic 'Schumpeterian dilemma' of weighing the static allocative efficiency of competitive markets against the supposed dynamic efficiency of monopolistic and oligopolistic firms (Blomström and Kokko, 1998). As emphasised by Motta (2004), firms are unlikely to make any investment unless they can expect to appropriate its returns. The expectation of market power thus represents a powerful

[5] See Caves (1996), Blomström and Kokko (1997, 1998), World Investment Report 1997 for a review of empirical studies.

incentive for firms to innovate and invest in R&D. According to empirical findings, it is generally expected that neither perfect competition nor monopoly but mildly oligopolistic markets are the most conductive of technical progress (see Kamien and Schwartz, 1982).

Market structure and concentration are themselves the product of the competitive process which is induced by increased foreign comeptition. The entry of a foreign firm (either through exports or FDI) namely disturbs the existing equilibrium in the host country and increases the intensity of competition. The competition also intensifies if the foreign firm was exporting prior to it establishing local production in the host-country market since by avoiding export costs the foreign firm's competitive position is improved. This is particularly important in markets characterised by high entry barriers in which trade and investment protection typically leads to the oligopolisation of the domestic market by a few firms, allowing them to exercise market power. In this case, a foreign entry increases the competition, reduces monopolistic distortions and depresses the price-cost margins of host-country firms.

The entry of foreign firms may provoke different offensive and defensive response strategies of local firms seeking to protect their existing market shares and profits. The least efficient local producers faced with competition from technologically sophisticated foreign affiliates may, in some cases, be forced out of the market which in the long run may contribute to some increase in market concentration, even though welfare may still increase. For example, according to World Investment Report (1997, p. 101) in the Visegrad countries only a few established television-producing firms (such as OTF in Slovakia, Videoton in Hungary and Elemis and Unimor in Poland) have survived the competition from imports and foreign affiliates.

On the other hand, in some countries and industries local firms may respond competitively and enforce stricter or more cost-conscious management and motivate their employees to reduce any slack or improve X-efficiency. When technical capabilities are well-developed, competition from MNEs may induce R&D and innovation by domestic firms. Recently, it has frequently been observed that industry consolidation induced by changes in foreign competition is accompanied by heightened merger activity. As quoted by Horn and Persson (2001), the European Commission found that between 1985 and 1995 restructuring in the EU appears to have mostly taken place through the capital market via mergers and acquisitions, with a more limited role being played by the entry, exit and internal growth or decline of existing firms. Several case studies at the firm and industry levels suggest that the effects of competition and productivity spillovers from MNEs to local firms vary according to the technological and entrepreneurial capabilities of local firms relative to those of foreign affiliates and the market strategies of MNEs and local firms.

Additionally, market structure effect crucially depends on motives behind and types of foreign firms' entry and the strategic interactions between foreign and local firms. As far as FDI entry mode is concerned, it is usually argued that a greenfield entry that 'adds' another firm to the market in question generates greater competitive pressure than an entry through the acquisition of already existing local firms. However, the acquisition of a local firm that would otherwise have exited the market also has a competition-enhancing effect. Moreover, the increased efficiency arising from the synergy between the merging parties can bring additional competitive pressure and offset the anti-competitive effects of a merger. Besides, these two different modes of entry may have different implications for the exit and entry process of local firms and other MNEs so this expectation cannot be generalised. Second, the motivation behind the internationalisation decision of an MNE may also matter for the industry-structure effect. It is expected that foreign affiliates are more export-oriented in the case of vertical FDI. Therefore, we expect less competitive pressure in the product market connected to the entry and presence of vertically-integrated MNEs.

Several models appearing since the second half of the 1980s examine firms' choices between different modes of foreign entry (export, FDI, licensing) and which determine market structure as the solution of the multi-stage game between international oligopolists (Smith, 1987; Horstmann and Markusen, 1987, 1992; Motta, 1992; Sanna-Randaccio, 1996; Petit, Sanna-Randaccio, 2000; Zajc Kježar, 2011) etc.). These models follow a new IO approach that models market structure as an outcome of conduct and performance rather than the cause, a possibility well-recognised as the endogeneity problem in the earlier SCP empirical literature.

Based on the theoretical foundations of the above mentioned models and using the case of the Slovenian retail trade sector in the period 2002-2007 we thus test several hypotheses about the changes in the competition process related to the larger exposure to foreign competition. An emphasis is put on the changes in the retail trade sector that followed the Slovenian accession to the EU in May 2004. First, we hypothesise that the accession to the European integration led to more intense entry of foreign firms on the Slovenian market. Initially, due to foreign firms' entry the number of firms operating in the domestic market increased compared to the pre-EU situation. Consequently the level of competition increased. Second, more intense competition led to decrease in the markup size. At the same time the Slovenia's accession to the EU led domestic firms to enter foreign markets and higher turnover of an average firm. Increased competition forced and scale economies allowed average costs to decrease. As a result of theoretically acknowledged firm heterogeneity within industry we also believe that the foreign firm entry caused least efficient domestic firms to exit the market. Both, larger average scale of business and the exit of least efficient domestic firms from the market increased the average industry productivity.

3. THE EMPIRICAL ANALYSIS OF THE COMPETITIVE PROCESS IN THE RETAIL TRADE SECTOR IN SLOVENIA

Our analysis is based on the data on Slovenian firms operating in retail sale in non-specialized stores with food, beverages or tobacco predominating (NACE Rev. 2 47.110) in the period 2002-2007. Geographically we consider the market within the Slovenian national borders since it is not very likely for consumers to substitute the domestic purchases with cross-border ones. In our analysis all firms registered in NACE Rev. 2 47.110 industry are included regardless of whether they realised positive revenues in a particular year or not.

The primary data source for the empirical analysis is the database of firms' financial statements collected by the Agency of the Republic of Slovenia for Public Legal Records and Related Services, extended by data from the Business Register of the Republic of Slovenia.

3.1. The evolution of the retail trade sector

In our firm level data analysis we first focus on firm entry dynamics. It should be noted that there exist certain specifics to retail industry when it comes to barriers to entry. Namely, in some of manufacturing industries firms are able to enter a new market with relatively low costs, whereas that is not true for retail companies (except when their internationalization strategy involves franchising). For retail firms market entry is usually associated with significant costs, largely connected to establishing new sales units. Further issue that the entrants to the Slovenian retail trade market have to face is that most of the attractive sales locations are already taken. Since the sales location is of extremely high importance in the retail sector, this represents a serious barrier to entry. Additionally, this characteristic of the Slovenian retail trade market may increase the relative attractiveness of acquisitions/mergers compared to greenfield investments. In addition to that, big Slovenian suppliers are reluctant to do business with smaller retailers since big retail chains are more profitable for them. Hence, entering the Slovenian market is very difficult for small retailers.

Table 1 Number of entrants into retail trade sector NACE Rev. 2 47.110

Year	No. of entrants	Entry rate in %	No. of domestic entrants*	No. of foreign-owned entrants	No. of EU-owned entrants
2003	50	9,2	45	5	1
2004	34	6,7	32	2	2
2005	24	5,2	23	1	0
2006	13	3,1	12	1	0
2007	26	6,5	25	1	1

* Domestic entrants and entrants with unknown origin are included

Source: APLR, 2010, own calculations

Data from Table 1 show that the number of all entrants into the observed retail trade market declined from 2003 to 2006 and picked up slightly in 2007. In order to establish whether the Slovenian accession to the EU coincides with an increase in foreign firm entry it is crucial to establish how many of these firms were foreign owned, or more importantly how many of these foreign-owned firms had owners coming from the EU member states. Data indicate that most of the entering firms were in fact domestically owned. At first glance the year 2004 when Slovenia became a member of the EU does not seem to stand out with regard to the number of firms with owners from the EU entering the observed market. However, if we consider the financial statements of these

EU-owned entrants, a different picture emerges. Namely, the EU-owned firm Billa that entered the market in the year 2003 did not realise positive sales till the end of year 2006. The similar goes for Lidl that entered the Slovenian market before 2003 and is hence not captured in Table 1 statistics. Lidl remained virtually inactive until 2007, when it opened several stores at once, accompanied by a huge PR campaign. Further, Hofer and Eurospin that entered the market in 2004 have become major market players. In 2006 they were already the fourth and the sixth largest companies in terms of sales in the observed sector respectively. It should also be noted that in the Slovenian market Lidl is another foreign-owned retailer with a strong market position. Although the Slovenian EU accession cannot be directly linked to higher foreign firm entry rate, these facts suggest that 2004 was associated with more intensive activity of foreign-owned competitors.

The next focus of our analysis is on the firm exit dynamics. Data in Table 2 show that the number of firms exiting the retail trade market NACE Rev. 2 47.110 declined each year. However, the exit rate showing the ratio between the number of exits and the number of active firms, decreased to a much smaller extent as a result of the decreasing number of firms operating in this sector. This of course does not necessarily indicate that the competitive pressures declined as well, since the firms that do survive are usually more capable of coping with competitive pressures.

Table 2 Number of active and exiting firms in retail trade sector NACE Rev. 2 47.110

Year	No. of exiting firms	Exit rate (%)	No. of active firms
2003	77	13,4	546
2004	76	13,9	504
2005	63	12,5	465
2006	57	12,3	421
2007	45	11,2	402

Source: APLR, 2010, own calculations

The continuously decreasing entry and exit rates observed in the Slovenian retail trade sector in the 2000-2007 might, according the product-life-cycle-based models of firm and industry dynamics, reflect the fact that this sector already experienced its major shake-out prior to the observed period, which suggest that the Slovenian retail trade has already passed the earlier/formative stage and is approaching its mature phase of the industry life cycle.

A logical consequence of a decrease in the number of firms operating in a market is an increase in market concentration, which is illustrated in Table 3.

Table 3 Hirschman-Herfindahl index of the retail trade sector NACE Rev. 2 47.110

Year	HHI	% change of HHI	K4	% point change of K4
2002	1,032.3	-	51.9%	-
2003	1,204.8	16.7	57.5%	5.6
2004	1,736.2	44.1	69.7%	12.2
2005	2,345.8	35.1	81.0%	11.3
2006	3,398.7	44.9	89.1%	8.1

Source: APLR, 2010, own calculations

The value of the Hirschman-Herfindahl index has been steadily increasing in the analysed period. Accordingly, we can classify the Slovenian retail trade sector as medium high concentrated market until 2005 and as highly concentrated market thereafter. As evident from the table, the annual changes of HHI elevated above 35% since 2004. Similarly, the concentration ratio K4 was increasing and exceeded 80% in 2005. The dynamics of both market concentration measures suggest that after Slovenian EU accession and even more upon the introduction of euro the selection process within the Slovenian retail trade sector intensified. This allowed most efficient firms to gain larger market shares at expense of their less efficient rivals.

3.2. The conduct and performance of the retailers

In this section we further explore the developments in the Slovenian retail trade sector in the average firm pricing behaviour, efficiency, profitability and average sales related to the increased foreign firm competition pressure during the period of 2002-2006. In Table 4 we first present the data on sales revenues, unit cost and labour productivity of an average retailer. Labour productivity is measured in terms of value added per employee.

According to the data presented in Table 4, the average sales per firm in the observed sector increased by 55% in the period between 2002 and 2006. This was accompanied by an increase in firm efficiency. Namely, the average unit cost declined by almost 16% and the average labour productivity grew steadily, cumulatively for 24% throughout the observed period. Although the total sales revenues in the Slovenian retail trade sector remained stable during the analysed period, the number of firms in the market decreased, as shown above and average sales revenues per firm increase as a result. This larger scale of operation of an average firm allowed retailers to realise higher returns to scale, expressed through decrease in the unit cost size. Decrease in unit costs together with the increase in the average labour productivity suggests that during the period observed the intensity of the competitive process in the retail trade sector in Slovenia increased.

Table 4 Sales revenues, unit cost and labour productivity of an average retail trading firm NACE Rev. 2 47.110 (in 1000 SIT, constant prices 2002)

Year	Average sales revenues per firm	Sales index 2002=100	Average unit cost	Average unit cost index 2002=100	Average firm labour productivity in fixed prices	Productivity index 2002=100
2002	992,567	100	1.155	100	30.45	100
2003	1,043,836	105.2	1.141	98.8	32.40	106.4
2004	1,200,472	120.9	0.993	86.0	35.24	115.7
2005	1,325,360	133.5	0.992	85.9	35.15	115.4
2006	1,541,642	155.3	0.974	84.3	37.86	124.3

Source: APLR, 2010, own calculations

The changes in the market competition conditions are, according to theory, also reflected in the markup size. Based on the available data, markup is computed as the ratio between the value of sales and the sum of labour costs and costs of material. Average markup size, return to equity (ROE) and return to assets (ROA) in the Slovenian retail trade sector are shown in Table 5.

Table 5 Average markup size, ROA and ROE in the retail trade sector NACE Rev. 2 47.110

Year	Average markup in %	Average ROE in %	Average ROA in %
2002	18.0	7.29	1.73
2003	18.2	14.25	3.26
2004	17.9	10.28	2.24
2005	17.0	13.80	3.08
2006	16.9	12.06	2.32

Source: APLR, 2010, own calculations

During the observed period the average markup gradually decreased from 18% to below 17 %. The largest fall in the markup size can be observed just after Slovenian accession to the EU, namely in the 2005, which corresponds to the entry of discount retailers Eurospin and Hofer to Slovenian market. The markup dynamics thus show the pro-competitive effect of the foreign entry. The profitability of the average retailer, however, varied throughout the period.

4. CONCLUSION

In this paper we investigate the changes in the competitive process and the link between the market structure dynamics and the entry of foreign firms. Our analysis is based on the case of the Slovenian retail trade sector NACE Rev. 2 47.110 in the 2002-2007 period. The period allows us to observe the link between the changes in the economic situation caused by the Slovenian accession to the EU in May 2004 and the changes in the competitive process of the oligopolistic retail trade sector. Our analysis of the market structure, conduct and performance elements of the retail trade sector provides new insights into the industry evolution process in relation to increased foreign competition. Additionally, the analysis carries important implications for the linkages between the increased foreign competition, market structure, pricing behaviour, performance and aggregate efficiency.

We find that although the Slovenian EU accession cannot be directly linked to higher foreign firm entry rate, our analysis suggests that 2004 was associated with more intensive activity of foreign-owned competitors. Furthermore, after EU accession and even more upon the introduction of euro the selection process within the Slovenian retail trade sector intensified.

Although the total sales revenues in the Slovenian retail trade sector remained stable during the analysed period, the number of firms in the market decreased and average sales revenues per firm increased as a result. This larger scale of operation of an average firm allowed retailers to realise higher returns to scale and consequently lower unit cost. Decrease in unit costs together with the increase in the average labour productivity suggests that during the period observed the intensity of the competitive process in the retail trade sector in Slovenia increased. This allowed most efficient firms to gain larger market shares at expense of their less efficient rivals, which resulted in increased market concentration. Despite the higher market concentration, the average markup of the retailer decreased. This finding is in accordance with theoretical predictions on the possibly inverse relationship between the concentration and competition level. Although the price level is not directly investigated in our paper, we may infer based on our findings about lower unit costs and about decreased markup size that the price level in the retail trade sector also decreased throughout the analysed period.

According to the product-life-cycle-based models of firm and industry dynamics, the observed continuously decreasing entry and exit rates in Slovenian retail sector and the concentration ratio above 80% suggest that Slovenian retail trade sector holds characteristics of a mature industry.

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EXPORT COMPETITIVENESS OF CROATIA'S HIGH AND MEDIUM-HIGH TECHNOLOGY SECTOR[1]

ABSTRACT

High and medium-high technology sectors contribute to growth by changing the key factors of success in the global economy. Those sectors have now emerged as key sources of wealth generation as opposed to resource-based industries that dominated the twentieth century. Existing studies on high and medium-high technology sectors indicate that they have higher growth rates than economies. Moreover, their share rapidly increased in domestic and international trade as well. High and medium-high technology sectors are characterized by a high degree of capital and R&D activities which make them top exporters in most economies. The main aim of this article is to explore and explain the crucial role of Croatia's high and medium-high technology industry, along with the analysis of comparative advantages and overall export competitiveness on the basis of chemical industry. The methodology of the paper is based on applying indicators of comparative advantages, industry trade, and export competitiveness.

Key words: competitiveness, high technology

JEL classification: F1

1. INTRODUCTION

High technology is frequently used as a term for businesses and industries which manufacture commodities or provide services that integrate advanced and innovative technology. High technology sector includes industries related to space exploration, pharmacy, computers, office equipment, electronic communication, and precise instruments, whereas medium-high technology sector includes electric machinery, motor vehicles, chemicals (except pharmaceutical chemicals), and other transportation, machinery and equipment (OECD, 1990). The difference between high and medium-high technology sectors mostly refers to R&D (research and development) expenditure-to-sales ratio. Because of the significance of pharmaceutical products in the category of

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chemical industry, the research will look at comparative advantages and export competitiveness of high and medium-high technology industry. On the other hand, competitiveness is defined as the ability of a country to produce and distribute commodities more effectively in comparison with its competitors. Using the value of realized export is an acceptable way of measuring competitiveness in the high technology sector (Seyoum, 2004).

In industrialized countries, high and medium-high technology sectors create jobs (especially in small and medium businesses) and employ qualified and highly-paid workforce. In general, these sectors are showing greater growth rate than economy, they are increasing their share in national and international trade, and they are taking the position of the main export industry in a lot of countries.

High and medium-high technology sectors contribute significantly to rapid growth in industrial production and services. Such rapid growth is reflected in the form of increased efficiency in work and capital units. Studies by OECD (1999) point to the significance of high technology which increases the comparative advantage of a company. This is illustrated by the fact that in most OECD countries, trade growth rate is stimulated by growth in international trade of high technology commodities.

The main feature of the high and medium-high technology sector is the high degree of capital and R&D activity, as well as productivity in creating new knowledge and technology. Consequentially, many high and medium-high technology businesses are increasing their investment in R&D and in innovation activities so that they could reach a higher level of export competitiveness.

However, there are high technology subsectors, for example those in the pharmaceutical industry, which are involved in a long-term and commercially “risky” (basic) research projects, with a long period extending from the beginning R&D program and implementation to the first marketing of new products. Such industries face fierce international competition and are often involved in advanced international cooperative research and manufacturing programs. This is supported by the fact that hi-tech businesses face shorter product lifespan.

The basic hypothesis of the paper is set within the framework of defined research issues. The hypothesis is that the structural analysis of the indicators of comparative advantages and export competitiveness enables us to evaluate the current state in the export competitiveness of Croatia’s high and medium-high technology sector.

Therefore, the main aim of the research is to measure comparative advantages, evaluate objectively the export competitiveness of Croatia’s high and medium-high technology sector, and, based on the results suggest measures and activities for increasing export competitiveness in high and medium-high technology sectors.

The paper consists of four systematically interconnected parts. Following the introduction, the second part of the paper reviews previous research which measured comparative advantages and competitiveness of businesses. The third part offers a methodological framework for the research. The fourth part of the paper consists of analytical frameworks and the results of comparative advantages and export competitiveness. These are based on the empirical analysis of foreign trade activity and the comparative advantages of Croatia's manufacturing industry. The final part of the paper gives suggestions, recommendations and comments.

2. PREVIOUS RESEARCH

At the very beginning of the research it is necessary to identify key theoretical points of reference on competitiveness and comparative advantages. Therefore, this part of the paper presents a concise overview of previous research which explored the issues of competitiveness and revealed comparative advantage.

The definitions of competitiveness by OECD and DTI (Department of Trade and Industry) point to the importance of technological factors in creating competitiveness. DTI (1994) defines competitiveness of a company as a possibility of producing the right goods and providing the right services in the right time and at the right price. The definition by OECD (1992), from a micro aspect, includes competitiveness which refers to a company's ability to compete, to maximize profit, and to achieve growth based on costs and prices, along with using technology, improving quality, and maximizing the effect of its products.

There are a significant number of scientists who are researching the relationship between competitiveness and technological abilities. Scientists like Fagerberg (2001), Kaldor (2001), Porter (2001), Lall (2001), Wignaraja (2003), and institutions like OECD, have opposed with valid arguments the opinions of other scientists who are trying to define competitiveness solely on the basis of price-based factors, highlighting non-price-related factors such as technology. The discussion led to the revision of traditional theories in the field of competitiveness.

There are two different aspects from which the idea of competitiveness is described in greater detail. The general macroeconomic aspect is known as a perspective which shows international competitiveness within the framework of price-based factors. On the other hand, the microeconomic aspect tries to define competitiveness at company-level using non-price-based factors, highlighting the research of rivalry among companies.

The macroeconomic aspect is accompanied by internal and external balance of economy where a lot of attention is given to the effects of price-based factors on the competition. The microeconomic aspect looks at the companies' internal dynamics which makes them strong or weak in relation to various influences (Wignaraja, 2003).

The microeconomic aspect refers to the presentation of competitiveness at company-level. The perspective as such includes rivalry among companies and their strategies. During the last few years, the microeconomic aspect has come to include new dimensions – the influence of technology and innovation. Lall (2011) criticizes neoclassical theory the presuppositions of which are based on the idea that technology is accessible to all companies which are able to use technology at technically "higher" levels. However, that seems to be a long-term learning process which starts by importing technology and continues into innovation.

Most experts have, completely or to some degree, become acquainted with two theoretical frameworks on trade based on comparative advantages: Ricardo's theory and the Heckscher–Ohlin (H-O) model. Ricardo's theory deals with comparative advantages realized on the basis of various technologies, whereas the H-O model takes the equal level of technology in all countries as an example. At the same time, the H-O model highlights the importance of comparative advantages in relation to different cost levels which are derived from unequal prices of manufacturing factors in countries in focus. The presuppositions of traditional trade theories are based on the principle of relative prices of comparative advantages, i.e. on the disparity of prices which are influenced by supply and demand factors.

According to the H-O model, the comparative advantage of an economy is determined by the relative factor of scarcity. However, empirical analysis has revealed irregularities in measuring comparative advantages and in confirming the Heckscher–Ohlin model due to the inability to observe relative prices under autarky (Balassa, 1989:42). With that in mind, Balassa (1965) suggests avoiding integral inclusion of all components that affect the comparative advantages of various economies. Instead, Balassa's analysis points out that comparative advantage are "revealed" and in line with theoretical assumptions, with one exception – the inability to observe relative prices. Based on the analyzed data, Balassa termed the results of his research as Revealed Comparative Advantage, i.e. RCA. In addition, RCA is an accepted method of analyzing the trade of countries in focus. Furthermore, Balassa creates an index (known as the Balassa Index of Revealed Comparative Advantage) with the purpose of measuring comparative advantages of countries. It is worth mentioning that the Balassa Index aims at identifying revealed comparative advantages instead of revealing "hidden" elements of an economy's comparative advantage.

However, the first version of the Balassa Index of Revealed Comparative Advantage has been revised and modified and today there are various indexes for measuring comparative advantage. Some research measure RCA at global levels (Vollrath, 1991), whereas other studies measure RCA at regional levels. There are also cases in which the Balassa Index has been used as a measure of bilateral trade (Dimelis and Gatsios, 1995).

Literature review has established that RCA indicators can be found in only several research papers by Croatian authors. Teodorović and Butorac (2006) determine industrial production by using the indicators of entropy, openness, comparative advantages, specialization in intra-industry trade, and marginal intra-industry trade. The authors conclude that Croatia has comparative advantages in international trade within seven subsectors. The authors point out that the manipulation of key factors of productivity and competitiveness can ensure a stronger development of industrial production. This means stimulating new investment, using innovation by increasing investment in research and development and in human resources, and implementing new technologies. Butorac (2007) supplements previous research with an empirical analysis which explores Croatia's manufacturing industry on the basis of the RCA index and the indicators of dispersion and concentration, comparative advantages, specialization levels in intra-industry trade, horizontal and vertical specialization, and export competitiveness. The author concludes that many sectors have come to a standstill or have seen a decrease in export competitiveness, and that Croatia's manufacturing industry has not significantly increased its export competitiveness on the EU 25 market. Butorac (2007) further explores the manufacturing industry by focusing on Croatia's textile and garment industry. The author draws conclusions on the position and development perspective of Croatia's textile and garment industry in international trade.

3. METHODOLOGY

The analytical approach is based on the scientific results of key indicators which measure the level of competitiveness and comparative advantages of the chemical industry in Croatia and 18 other countries. The aforementioned indicators have been widely used in modern economy research where the importance of trade regulations and the specialization of a country are evaluated and highlighted. The countries in focus have comparative advantage in certain commodities that are the objects of foreign trade.

An often used index is the Index of Revealed Comparative Advantage (the RCA Index). Balassa suggests using the values of export results for discovering an economy's comparative advantages, with the exception of production cost factors (Balassa, 1965:93).

The Index of Revealed Comparative Advantage has been calculated according to the following formula (Balassa, 1978: 203):

$RCA_0 = [\ (X_{ij}/\ X_{nj}) / (X_{it}/X_{nt})\ ]$

where:

X_{ij} - exports of commodity "i" by country "j",
X_{it} - world exports of commodity "i",
X_{nj} - total exports by country "j",
X_{nt} - total world exports.

The RCA Index measures the comparative advantage in exporting commodity "i" by country "j". If the value is greater than 1, then the analyzed country has revealed comparative advantages in the export of a certain commodity. On the other hand, if the value is less than 1, then there is an evident absence of comparative advantage in the export of a certain commodity.

The RCA Index indicates the state of economy together with the expansion of certain commodities which have market potential. In addition, the Index can reveal the perspective and the potential of foreign trade. Countries with similar RCA indexes have high bilateral trade intensity, with the exception of intra-branch trade.

Furthermore, Amir (2000:123) uses the Export Competitiveness Index (XCI) to identify production success or failure when facing competition from emerging markets. The Export Competitiveness Index indicates the measure of export efficiency of a product or a group of products. An increase in index values during the reference period shows export success of a commodity in competitive emerging markets. The Export Competitiveness Index has been calculated according to the following formula:

$(XC_{0}) = (X_{ij} / X_{it})_{t} / (X_{ij} / X_{it})_{t-1}$

where:

X_{ij} - exports of commodity "i" by country "j",
X_{it} - world exports of commodity "i",
$_{t}$ - reference period,
$_{t-1}$- previous period.

Export competitiveness of commodity "i" by country "j" can be explained as the proportion of the share in the world market of country "j" with the commodity "i" in the reference period (t) with the proportion of the share in the previous period.

If the XCI is greater than 1, then growing export competitiveness is present. In contrast, value lesser than 1 implies a negative trend in export competitiveness. The XCI can also be interpreted as the ratio of export growth rate of commodity "i" from country "j" and the growth rate of commodity "i" on world markets.

Edwards, Mlangeni, and van Seventer (2000:75) use the proportion of exports and total trade to measure country trade effects which imply the ability of export and import within certain categories of commodities.

The indicator can be noted in the following formula:

Net export $RCA_{ij} = (X_{ij} – M_{ij})/(X_{ij} + M_{ij})$

note:

X_{ij} - exports of commodity "i" by country "j"
M_{ij}- imports of commodity "i" by country "j"

The aforementioned ratio shows results in the interval from -1 to +1. Values show an absence of comparative advantage if they are between 0 and -1. When the values are between 0 and +1, then comparative advantage is present. However, when the value is 0, the implication is that commodity export equals commodity import. Thus, the Index represents a degree of specialization of a country in the export of a certain commodity.

The results from RCA measuring are especially useful when used with other indicators (such as Net export RCA_{ij}) in order to overcome the limitations of the RCA Index.

The problem of similar RCA indexes is that taking trade as an example may be unreliable due to state intervention. It is considered that state measures like import bans, export subventions, and other kinds of government protection can influence the reliability of RCA measuring.

Vollrath (1991) suggest that the RC Index should be used more because it shows balance in supply and demand. However, there are drawbacks to Vollrath's three indexes. Vollrath acknowledges that the RXA Index (Relative Export Advantage), which balances out distorted effects, is used more often in practice.

Relative Trade Advantage (RTA) is calculated as a difference between relative export comparative advantage, which is equivalent to the original Balassa Index (Vollrath, 1991:270), and relative import comparative advantage. The difference between Vollrath's RXA Index and the Balassa Index is that the former prevents double counting.

RTA=RXA-RMA

where

$RXA=RCA=(X_{ij}/X_{it}) / (X_{nj}/ X_{nt})$

and

$RMA=(M_{ij}/M_{it})/ (M_{nj}/M_{nt})$

where M stands for import.

$RTA=RXA-RMA=(X_{ij}/X_{it}) / (X_{nj}/ X_{nt}) - (M_{ij}/M_{it})/ (M_{nj}/M_{nt})$.

With Relative Trade Advantage, the original Balassa Index of Revealed Comparative Advantage and its other extreme, the Index of Revealed (Import) Comparative Advantages, are taken into account.
As part of the example of the chemical industry, the following index will be used:
RCA-2 (Relative Trade Advantage) = RXAi – RMAi

where:

RXAi = (Xi/X) / (Xiw/Xw)
RMAi = (Mi/M) / (Miw/Mw)

RXAi: relative export comparative advantage of commodity "i"
RMAi: relative import comparative advantage of commodity "i"
X: country's total exports
Xw: sector (or world) total exports
M: country's total imports
Mw: sector (or world) total imports

The results of RTA (RCA-2) can be greater or less than 0. Positive values suggest revealed comparative advantages of the observed phenomenon, whereas negative values suggest an absence of comparative advantages.

The applied model of this research is based on the combination of indicators which measure the import competitiveness of Croatia's manufacturing industry. The Balassa Index of Revealed Comparative Advantage represents a starting point in measuring export competitiveness. The statistical data is presented as a key element in the calculation of export competitiveness using exact identification of comparative advantages.

The Index of Revealed Comparative Advantage has a significant role in measuring comparative advantages of a tested area. The Index was an essential part of other indexes in the research of comparative advantages by Amir and Mlangeni. What links Balassa's, Amir's, and Mlangeni's indexes is the use of parameters of export competitiveness such as commodity export at national and global level.

4. ECONOMIC FRAMEWORKS AND THE RESULTS OF THE ANALYSIS OF EXPORT COMPETITIVENESS AND COMPARATIVE ADVANTAGES OF CROATIA'S HIGH AND MEDIUM-HIGH TECHNOLOGY SECTOR

This part of the paper starts with the identification of comparative advantage and export competitiveness of Croatia's high and medium-high technology sector and of other selected countries with chemical industry in mind. Table 1 shows the analysis of comparative advantages of the chemical industry sector in the period from 2006 to 2009.

The values taken into account in the study are those of the entire chemical industry which includes pharmaceutical industry (high technology sector) and other parts of the chemical industry (medium-high technology sector). The results of selected countries, among which are EU countries, countries which are leading exporters of high and medium-high technology commodities, and Croatia, are presented in the analysis.

As part of the research, the overall results of selected countries' comparative advantages are included to enable comparison. The RCA_0 formula variables have not been significantly altered in relation to the original model: the total world exports variable remains unchanged whereas the total exports of country "j" variable includes total exports of the chemical industry. What follows is Table 1 which shows the indexes of revealed comparative advantage for Croatia and reference countries.

Table 1 The Index of Revealed Comparative Advantage (RCA), 2006-2009

Commodities Croatia/*RCAi	2006	2007	2008	2009
Austria	0,88337	0,87567	0,89313	0,96590
Bulgaria	0,62422	0,72761	0,77507	0,66253
China	0,45230	0,47712	0,53868	0,44706
Croatia	0,90329	0,90712	0,95949	0,83910
Finland	0,73302	0,72200	0,79578	0,87840
France	1,49469	1,53486	1,62023	1,57934
Germany	1,39727	1,34265	1,44369	1,33516
India	1,14091	1,05079	1,02025	0,98687
Italy	1,02338	0,96917	0,96264	0,96404
Japan	0,87642	0,89608	0,85303	0,91615
Romania	0,55699	0,54384	0,58934	0,43465
Slovenia	1,20910	1,16146	1,19508	1,20319
Sweden	1,06795	0,99456	0,99678	1,10381
United Kingdom	1,40847	1,58025	1,58154	1,68351
United States	1,28410	1,27728	1,33404	1,30703

*RCAi = the RCA index for chemical industry commodities

Source: authors' analysis

The results of the RCA Index taken from data in Table 5 (see appendix) show comparative advantages of chemical industry exports significantly revealed in Germany, France, India, the USA, the UK, Sweden, Italy, and Slovenia. In other words, it is obvious that more developed European countries dominate in the context of the RCA Index values. In addition, it is worth noting that the chemical industry of the UK has the highest level of revealed comparative advantages. The values of comparative advantage of the chemical industry in other countries indicate an absence of comparative advantages. One of those countries is Croatia, with the chemical industry “hovering” around 1, but without reaching the level of revealed comparative values.

The analysis of the RCA Index trend shows that the highest value in the RCA Index for Croatia’s chemical industry was noted in 2008, whereas the lowest value was noted in 2009. The downward trend in 2009 confirms the influence of the global economic crisis which can be noticed in the results of most countries in the research. It is interesting to note that China, the biggest exporter in the world, has recorded low values of revealed comparative advantages in the chemical industry. This finding is in line with China’s orientation toward industrial sectors which do not place emphasis on high technology in manufacture and in final products.

Table 2 shows export competitiveness of the chemical industry in selected countries in the period from 2007 to 2009.

Table 2 Export competitiveness of the chemical industry, 2007-2009

Chemical industry/*XC	2007	2008	2009
Austria	1,028077954	0,979042041	1,064134453
Bulgaria	1,237883366	1,114401165	0,814705968
China	1,14919572	1,150630956	0,905026677
Croatia	1,037722564	1,048724091	0,841447673
Finland	0,995530784	1,023085883	0,929064061
France	0,990650724	0,996308667	1,001361679
Germany	0,993104672	1,019648415	0,929606104
India	0,983239796	1,09423729	1,04825405
Italy	0,984345087	0,934299671	0,967959537
Japan	0,955692182	0,928374994	1,02831836
Romania	1,055733926	1,148602926	0,783880312
Slovenia	1,0789705	1,010649313	1,003074687
Sweden	0,922367242	0,942677253	1,026146508
United Kingdom	0,951799399	0,907683703	1,056307777
United States	0,966203859	1,015080184	1,031582713

*XC = Export competitiveness index for chemical industry commodities

Source: authors' analysis

Although Croatia recorded an upward trend in 2007 and 2008, the results from 2009 clearly indicate a significant decrease in the export competitiveness of Croatia's chemical industry which stands as an example of high and medium-high sector. In 2009, commodities have not reached a satisfying level of export efficiency, which implies a negative trend in the export competitiveness of Croatia's manufacturing industry. The reason for this can be found in the disproportionate dynamics between Croatian and world exports in the chemical industry. It is worth noting that the situation is similar in most European countries in transition, which suggests an explosion of negative effects of the economic crisis. On the other hand, it is interesting to note that highly developed European and non-European countries like the USA, Japan, and India are seeing growth in export competitiveness which is reflected in the resistance towards the effects of global economic crisis and the systematic strengthening of the position of the chemical industry.

The answer to the question of the actual level of total RCA exports of the chemical industry in the selected countries can be found in Table 3. The table shows imports and exports values of the chemical industry in the period from 2006 to 2009 (Table 5, see appendix).

Table 3 Values of net RCA exports of the chemical industry in selected countries, 2006-2009

CHEMICAL INDUSTRY /NET RCA EXPORTS	2006	2007	2008	2009
Austria	-0,833974956	-0,824277127	-0,829985443	-0,825089791
Bulgaria	-0,363217646	-0,301365764	-0,282206005	-0,346637843
China	-0,323137274	-0,280638176	-0,200112553	-0,287187717
Croatia	-0,420106463	-0,416545186	-0,39867243	-0,441857744
Finland	-0,133228244	-0,100480735	-0,095825498	-0,054243101
France	0,056076227	0,041933594	0,058134467	0,05019859
Germany	0,193137447	0,188476309	0,200700755	0,177027105
India	-0,107301781	-0,107139023	-0,262379087	-0,21563402
Italy	-0,121977192	-0,126244432	-0,121412422	-0,129930706
Japan	0,17247179	0,177667538	0,117992494	0,115874309
Romania	-0,493819564	-0,507897755	-0,491898615	-0,571313177
Slovenia	0,009461742	0,011774279	0,021824088	0,063105745
Sweden	0,109353569	0,04856955	0,014640389	0,065485858
United Kingdom	0,048203325	0,030964412	0,042203944	0,067426025
United States	-0,039619714	-0,015622506	-0,005648621	0,017398787

Source: authors' analysis

Generally speaking, Croatia and most other countries are faced with an absence of comparative advantage. This is supported by the results of net RCA exports which are below 0. By including the import variable, the situation in the chemical industry is completely different: negative indicator values show slower growth dynamics in exports in relation to dynamics in imports in the reference period. However, in certain periods, the total RCA export values become significantly less than zero due to reduced import activity and a sharper decline in relation to manufacturing industry imports. This is a state in which we find Croatia, but other economies also. The exceptions are the economies of Sweden, France, Germany, Japan, and Slovenia. These are characterized by a high level of revealed comparative advantages, which at the same time confirms the validity of results from previous tables.

To calculate the Index of Relative Trade Advantage, the Index of Revealed Comparative Advantage (RCA) is shown as the Index of Relative Export Advantage (RXAi). The Index of Relative Trade Advantage (RCA-2) can be calculated by subtracting indicators of Relative Import Advantage (RMAi) from the indicators of Relative Import Advantage (RXAi). A detailed calculation is shown in Table 6 (see appendix), and the final results are presented in the following table.

Table 4 Relative Trade Advantage of the chemical industry in the selected countries, 2006- 2009

Commodities Croatia/*RCA-2	2006	2007	2008	2009
Austria	-8,58979	-8,01943	-8,36796	-8,60489
Bulgaria	-0,22054	-0,08913	-0,04644	-0,28968
China	-0,60236	-0,57752	-0,46057	-0,50898
Croatia	-0,13719	-0,12075	-0,04422	-0,22047
Finland	-0,30586	-0,22691	-0,19682	-0,12738
France	0,30395	0,30899	0,41315	0,36057
Germany	0,27239	0,22322	0,29515	0,22365
India	0,20011	0,21780	-0,01671	0,00076
Italy	-0,17652	-0,22076	-0,19959	-0,25754
Japan	0,20074	0,20659	0,17338	0,15836
Romania	-0,45884	-0,39173	-0,40936	-0,74559
Slovenia	0,09704	0,10649	0,16264	0,16235
Sweden	0,10020	0,02080	-0,04309	0,04933
United Kingdom	0,47914	0,55941	0,54788	0,61896
United States	0,55116	0,53770	0,54162	0,48477

*RCA-2 = Index of Relative Trade Advantage for the manufacturing industry

Source: authors' analysis

A survey of relative trade advantages shows that, within the reference index, there are no significant deviations in relation to previously established models. Activity in Croatia's chemical industry is characterized mostly by a negative trend. Such state undoubtedly suggests an absence of comparative advantages in the last years of the reference period. The greatest gap has been noted in Austria where the imports have a dominant position in relation to exports. The essence of the problem is in the fact that Austria and Croatia, along with other European countries, have import-oriented economies in the context of the chemical industry's foreign trade activities.

A closer look at the results presented in previous tables brings a number of interesting conclusions. Finland, a country which has a significant role in the manufacture of telecommunication devices and other high and medium-high technology commodities, does not, unlike Sweden, have revealed comparative advantages in the chemical industry. Although China is the world's greatest exporter, it does not generate comparative advantages. What makes the situation interesting is the fact that Slovenia has prevailed over most reference economies in the context of the chemical industry's comparative advantages.

5. SUGGESTIONS AND COMMENTS

A combined look at the results from the indexes leads to a conclusion that Croatia's chemical industry is characterized by an absence of comparative advantages. Such situation is especially noticeable in 2009 due to the effects of the global economic crisis. Hower, Croatia's chemical industry does not have such a weakened position as that of China, Bulgaria, or Romania. Furthermore, the Balassa Index implies an absence of comparative advantages which is unquestionably confirmed by the indicators of relative import advantage. This is also confirmed by the results of total RCA export values for the chemical industry and by the indicators of export competitiveness of Croatia's chemical industry. A possible reason can be found in insufficient investment in research and development which play a key role in generating new knowledge, technology, and export competitiveness of the chemical industry. In contrast to the European countries like Germany, France, or the United Kingdom, export competitiveness of Croatia's chemical industry is seriously lagging behind.

The aforementioned countries are highly developed countries and are thus not good candidates for comparison to Croatia's chemical industry. However, what should be pointed out is the enviable position of Slovenia's chemical industry which is at the forefront of revealed comparative advantages and export competitiveness in comparison to bigger and stronger economies like those of India, Finland, Sweden, and China. Therefore, the strategy for increasing comparative advantage and export competitiveness of Croatia's chemical industry should be based on the guidelines and the experiences of Slovenia's chemical industry. Bulgaria and Romania, two European countries in transition, are lagging behind export competitiveness of Croatia's chemical industry in 2009, although in 2006 and 2007 they had a higher level of export competitiveness and comparative advantages. Therefore, it is imperative to identify the causes of and the reasons for export competitiveness of new EU member countries – Romania and Bulgaria – so that the position of Croatia's chemical industry could be firmly established when the country becomes a full member of the EU.

In order to reach export competitiveness of the chemical industry it is indispensible to stimulate investment in research and development and in innovation which undoubtedly contributes to assuming and keeping a competitive position on the market, which in turn results in greater profitability.

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ANNEX

Table 5/a Exports of the chemical industry, 2006-2009 (in thousands of US dollars)

EXPORT i/Year	**2006**	**2007**	**2008**	**2009**
Austria	12257788,76	14859580,99	16618925,32	15277149,28
Bulgaria	957375,268	1397430,814	1778962,955	1252018,321
China	44529591,440	60340804,260	79312598,720	62007817,120
Croatia	951910,116	1164784,51	1395410,102	1014312,689
Finland	5742530,759	6741032,298	7878318,453	6322983,874
France	75206161,260	87850121,640	99984184,160	86489852,550
Germany	157108524	183976841	214293322	172087960
India	14113840,61	16363380,94	20454062,73	18522048,39
Italy	43289250,790	50245344,910	53626204,410	44841191,550
Japan	57849940,9	65191254,28	69136565,71	61415539,98
Romania	1834459,291	2283657,348	2996373,106	2029030,285
Slovenia	2850016,356	3625979,191	4186208,202	3627412,768
Sweden	16015499,110	17418579,390	18757320,180	16627350,250
United Kingdom	64120223,49	71962930,01	74617107,06	68088186,43
United States	135404135,5	154265595,8	178881102,2	159408472,5
Σ EXPORT	**2006**	**2007**	**2008**	**2009**
Austria	136,6296952	163,4015648	180,5526311	137,0434177
Bulgaria	15,1015	18,49351433	22,2713219	16,37393699
China	969,38	1217,79	1428,66	1201,79
Croatia	10,3763	12,3643	14,1117	10,4738
Finland	77,13720913	89,90446142	96,06360104	62,36998509
France	495,4267911	551,1433824	598,7854442	474,500366
Germany	1107,121042	1319,446792	1440,297352	1116,769512
India	121,806	149,951	194,531	162,621
Italy	416,5045895	499,212906	540,5435326	403,0220718
Japan	649,931	700,538	786,43	580,845
Romania	32,42901071	40,4340469	49,33379002	40,44826063
Slovenia	23,20920551	30,061478	33,98930798	26,12221311
Sweden	147,6613676	168,6437794	182,5945972	130,519454
United Kingdom	448,2539994	438,5039588	457,7993114	350,4326078
United States	1038,27	1162,98	1301,11	1056,75
Σ EXPORTi/WORLD	1231783665	1452455464	1659196628	1433312005
Σ EXPORT (WORLD)	12128,59608	13986,00098	16099,6118	12419,05438

Source: www.unctad.org (22. 2. 2011)

Table 5/b Imports of the chemical industry, 2006-2009 (in thousands of US dollars)

IMPORT i/Year	2006	2007	2008	2009
Austria	135404135,5	154265595,8	178881102,2	159408472,5
Bulgaria	2049539,925	2603033,926	3177787,775	2580521,741
China	87046841,26	107421237,8	118996798,6	111972959,1
Croatia	2331141,184	2827930,89	3245687,933	2620290,06
Finland	7507856,592	8247045,354	9548225,736	7048282,842
France	67219469,33	80778900,66	88997816,28	78221571,33
Germany	106245081	125624351	142653771	120323250
India	17506790,68	20290434,97	35005489,39	28706028,48
Italy	55316959,43	64764726,01	68447464,15	58233797,62
Japan	40830370,85	45521238,28	54543273,05	48660549,24
Romania	5413783,277	6997573,825	8798017,527	7437228,894
Slovenia	2796589,626	3541586,273	4007390,387	3196767,768
Sweden	12858071,14	15804928,55	18216016,15	14583482,12
United Kingdom	58222879,18	67640201,17	68573882,52	59486343
United States	146576112,2	159162122	180913445,1	153956305,4
Σ IMPORT	**2006**	**2007**	**2008**	**2009**
Austria	137,0898926	162,8192325	183,5446986	142,8025712
Bulgaria	23,2696	29,92115558	36,75824239	23,23532921
China	791,605	956,254	1131,62	1004,17
Croatia	21,4883	25,8295	30,7284	21,2026
Finland	69,31350992	81,59449606	91,40860261	60,08280443
France	541,4373099	618,645913	700,6180032	550,2715147
Germany	905,8774359	1053,571607	1180,253453	928,1242266
India	178,474	228,686	320,785	249,585
Italy	442,1610262	510,9778222	559,6369697	408,7180138
Japan	579,574	619,829	762,592	550,553
Romania	51,11497803	70,21955628	83,7118152	54,02741652
Slovenia	24,11944345	31,51683044	36,88382472	26,33296935
Sweden	127,4336179	152,3788604	166,4604653	118,5752891
United Kingdom	600,8888883	622,0635668	630,4037469	479,0965084
United States	1918,08	2020,4	2169,49	1605,3
Σ IMPORTi/ WORLD	1290239767	1517049082	1731236044	1468478403
Σ IMPORT (WORLD)	12374,81607	14242,52539	16451,14166	12590,40769

Source: www.unctad.org (22. 2. 2011)

Table 6 RCA and RMA index results, 2006-2009

Commodities/RCAi*	2006	2007	2008	2009
Austria	0,88337	0,87567	0,89313	0,96590
Bulgaria	0,62422	0,72761	0,77507	0,66253
China	0,45230	0,47712	0,53868	0,44706
Croatia	0,90329	0,90712	0,95949	0,83910
Finland	0,73302	0,72200	0,79578	0,87840
France	1,49469	1,53486	1,62023	1,57934
Germany	1,39727	1,34265	1,44369	1,33516
India	1,14091	1,05079	1,02025	0,98687
Italy	1,02338	0,96917	0,96264	0,96404
Japan	0,87642	0,89608	0,85303	0,91615
Romania	0,55699	0,54384	0,58934	0,43465
Slovenia	1,20910	1,16146	1,19508	1,20319
Sweden	1,06795	0,99456	0,99678	1,10381
United Kingdom	1,40847	1,58025	1,58154	1,68351
United States	1,28410	1,27728	1,33404	1,30703

Commodities/RMAi*	2006	2007	2008	2009
Austria	9,47316	8,89510	9,26110	9,57079
Bulgaria	0,84476	0,81675	0,82150	0,95221
China	1,05466	1,05464	0,99925	0,95604
Croatia	1,04048	1,02787	1,00371	1,05958
Finland	1,03888	0,94891	0,99260	1,00579
France	1,19074	1,22587	1,20708	1,21877
Germany	1,12488	1,11943	1,14854	1,11152
India	0,94081	0,83299	1,03696	0,98611
Italy	1,19990	1,18994	1,16223	1,22158
Japan	0,67568	0,68949	0,67966	0,75779
Romania	1,01583	0,93557	0,99871	1,18024
Slovenia	1,11206	1,05498	1,03244	1,04084
Sweden	0,96774	0,97377	1,03988	1,05448
United Kingdom	0,92933	1,02084	1,03366	1,06455
United States	0,73293	0,73959	0,79242	0,82227

Source: authors' analysis based on www.unctad.org (22. 2. 2011)

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INFLUENCE OF CORPORATE COMMUNICATIONS ON COMPANY'S OPERATIONS AND COMPETITIVENESS

ABSTRACT

Successful corporate communications to clients, perception of their demands and needs is the key to the new marketing concepts and philosophy of business operations of modern companies. In the time of globalization and computerization, which result in a higher level of clients' being well informed, as well as in their higher demands towards suppliers, it seeks the answer to the question how to create efficient corporate communications which shall result not only in higher sales but also in clients' satisfaction as the end goal in business operations of marketing oriented companies. Up until recently, corporate communications were explicitly related to managers' offices, until the organization managements realized the importance of balanced and constructive relations with the most important stakeholders such as: employees, buyers, users, investors, shareholders, and government and non-government sectors. In order for a company to succeed in its business operations, regardless of its size, it needs to be prepared for a wide range of communication activities which need to be accepted, planed and implemented, all aimed at reaching the company's success on the market. One of the main goals of corporate communication is to increase the reputation of a company, as its reputation strongly influences the attracting of clients, users and investors, which has, as its final result, better business operations and the strengthening of company's competitive activities.

Keywords: corporate communication, target audience, competitiveness, reputation

JEL classification: M14

1. INTRODUCTION

In modern business, companies are faced with multiple uncertainties as a result of less predictable business environment. Only those companies and their management, who understood the role and importance of corporate communications in the operation of successful businesses, can adapt to new business environment. Bearing in mind that past few years brought a sharp turnaround and development of information technology, such process strongly affected the way of business communication with different target groups.

Usage of modern information technology has ceased to be an exclusive privilege of the most developed market-oriented countries. Process of globalization and normalization has led to increased intensity of corporate information exchange, which made possible companies to meet the needs of different target groups both at local and international level. There is wide area of corporate communications actions which have strong influence on the quality of decision making. Outcome and quality of each company operations depend on decesions made in that process. Because of such significant impact of corporate communications at various levels of company management, the marketing activity of recent times is increasingly occupying the attention and interest of a large number of top marketing experts and practitioners.

Corporate communications can be presented through few dominant roles, in which their connection to the disciplines such as management communication, marketing communication and organizational communication, is shown. All these three forms of corporate communications present different levels of business activities: marketing communication is predominantly engaged in advertising, organizational communication deals with public relations as the dominant activity, and managerial control and communication is increasingly gaining in importance recently. Importance of corporate communications is affected by powerful changes that come from the environment, usually as a threat rather than as an opportunity.

2. CORPORATE COMMUNICATION GOAL

One of the main corporate communications goals is to increase the company's reputation, which strongly influences on the attraction of clients and investors. As result of achieved reputaition, competitive activities of the company are strengthened. Although the company has more than one target group, it is primary important to satisfy clients, because of their satisfaction and willingness to use the products and services of particular business, depends the satisfaction of all other target groups. Reputation increases the value of all company activities, as well as its products and services. Managing reputation is the responsibility of strategic management, but the implementation is the responsibility of each employee in the company. Therefore, the external reputation is the product of internal factors of the company, resulting primarily from the vision, strategy and official policy of the company. Strategic management defines vision, strategy, and corporate culture. These are guidelines and instructions to employees, to create a company that is authentic and meets the expectations of stakeholders who control the destiny of the company. Therefore, all employees of the company should have unique appearance and the attitude to the outside.

Corporate reputation can be defined as values that are assigned to the company, such as authenticity, accountability and integrity, as result of the corporate image. The image presents overall rating of the company, which consists of a set of perceptions and feelings. Understanding the company is done through corporate identity, which includes signs and other elements that are used as identifiers (name, logo and slogan). Reputation is product of the public and the inputs of this product are results of company activities.

In a broader sense, the public is shown in two main groups:

1. Internal public;
2. External public.

Internal public are the people with whom the organization regularly communicates through daily work, such as employees, shareholders, suppliers, marketing agents, current or loyal clients. External public are the people with whom the organization communicates, but there is no regular or particularly close relationships, such as the media, local communities, local governments, other levels of government and governmental agencies, financial organizations, groups with special interests, potential clients, employees and investors (Brkić, 2003:366).

2.1. The importance of image in process of building reputation

All companies have relationships with other companies and individuals, and that interaction is resulting image. The difference between companies in the process of creating the image is that if the image came up by chance on a vague, chaotic way, or through the planning process, implementation and control. The image is a dynamic category and is the result of a permanent influence on the target public groups, which indicates possibilities to manage the image. Number of business disputes, such as bad products and services, irregular distribution, poor relationships with clients, decrease prices of the shares or acquisitions, is the result of a lack of mutual communication, which leads to a lack of mutual understanding.

Lacks to users are most likely to occur in large companies, especially those who operate in multiple territories, either in terms of one or more states and even in those where there is a unique regulation of internal and external communication, with the aim of satisfying clients. Failure to adapt to local conditions, business culture and habits may lead to disturbances in the formation of opinion of the target public. One of the banks operating in Bosnia and Herzegovina, in year 2011 has organized process of reissuing credit and debit cards to citizens in a way that the new cards are sent to home addresses of users. In the period before 2011, the cards were reissued through bank's branch offices in the place of residence of users, with the previous phone call. This new approach has been done with no communication with the user in order to announce changes and the selection of a new distribution has led to dissatisfaction with the large number of users on the territory of Bosnia-Herzegovina, for the following reasons:

1. Clients were used to receive reissued cards through branch offices The new distribution system was shown as unreliable, because a large number of users have not got reissued card at all;
2. Users were not notified of the change of mode of delivery card;
3. Users were not able to use their money through credit or debit cards, because of untimely delivery of cards, and previous cards were inactive.

This approach to changes with no communication with clients does not necessary lead to permanent changes in the bank's image, but a number of clients can decide to change banks with condition that there are no obstacles in moving to another bank, such as previously used amount of the card limit or the existence of indebtedness to the bank. In this case we can consider whether the bank made mistake in choosing distribution method of reissued card, or the greater omission is done due to lack of communication on service delivery changes. In order to determine consumer perceptions of the bank, a survey of bank clients in branches in Bosnia and Herzegovina has been done. One inadequately communicated segment of all bank services does not significantly affect the image, but a number of potentially recurring situation could jeopardize the image and get in the way of good reputation. Since each company has multiple target public, the basic targets are both employees and consumers, because if their interaction is not satisfactory, consumers will not consume the products and services of the company, and consequently neither the interests of other target groups can not be met.

2.2. Creation of image in function of strengthening the company's reputation

Through the planned messages, companies can plan to create a corporate image and reputation of the company and to manage it. Unplanned message that the company sends to the external public, as a result of failures in the elements of brand image and reputation continue to refer to some of the cases:

1. Sloppy dealer;
2. Poor appearance of retail space;
3. Non-compliance with working hours;
4. Inadequate communication of sales staff to clients;
5. Lack of communication via web pages for all users;
6. Lack of concern on environmental protection in business companies

Bearing in mind that the competition has used almost all possible forms of differentiation of their company, products or services on the market, it becomes important what consumers think about them, and who they really believe. Until recently, the competition struggled in trying to differentiate from other companies creating new product design, setting lower prices, finding closer and more attractive locations to the ultimate consumers. However, all of that can be copied and offered by the competition in a very short period of time, and previously achieved differentiation from the competition has no more effects. And if all of the products or services are skillfully copied and can not continue to attract the attention of the targeted public, then it is necessary to include other forms of communication with current and potential clients.

Besides all the usual forms of advertising products and services, ranging from PR, sales promotion, direct marketing, different forms of promotional communication, including publicity, there are also other almost equally important forms of communication that are associated with the employee and his sale place. Such forms of communication are most often manifested through the appearance of the seller, his attitude, voice, and the ability of listening to his interlocutor, the art of beautiful, patient and kind speech, and exceptional knowledge and skillful presentation of products or services. Essential is the attitude of sales management towards all the factors and relationships which may affect the effectiveness of the sales process. Modern business activities are primarily struggle for reputation in the world where both clients and investors have the opportunity to choose the company that will meet most of their expectations and make them interested to cooperate and interact with the company.

2.2.1. Elements of corporate image

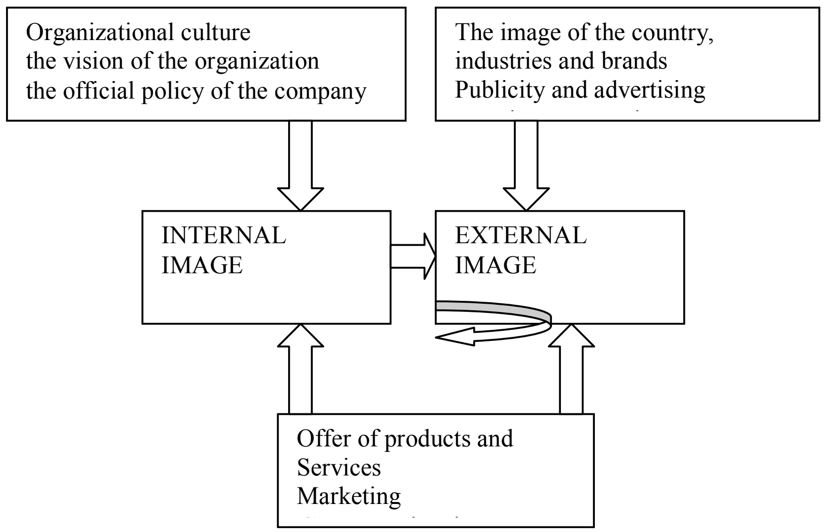
The image is a complex category and one single factor does not affect the overall perception of the company. Target public creates a public image in relation to the whole spectrum of image elements, such as:

1. Competent and proactive management;
2. Satisfaction of employees;
3. Financial indicators and features;
4. Quality of products and sevices;
5. Investing in development;
6. Socially responsible behavior Concern for the environment;
7. Actuality and attraction of business;
8. Development of new products and services, as well as after-sales care;
9. Transparency in the overall business;
10. Information and interaction with target groups.

For a desired target public it is necessary to estimate on which base it assesses the company and how it form a conception about company, since the various elements of the image have a different significance for different target groups. Target public creates perceptions about the company through its own experience or the experience of others, direct communication with the staff of the company and external information about past and current behavior of the company and its employee and through mass communication through which a company presents itself to the target and the public accepted the idea of own business .

In the process of researching the image of the company the first step is to examine and evaluate familiarity and preference that the main target groups have to the company. This is the initial effect in the hierarchy of communication effects, and covers the first phase in the process of decision making towards the target public. Familiarity and preferences influence on further actions of the target group towards the company and desired behavior of target groups for each company is the one that make company able to achieve its goals.
Familiarity of target groups is a result of informative and educational communication of the companies, as well as from other sources: personal experience, media, and friends. Preferences are the result of persuasive communication, through which companies try to convince the public that preferring the company and its products and services is best way to meet their needs. Examination of familiarity and preference enable global positioning of the company in the minds of target groups and indication of what the main problems of the company's image are. Problems that may occur are: company is well-known but with a poor image or quite unknown company with a vague image, based on previous experience.

Figure 1 Creation of corporative image



Source: authors

In accordance with the familiarity with the company and preferences toward him, the possible states are:

1. Target groups are not familiar with the company, but have preferences;
2. Target groups know company and have preferences;
3. Target groups are not familiar with the company and have no preferences;
4. Target groups known company and have no preferences.

Each of the state of familiarity and preference requires a specific strategy for the formation or promotion of an image. When designing strategy of building or changing the image, companies should always be aware of the attitudes of target groups.

The most difficult task for each company is to act in a situation where the target groups are familiar with the company, but have no preferences. This requires a completely new concept of marketing function, determination of the position and role of public relations and change of organizational culture. In this case it is necessary to operate in the domain of both internal and external image. Public relations should be in correlation with business objectives and corporate strategies. In other states applicable is the strategy of creating the image from the star point, by the principle: information-attitude-behavior.

Table 1 Company image strategy

Awareness and preferences	Image strategy
Do not know/have preferences	The expansion - to familiarize target groups with the company. Target groups are satisfied with the behavior of company, but do not know the products and services
Know/have preferences	Maintain image
Do not know/have no preferences	Create-to familiarize the target groups with the company, to eliminate the causes of poor image (ignorance, misunderstanding, prejudice)
Know/have no preferences	Modification-to do detailed analysis and eliminate the causes of poor image. At the stage of analysis to avoid a lot of advertising

Source: authors

3. IMAGE OF BANK "XY"s FOR RETAIL TARGET GROUP

3.1. Examination of the bank's image and client attitudes

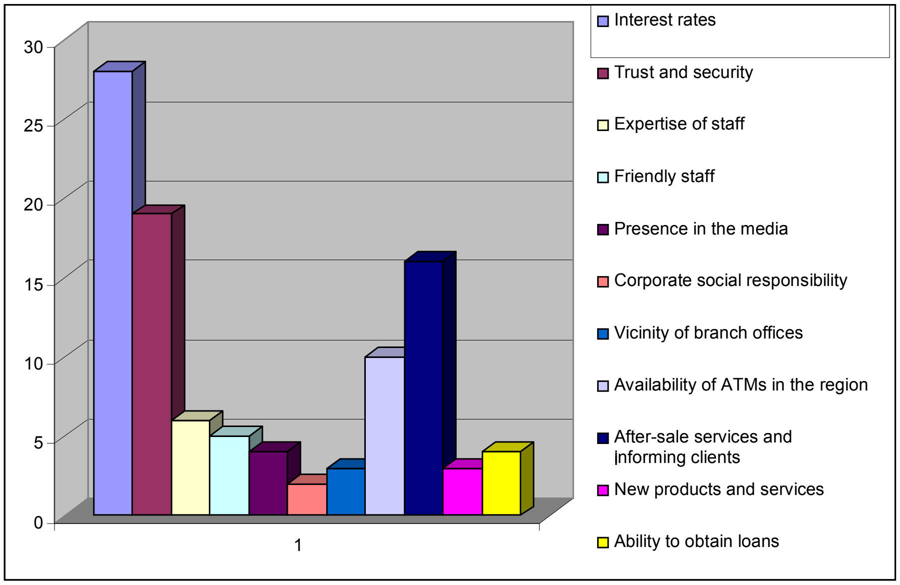
The case study refers to attitude of the target group in relation to key dimensions of the bank image. Data collection was done through surveys on the ground in random patterns. Therewith it was possible to determine which are the key criteria for the target group and to which elements of corporate image they give the highest importance. In doing so, following elements have been considered:

1. Quality of products and services;
2. Concern for the environment and socially responsible business;
3. Actuality and attraction of business;
4. Development of new products and services, as well as after-sales care;
5. Information and interaction with target groups.

In addition to identifying the most important elements of the bank's business activities in terms interest of target groups, it has been estimated what are the most important sfactors when choosing the bank.

Due to the problem arising in the process of reissuing cards, a survey is made, in order to determine the attitudes of clients towards change of the mode of distribution of credit and debit cards, and towards communication between bank and clients.

Figure 2 Dimensions of the bank image in %

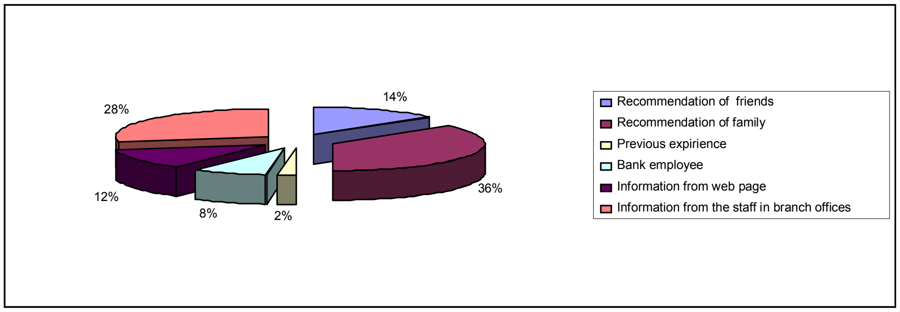


Source: authors

Considering business activities of, XY, bank the target group have chosen the most important quality elements:

1. Interest rate 28%;
2. Trust and safety 19%;
3. After-sales services and informing clients 16%;
4. The availability of ATMs in the region of 10%;
5. Expertise of staff 6%.

Figure 3 Methods of choosing banks

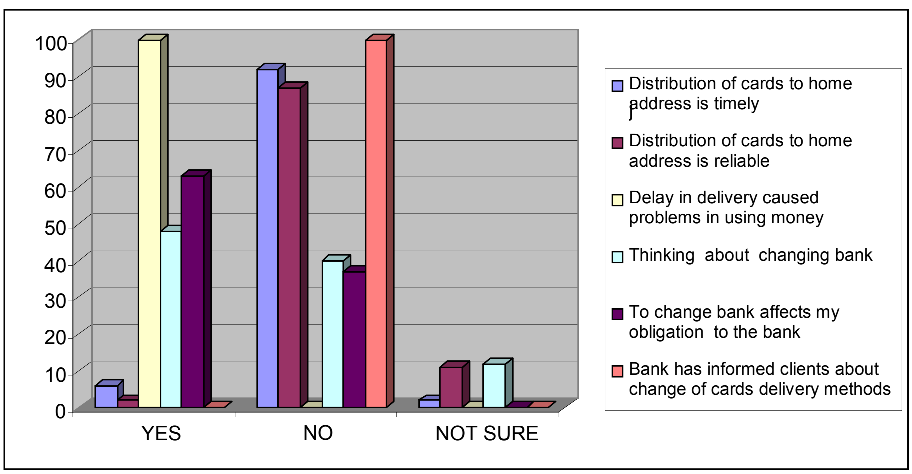


Source: authors

According to survey made, most decisive factors in process of choosing bank are:

1. Recommendation of family 36%;
2. Information from the staff in branch offices 28%;
3. Recommendation of friends 14%.

Figure 4 Attitudes of clients about the change of service delivery



Source: authors

Attitudes of clients about the changing distribution methods are:

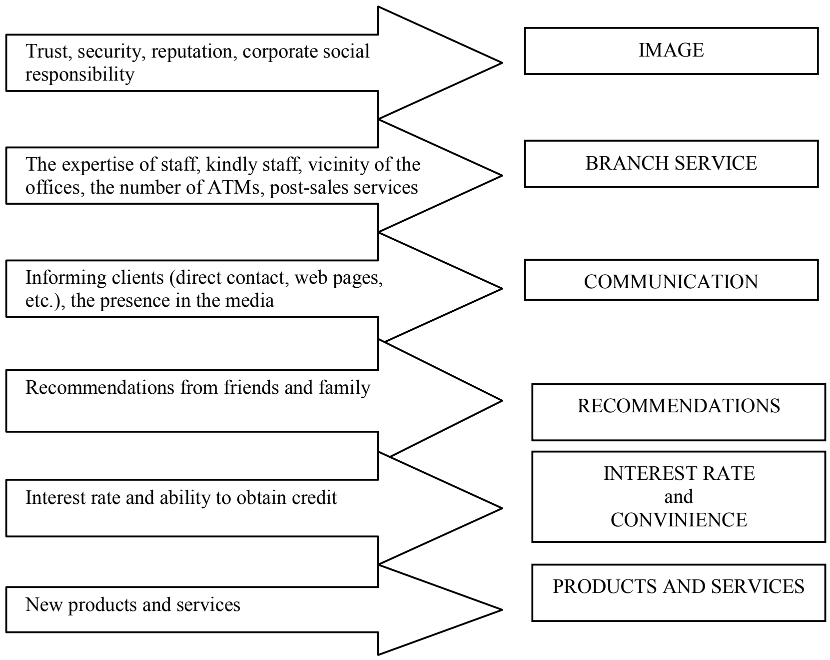
1. Distribution of cards to home address 87% of clients has considered as unreliable;
2. Card distribution to home address has been untimely delivered for 92% of clients;
3. Delays caused the problems in using money for 100% of clients who did not get reissued card at all, through delivery to home address;
4. 48% of clients is thinking about changing the bank,;
5. Obligations to bank are affecting 63% of clients in decision to change bank,
6. 100% of clients have not been informed about change of card delivery method.

3.2. Interpretation of surveyed elements of the image and clients' attitude

From the standpoint of the elements that clients in the case of bank,, XY,, perceive as the most important, such as interest rates and confidence and security, the bank has built a reputation as a reliable institution, with interest rates which in terms of the environment in which it operates is the most important factor for clients in terms of choosing bank. The results indicate that clients are familiar with the terms of services and the stability of the bank. Familiarity is the result of informative company communication, where information is collected by the client at the bank, usually obtained by direct contact in the office in 28% of cases, but not less significant are information collected via the website, at 12% of cases. In addition, the information from sources outside the company constitutes an important element of familiarity: friends (14%) and relatives (36%), as main ways in which clients choose the services of this bank. Sources outside the company are an important factor in communicating with potential clients, given that a positive client experience is transferred to at least ten people from the environment, attracting new clients.

Preferences are made from awareness, opinions and attitudes of clients, and are more permanent category, which is more difficult not only to build but also to maintain in a positive sense. Rating familiarity and preferences enable bank to understand position of the bank in the minds of the target group, and may indicate the first signs of image problems, in this case caused by bank decision to change method of service delivery, with no communications with clients. According to a survey conducted and the results obtained, it is possible to categorize elements of the image:

Figure 5 Categorization of the bank's image elements



Source: authors

Maintaining a good image is very important and difficult task, as well as the procedure for achieving it. Since banks by approving overdrafts on the cards, have a high income, this service should not be discounted as significant in terms of satisfying users with mode of service delivery and communication of changes. If corporate and commercial communications are not consistent with reality, previously satisfied clients are starting to think about choosing another bank, which will benefit from this type of service. Problems related to technical and/or functional quality of products or services are leading to the current disruption in consumers' perceptions of caring for him. As an essential element of the Bank services clients have specified after-sales services and informing clients (16%).

Perception of security of the entire bank's business is not disrupted, but confidence in the client care and safety in the delivery of services is disrupted. For all clients it is very important to be able to use credit or debit cards 24 hours a day, at any location, including internet payments. In this case, clients have been waiting an average of 28 days to obtain a new card after making a new application for reissuing cards. During the survey, it was not possible to obtain information on how many complaints the bank has received, how bank dealt with it or how many clients really decided not to continue to use this service. What clients have particularly noted was the lack of communication in the process of resolving the situation.

4. CONCLUSION

Corporate communication is in direct connection with a corporate image, presenting a continuous process of each company, in which the management structure should have an awareness of the significant elements of the image relevant for each target group. The perception of the company differs within target groups, creating different image of the company. Maintenance or improvement of existing image can be achieved by improving communication of important factors of the image for each target groups. Considering that the construction of the image is always associated with the mission, vision, company policy and its organizational culture, adapting to the target groups does not mean the creation of contradictory plans or broadcast of the contradictory messages and creation of confusion. At issue is highlighting one or more aspects of the company identity, which to target group can be more expressive than other. The most common disorders in the process of building and maintaining the image are caused by improper, untimely communication. In situations where companies make mistakes in decisions relating to the consumer, it is necessary to communicate an error and thus to reduce the negative effects. Although no company, not even the banks, can reach the level of perfection, successful companies have a reputation to make fewer mistakes and communicating to clients in order to solve them.

Continuous assessment of key elements of the image with each target group is helping businesses to remain vigilant. Improving their services, companies can hold leading positions in markets of interest to their business. What is increasingly important is that the image of the company becomes a key factor for gaining competitive advantages in the market, and that it is created based on its own personality and identity can not copy or imitate by competitors. Competitiveness of companies as well as his image is based on wholeness and intensity of an integrated corporate communications with the implementation carried out by using skillful marketing, organizational and managerial communication.

It is evident that companies still do not sufficiently use all the possibilities or the potential of corporate communications. Attention is mostly given to advertising, while the communication of corporate social responsibility is almost entirely neglected, which ultimately hinders the sustainability of corporate image in long term. Changes in client behavior as well as their more sophisticated requirements have become imperative to seek for new and even undiscovered possibilities of different forms in corporate communication, especially in the area of organizational and marketing communications. The ultimate goal of corporate communication should not only be competitive business, but also increased client satisfaction and perception of the company image.

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THE SOCIAL MEDIA INTERACTION: CASE STUDY IN STUDENTS PERSPECTIVE

ABSTRACT

New social media, such as Facebook, YouTube, LinkedIn and Twitter, are being adopted by a growing number of business people and consultants who seek to deploy them for the benefit of their business. Social media play an important role, as marketing tools, in integrating the online global markets and connecting with the offline communication approach. To explain this integration, our paper investigated the trends and the influence of consumer's online behavior, possibility to personalize communication messages and to create successful online marketing strategy. We used online questionnaire for reaching the students population. Limitation of our study is that majority of respondents live in the urban area of Belgrade and Sarajevo. The study explained the use of social media, such as Facebook, LinkedIn and Twitter, among students' population in Serbia and Bosnia and Herzegovina and provided implications for academia, consultants and managers interested in the field of social media. Findings explained similarities and differences in students' usage of social networks and factors that moderate opportunities for integration of the integrated marketing communication strategy. These results differed by gender. Results also showed that students from Serbia used Facebook and Twitter for communication and interaction more than students from Bosnia and Herzegovina. We also identified that students prefer to use social networking for searching for internships and jobs in Serbia. Some integrated social networking strategies that are suggested are related to the differences of Serbia's and Bosnia's online landscapes. This study contributes to the overall understanding of why companies should adopt a specific strategy for the younger population.

Key words: social media, online interaction, students' perspective, Serbia, Bosnia and Herzegovina

JEL classification: Z1

1. INTRODUCTION

Interest in the research on social media and the influence of defining an integrated marketing communication strategy which will connect the online and offline marketing approach has grown in the past decade.

"Social media represents a group of concepts that define several activities that integrate technology, social interaction and construction made out of words, pictures, video and sound."

A major category of social media activity is social networking. Authors (Coyle and Vaughn's, 2008) in their research study found that in today's digital age, social networking is a new form of communication that continues to evolve. Social networking websites, such as Facebook, MySpace and Twitter, have become an integral part of the U.S. college students' lives. (New Media Consortium 2007). Social Networks – probably the most recognizable and the most popular form of social media. They enable people to have their own personalized profiles, through which they can connect with other people. The most popular ones are LinkedIn, MySpace, Facebook, Orkut, Bebo etc. (Bjelic and Matovic, 2010).

Compared with the earlier work on the influence of social networks on defining the image of Serbia's students' population (Okanovic et. al, 2010), our study undertakes a different angle on the students' perspective with the comparison of two different countries Serbia and Bosnia and Herzegovina in the SEE region.

This study shows students' participation in social media and attempts to identify the similarities and differences in their behavior, this will provide guidelines to academics and practitioners in defining better communication strategies for younger people, which will include student interaction.

2. SOCIAL MEDIA

Social media are using technology to build conversations that create value for participants who are active on-line. Key technologies that researchers should analyze are blogging: http://www.wordpress.com,microblogging: http://www.twitter.com, socialnetworking/community: http://www.facebook.com, social Networking/Profile: http://linkedin.com, social bookmarking: http://stumbleupon.com, online media sharing: video/photos: http://flickr.com, http://www.youtube.com, podcasting: http://www.podbean.com/, wikis: http://www.wikipedia.com, others: review web site. (Stearns, 2011).

Social networking focuses on building and reflecting personal and social relations between on-line users who share common interests, causes or goals. Social networks, whether they are informal networks (e.g., Facebook or Twitter) or professional networks (e.g., LinkedIn), have different influence on Internet users. (Damnjanovic, 2011)

LinkedIn operates the world's largest professional network on the Internet with more than 100 million members in over 200 countries and territories. There are 20 million members in Europe as of December 2010. Social networking via online professional social media sites, such as LinkedIn (www.LinkedIn.com), is a must. These sites provide an opportunity for professionals to make connections. Also, they have become a critical resource for HR professionals, when searching for candidates for job openings. (Gourniak, 2010). Always try to keep your comments professionally relevant on LinkedIn. For personal topics, you can use Facebook. (Santiago, 2011).

Statistics about using Facebook in Serbia and Bosnia and Herzegovina in 2011 showed that penetration of on-line population (66,14% in Serbia and 71,56% in Bosnia and Herzegovina) is extremely high. Likewise, it showed that students had accounts on Facebook, the most popular social network site. We can also compare Serbia and Bosnia and Herzegovina total users (2716340 in Serbia and 1031220 in Bosnia and Herzegovina).

Table 1 Facebook statistics (Serbia vs. Bosnia and Herzegovina, 2011)

Serbia		**Bosna and Hercegovina**	
Total Facebook Users:	**2 716 340**	Total Facebook Users:	**1 031 220**
Position in the list:	**42.**	Position in the list:	**71.**
Average CPC:	**$0.16**	Average CPC:	**$0.11**
Penetration of population:	**36.98%**	Penetration of population:	**22.31%**
Penetration of on-line population:	**66.14%**	Penetration of on-line population:	**71.56%**
Average CPM:	**$0.07**	Average CPM:	**$0.05**

Source: www.socialbakers.com

Twitter is "the leading platform among "microblogging" forms of social media that provides a way of broadcasting brief posts. In Twitter, these messages (called tweets) are very short: the maximum is 140 characters. Users can post original tweets under their Twitter accounts, but they can also "retweet," Twitter users have a profile page, which describes them and indicates their followers, as well as users that they follow. When a person chooses to follow someone, he/she receives that someone's tweets. Therefore, Twitter users are both consumers of tweets (followers) and producers of tweets (followed)."(Fisher and Rueber, 2011).

There are no such studies that analyze the behavior of students population on social media in Serbia and Bosnia and Herzegovina. The purpose of the research is to investigate students' interaction on different social media (Facebook, Linkedin, Twitter) and develop implication for defining better on-line communication strategy for young generation.

3. METHODOLOGY

The methodology includes interviews and short self-report diaries. We interviewed students from Serbia and Bosnia and Herzegovina by questionnaire form. The interview lasted between half an hour and one hour. They were asked about their usage of Facebook, Linkedin and Twitter during usual day, also we asked them to provide examples of how their social life was influenced by their usage of social media. We also discussed their activities on Facebook during last 24 hours, particularly social meetings and social communication. Respondents were between 20 and 24 years old. They had to be active on Facebook in order to complete the survey. The SPSS 17.0 statistical computer analysis package was used to analyze research findings.

4. FINDINGS

In total there were 57 respondents from Serbia and 44 respondents from Bosnia and Herzegovina. All respondents have profiles on Facebook. When analyzing other social networks we have come to the results that in Serbia 15,8% have profiles on MySpace, 52,6% have profiles on LinkedIn, while 29,8% have profiles on Twitter. The results for Bosnia and Herzegovina differ from the ones from Serbia, in Bosnia 27,27 respondents have profiles on MySpace, 13,63% have profiles on LinkedIn and 22,72% have profiles on Twitter.

When analyzing the number of friends that respondents have on Facebook we have come to the results that in Serbia 29,8% have from 201 to 300 friends on Facebook, the same percentage of respondents have from 301 to 500 friends. On the other hand, in Bosnia and Herzegovina 36,36% of respondents have from 201 to 300 friends.

If we analyze the frequency of Facebook usage among the students' population, we can see that 59,6% use Facebook several times a day, in Bosnia this percentage is also high 56,81%. In total 29,8% respondents in Serbia say they use Facebook everyday, which shows that students have the habit of frequently visiting social networks.

When dealing with reasons for using Facebook in Serbia, we can see that a certain difference exists according to gender. Females use Facebook for looking up people they have met in person more than males do (test statistics sample realization is 6.457, and df is 2. p-value is calculated which accounts for 0.042), this confirms the null hypothesis that the difference in Facebook usage among males and females does exist.

Respondents in Serbia who have Twitter profiles use them for getting new information (17,5%) and for fun (17,5%). Some students use the micro blogging platform to find people they trust and admire (15,8%), while only 8,8% use Twitter for networking. The largest percentage of students in Bosnia and Herzegovina use Twitter for informing (29,54%), 18,18% use it for fun which is similar to the results in Serbia.

There are certain differences in the usage of Facebook among the students of these two countries, they are shown in table 2.

Table 2 Differences in Facebook usage among the students' population Serbia vs Bosnia and Hercegovina

Reasons	Serbia	Bosnia and Herzegovina
Look up someone I met in person	17,5%	40,90%
Learn more about my colleagues that I go to class with.	15,8%	9,09%
Learn about people that live nearby	14%	13,63%
Stay in touch with my old friends	91,2%	61,36%
Meet new people	12,3%	18,18%
Know what my friends are doing	73,7%	81,81%
Find an internship or a job	17,5%	11,36%

Only 6 respondents from Bosnia and Herzegovina use LinkedIn, this is a very small percentage, so the results for this market are not relevant. On the other hand, more than half of respondents from Serbia use LinkedIn. The usage of LinkedIn in Serbia is shown in table 3.

Table 3 Reasons for using LinkedIn for students in Serbia

Reasons	Percentage of respondents' responses
For linking with people from the field I am interested in	33,3%
Networking with people from abroad	19,3%
For self branding	17,5%
For new business opportunities	5,3%
For finding firms/people for doing business	14%
For finding a job	14%
I use it rarely	14%
For asking/answering questions	1,8%

5. CONCLUSION

Based on the research, we have identified similarities and differences between usage of Social media among students' population in Serbia and Bosnia and Herzegovina.
If we analyze similarities, the frequency of Facebook usage among students' population is similar in these two markets, because more that 55% of the respondents use Facebook few times a day. Another important conclusion refers the usage of Twitter - the reasons for using this social media are the same in these two countries and they are: getting informed and for fun.

The main differences between these two markets are that MySpace is more used in Bosnia and Herzegovina than in Serbia, also Serbian students use LinkedIn more than Bosnian students. This shows shat Serbian students, between 20 and 24 years old, use social media for business interaction; they connect with people from the field they are interested in (33.3%), for international networking (19.3%), for self branding (17.5%), for finding a job (14%) and for business deals (14%).

There were also certain differences, when we analyzed the usage of Facebook. The priority for students from Bosnia and Herzegovina is to know what their friends are doing (81.81%), which indicates that they are more curious than students from Serbia. On the other hand, Serbian students use Facebook mostly to stay in touch with their old friends (91.2%), which indicates the need for preserving relationships that were made in the previous period. If we compare the looking up someone they met in person, students from Bosnia and Herzegovina look up more (40.9%) than students from Serbia (17.5%).

It is important to mention that students' behavior on social media and on-line markets influences the changes in their off-line behavior (Peluchette, 2010). According to (Wilson, 2009) business people are using social networking tools to find new opportunities, expertise, employees, and information on how young customers utilize their products and services.

Finally, our findings point out the importance of considering usage of different social networks from the students' perspective. Even the differences in students' behavior on social networks indicate that the experiences are quite distinct. It is therefore essential to examine the on-line usage of social networks considering these new technologies, and to from more holistic viewpoint. This implies the way companies communicate with young population on the analyzed markets. The purpose of the future study is to determine the influence of social networks on building country brand image and reputation among students' population.

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REGIONAL COMPETITIVENESS AND USE OF EUROPEAN UNION FUNDS – THE CASE OF CROATIA

ABSTRACT

In the middle of 2011, Croatia temporarily closed all chapters of negotiation with the European Union. During this process, Croatia started implementing regional reforms and economic policies leading to competitive progress and more effective use of EU funds. This paper deals with statistical division of Croatian territory in three regions. It analyses statistical indicators which describe factors and areas of competitiveness of Croatian (Counties) regions. It also synthesises economic effects of use of EU funds and processes which are taking place in Croatia during preparations for the accession to full EU membership, as well as possibilities to participate in various pre-accession programmes and other forms of financial and technical assistance.

Key words: regionalization, competitiveness, accession, European programmes and funds

JEL classification: F15, F36

1. PROCESS OF CROATIA'S ACCESSION TO THE EU

The idea of establishment of the European Union originated from Winston Churchill's proposal about the forming of the United States of Europe in his speech in Zurich on 19 September 1946. The speech prompted good cooperation of six countries, namely Belgium, France, Germany, Italy, Luxembourg and the Netherlands, which on 18 April 1951 signed the Treaty of Paris establishing the European Community, which on 1 November 1993 became the European Union - inter-governmental and supra-national community of European countries, based on the Treaty on European Union, better known as the Maastricht Treaty. In 1973, Denmark, Ireland and Great Britain joined the European Community/Union, followed by Greece in 1981. In late 1986, Portugal and Spain joined the Union, whereas Austria, Finland and Sweden joined in 1995. In 2004, the membership was enlarged by Cyprus, the Czech Republic, Estonia, Latvia, Hungary, Malta, Poland, Slovakia and Slovenia, and Bulgaria and Romania joined in 2007. Today, the European Union has 27 Member States and nearly 500 million citizens.

The legal basis and the first Stabilisation and Association Agreement between Croatia and the EU were signed on 29 October 2001. The Agreement emphasized that the entry of Croatia in the EU was a vital foreign policy and economic goal (Vukadinović and Čehulić, 2005). In December 2002, the Croatian Parliament adopted the Resolution on Croatia's Integration into the European Union. Soon afterwards, on 21 February 2003, Croatia applied for full membership in the EU. The European Council, on its meeting in Thessaloniki in June 2003, reiterated its determination to fully and effectively support the European perspective of the Western Balkan countries. There followed the regular procedure of composing the Opinion, based on which the European Commission, in July 2003, submitted a Questionnaire comprised of 4560 questions. In October 2003, the Government of the Republic of Croatia submitted the answers to the European Commission. In April 2004, the European Commission published its positive Opinion on Croatia's Application for Membership of the European Union. On 18 July 2004, the European Council recognized the Republic of Croatia as a candidate country for the full membership of the EU.

Subsequently, the Council of European Union adopted the Negotiating Framework for negotiations with the Republic of Croatia, which started on 3 October 2005. By 10 June 2011, Croatia opened and closed the total of 35 negotiation chapters, namely: 1) Free Movement of Goods, 2) Freedom of Movement for Workers, 3) Right of Establishment and Freedom to Provide Services, 4) Free Movement of Capital, 5) Public Procurement, 6) Company Law, 7) Intellectual Property Law, 8) Competition Policy, 9) Financial Services, 10) Information Society and Media, 11) Agriculture and Rural Development, 12) Food Safety, Veterinary and Phytosanitary Policy, 13) Fisheries, 14) Transport Policy, 15) Energy, 16) Taxation, 17) Economic and Monetary Policy, 18) Statistics, 19) Social Policy and Employment, 20) Enterprise and Industrial Policy, 21) Trans-European Networks, 22) Regional Policy & Co-ordination of Structural Instruments, 23) Judiciary and Fundamental Rights, 24) Justice, Freedom and Security, 25) Science and Research, 26) Education and Culture, 27) Environment, 28) Consumer and Health Protection, 29) Customs Union, 30) External Relations, 31) Foreign, Security and Defence Policy, 32) Financial control, 33) Financial and Budgetary Provisions, 34) Institutions and 35) Other Issues.

After closing all 35 negotiation chapters, on 1 July 2013 the European Commission recommended the admission of Croatia in the full membership. Each candidate country has to accept the 'acquis' before it can join the EU, and make EU law part of its own national legislation. Only after this the representatives of EU Member States and the accession country can sign the Accession Treaty which then has to be ratified by all signatory states, according to their constitutional provisions. After finalising the ratification process, the accession country becomes the full EU Member State, provided that its citizens gave their consent on the EU membership referendum. Once it becomes the EU Member State, Croatia will have equal rights in the Council of European Union and in the European Commission as other Member States, including the right of veto. In the European Parliament, which comprises 750 seats, based on the population count and the distribution of seats, Croatia will probably have 13 representatives who will be elected in the following Elections to the European Parliament in 2014.

2. COSTS OF ADJUSTMENT AND THE USE OF EU FUNDS

Not all structures of Croatian society will be equally affected by the EU membership. EU accession will bring numerous transfers from EU budget, but also the loss of customs revenues and the need to adjust tax revenues. Analysis of fiscal impacts based on income analysis shows that, upon entry in the EU, there will definitely occur certain changes. That is, a part of the budget revenues collected from the value-added tax (VAT) and customs duties will go to the EU budget through standard mechanisms, whereas, at the same time, there could open a space for increase of certain categories of income (e.g. excise duties) due to tax system adjustments. As a counterweight to this net cash flow, there will be transfers from the EU budget to the Croatian budget.

It should be noted that some Member States have still not fully adjusted their structure of excise duties, which, on the other hand, leads to a conclusion that Croatia, too, will not have to do that immediately after its accession to the EU. The adjustment will have to be performed within the agreed monitoring period. However, the question is whether all these costs will have a neutral, positive or a negative effect on public finances. With considerable expenses for adjustments in the areas such as environment, agriculture and transport, as well as allocations for the EU budget, there will be changes in the structure of expenses. The EU accession should not significantly increase prices in Croatia, but there could be a certain pressure regarding the increase of general government deficit by about 1.1 percent GDP in the first years of the membership.

Based on experiences of some EU Member States, the total macroeconomic effect of the EU accession on Croatia is estimated to 0.25% GP, i.e. 11 billion EUR (Belošević et al, 2009). Environmental and health protection will probably be the area with the highest financial costs. It is estimated that almost 10 billion HRK will have to be invested in water protection, about 5.8 billion HRK in waste management, and more than 24 billion HRK in water management. Agriculture will probably encounter most difficulties and, after the accession, this field can expect about 2.5 billion HRK per year of direct aid from the EU. However, it will not be enough to make up for the current state aid. However, the experts consider that the costs of the Croatian accession will be short-term and single, whereas the benefits will be long-term and numerous. The EU accession should contribute to about 0.6% faster growth of GDP per year.

In early 2002, Croatia started adjusting its system of aids with EU standards. Harmonisation of the state aid system actually means phasing out of sector assistance and relying on horizontal assistance which does not favour certain producers or products over the other. According to the Institute of Public Finance (Kesner-Škreb, Pleše and Mikić, 2003), state aid in Croatia amounts to 5.25% GDP, whereas in the EU it amounts to only 1% GDP. Based on these data it can be assumed that the adjustment with the EU will bring savings to the Croatian budget by about 4% GDP.

By acquiring the status of the candidate country, the Republic of Croatia has been presented with the possibility to participate in a number of pre-accession programmes and other forms of financial and technical support by various funds for certain projects. European funds differ by purpose, scope and country for which they are intended for regional aid, preservation of natural resources, pre-accession assistance, external assistance and EU programmes. Based on EU practice, there are Structural Funds and Cohesion Funds. Structural Funds are intended for particular regions of EU Member States, whereas the Cohesion Fund is intended for the poorest Member States. Within the new Cohesion Policy 2007 - 2013, the following funds are available (Kandžija V., and Cvečić, 2011):

1. **The European Social Fund (ESF)** - aims at promoting a high level of employment, geographic mobility of labour force, and labour force training and education;
2. **European Regional Development Fund (EROF)** - aims at correction of regional imbalance in the Union, especially by financing of infrastructure, investment and innovation;
3. **Cohesion Fund** - aims at projects in the fields of environment, transport and renewable energy;
4. **European Agricultural Guarantee Fund EAGF/FEAGA**
5. **European Agricultural Fund for Rural Development (EAFRD / FEADER)**;
6. **European Fisheries Fund (EFF/FEP)**,
7. **EU Solidarity Fund (EUSF/FSUE)** aims at EU areas affected by major natural disasters;
8. **European Investment Fund (EIF)** is a financial institution which invests capital and grants guarantees to banks and other agencies which invest in infrastructure projects and the development of small and medium businesses in the EU and outside of it;
9. **European Globalisation Adjustment Fund (EGAF/FEAM)** aims at business entities in the EU which need assistance in solving organisational and technological surplus of labour.

The mentioned EU funds are assisted by various institutions, organisations, companies and associations from the EU through programmes in the fields of research, competitiveness and innovation, education, health, culture, media, human resources, solidarity etc. Certain programmes allow participation of beneficiaries from third countries, provided that appropriate agreements were signed. Various projects are financed, from institutional development assistance and democracy development, research and development projects to humanitarian aid. Table 1 shows the structure of the used EU funds.

Table 1 Funds and resources for rural development for new EU member states, from 2005 to 2009

Country	Structural funds (% of GDP)					
	2005	2006	2007	2008	2009	Average
Bulgaria			0.29	0.37	0.50	0.39
Czech Republic	0.14	0.22	0.54	0.71	0.90	0.50
Estonia	0.61	0.65	0.86	0.77	0.81	0.14
Latvia	0.67	0.41	0.34	0.98	0.79	0.04
Lithuania	0.52	0.58	1.10	1.18	3.15	1.31
Hungary	0.29	0.62	0.93	0.73	1.42	0.80
Poland	0.31	0.59	1.01	0.83	1.19	0.79
Romania			0.21	0.28	0.53	0.34
Slovenia	0.16	0.19	0.30	0.35	0.57	0.32
Slovakia	0.30	0.43	0.82	0.79	0.61	0.59
Average	**0.37**	**0.46**	**0.74**	**0.70**	**1.35**	**0.72**

Country	Cohesion funds (% of GDP)					
	2005	2006	2007	2008	2009	Average
Bulgaria				0.26	0.26	0.23
Czech Republic	0.02	0.19	0.18	0.42	0.54	0.27
Estonia	0.03	0.41	0.51	0.70	0.92	0.51
Latvia	0.16	0.47	0.73	0.69	0.75	0.56
Lithuania	0.23	0.22	0.53	0.77	1.29	0.61
Hungary	0.09	0.15	0.37	0.39	0.92	0.38
Poland	0.01	0.12	0.34	0.44	0.77	0.34
Romania			0.13	0.19	0.26	0.19
Slovenia	0.03	0.10	0.16	0.28	0.47	0.21
Slovakia	0.11	0.17	0.33	0.46	0.32	0.28
Average	0.08	0.23	0.35	0.46	0.65	0.36

Country	Resources for rural development (% of GDP)					
	2005	2006	2007	2008	2009	Average
Bulgaria				0.68	0.36	0.35
Czech Republic	0.15	0.16	0.28	0.17	0.27	0.20
Estonia	0.44	0.32	0.45	0.33	0.69	0.44
Latvia	0.70	0.59	0.53	0.54	0.56	0.58
Lithuania	0.66	0.58	1.08	0.23	0.93	0.70
Hungary	0.15	0.26	0.47	0.15	0.57	0.32
Poland	0.27	0.42	0.61	0.30	0.34	0.39
Romania				0.40	0.49	0.30
Slovenia	0.24	0.38	0.37	0.25	0.32	0.31
Slovakia	0.27	0.29	0.40	0.29	0.46	0.34
Average	0.36	0.37	0.42	0.33	0.50	0.39

Source: adapted from http://epp.eurostat.ec.europa.eu/

Table 1 shows that the most successful countries were those where good cooperation between the public and private sector had been achieved, such as Estonia, Latvia, Lithuania, Poland and Hungary; they achieved above average utilisation of almost all EU funds. This also reflected on their competitiveness. The most significant funds and budgetary instruments of the Union in the period from 2007 to 2013 are the following:

1. **Instrument for Pre-Accession Assistance (IPA) -** designed for EU accession candidate countries. This unique pre-accession instrument distinguishes between two groups of countries: 1) Countries with the status of potential candidate for membership of the Union (Albania, Bosnia and Herzegovina, Montenegro and Serbia) 2) Countries with the status of candidate for membership of the European Union (Croatia, Macedonia and Turkey). The IPA programme consists of the following five components: IPA I - capacity building and institution building IPA II - cross-border cooperation IPA III - regional development IPA IV - human resources development IPA V - rural development;
2. **European Neighbourhood and Partnership Instrument (ENPI/IEPV)**
3. **European Development Fund (EDF)** - financed outside of the EU General Budget (ACP and OCT countries);
4. **Development Cooperation Instrument (DCI)** - includes other developing countries and specific thematic programmes (e.g. migrations and asylum).

All the above funds and instruments are intended primarily for the financing of harmonisation with European Union standards. Candidate countries have at their disposal great amounts of grants for the harmonisation with EU standards in the pre-accession period (for the Republic of Croatia, approximately 380 mill. EUR per year through the IPA programme), and very abundant funds through other programmes and donations (for the Republic of Croatia approximately 1 - 1.2 billion EUR per year) aimed at achieving development stages in conformity with the EU average. Table 2 provides an overview of programmes and used resources.

Table 2 Overview of used programmes and resources up to 31 December 2009

Absolute amounts in EUR							
PROGRAMME	Allocated	Contracted	%	Received	%	Paid	%
CARDS	75,940,045	72,751,141	95.80	72,147,965	99,17	67,268,693	92.46
PHARE	137,289,500	118,580,349	86.37	109,124,693	92,03	89,265,470	75.28
ISPA	59,000,000	35,169,222	59.61	20,846,023	59,27	14,175,086	40.31
SAPARD	25,000,000	15,425,682	61.70	13,960,233	90,50	12,083,170	78.33
TOTAL	297,229,545	241,926,394	81.39	216,078,914	89,32	182,792,419	75.56
IPA	372,108,020	28,651,823	7.70	80,602,248	281,32	13,716,305	47.87
GRAND TOT.	669,337,565	270,578,217	40.42	296,681,162	109,65	196,508,724	72.63

Source: Ministry of Finance, National Fund, 2010

The high utilisation rate (92.46 %) of the CARDS programme can to a large extent be attributed to the fact that the programme was managed directly by bodies of the European Commission. The Republic of Croatia was granted, through the pre-accession programmes CARDS 2003, CARDS 2004, PHARE, ISPA and SAPARD, a total of 297.23 million EUR, of which 241.93 million EUR or 81.39 % was contracted until 31 December 2009. The European Commission allocated 216.08 million EUR or 89.32 % of the contracted funds. During that period, from the allocated funds, 182.79 million EUR or 75.56 % of the contracted amount was paid to end beneficiaries (Fićor, 2009).

If funds from the IPA programme are added to this, it follows that until 1 December 2009 the Republic of Croatia was granted a total of 669.34 million EUR through all programmes, and that a total of 270.58 million EUR or only 40.5 % of allocated funds was contracted and 196.51 million euros or 72.63 % of the contracted amount was paid to end beneficiaries, which means that only one third of the allocated funds were utilised. Croatia is not unique in this experience since almost all countries that became member states in the last two waves of enlargement experienced great difficulties in the use of Structural and Cohesion Funds.

The use of EU funds and other forms of financial and other aid was supposed to raise Croatia's level of competitiveness. However, this assumption did not hold true. An important factor in such a development was strong centralisation of the state in Croatia and poor personnel structure in the public administration and self-government. There are numerous examples that directly connect the level of decentralisation of a country with the capacity to utilize EU funds so it can be generally argued that decentralised countries with strong regional governments are the most successful in drawing EU funds.

Since 1990, Croatia has made great advances in adjusting to a functional market economy and many analysts agree that the Croatian economy today is not only a functional market economy, but to a great extent integrated in the wider European environment. Nonetheless, difficulties are evident, especially in the production sector, and it is necessary to maximally use the financial aid that is available within the Instrument for Pre-Accession Assistance (IPA) for the development of the competitiveness of the economy, and for the creation of infrastructure preconditions necessary for the development of the economy. After EU accession, much greater funds will be available for this purpose, and it is necessary to invest much greater efforts to motivate and enable businessmen and the public administration to utilise these instruments.

EU regulations certainly envisage a wide range of instruments designed precisely for increasing competitiveness and for the development of an economy based on know-how and innovations, which creates a great added value. It is important to emphasise that all new member states recorded accelerated growth rates in the first years after accession, and that they, with almost no exception, achieved great results precisely with the effective use of EU funds for the development of business infrastructure, attracting foreign investments and development of a competitive economy.

The availability of Structural Funds and some other instruments of EU aid for the economy gained additional importance as a result of the Lisbon Strategy, which directed EU funds into the commercialisation of research and development and stimulation of synergy between the educational, that is, science system and the economy. Croatia currently utilises the IPA programme, whose component III, Regional Competitiveness, has three defined priorities:

1. Construction of business infrastructure in regions that are underdeveloped;
2. Creation of a positive investment climate (providing advisory assistance to small and medium businesses, development of clusters and business zones, e-business and creation of infrastructure for innovative products);
3. Technical assistance for project management.

For the purpose of achieving the indicated programme priorities, it is necessary to build a partnership for the successful management of EU financial instruments. Partnership is necessary both in the vertical and in the horizontal sense. Particularly important is the partnership of small municipalities and towns because of a greater functionality of the systems in their jurisdiction, and the partnership between economic operators for the purpose of expenditure rationalisation and increase of competitiveness.

3. REGIONALISATION AND REGIONAL COMPETITIVENESS OF CROATIA

The European Union regional policy is an instrument of financial solidarity and cohesion, and aims at achieving harmonious, uniform and sustainable development, as well as at the strengthening of economic and social cohesion within the Union. Along this line, EU regional policy is dedicated to building regions' capacity to be competitive by promoting economic growth and creating new workplaces. European regional policy has been designed in such a way as to reduce the gap between the stages of development of different regions by actual results and by promoting economic and social cohesion. The policy helps finance particular projects for regions, towns and their inhabitants. The idea is to create potentials, so that regions can fully contribute to achieving higher growth and competitiveness.

EU regional policy consists of three objectives which are especially encouraged: convergence, regional competitiveness and employment, and European territorial cooperation. The European Union is among the richest areas of the world, but within it there are big differences in income and possibilities between its regions. Differences in wealth are great both between the countries and within each of the EU countries. The most successful regions according to the per capita GDP are the urban regions of London, Brussels and Hamburg. Luxembourg, the richest EU country, is more than seven times richer than the poorest new EU member states, Romania and Bulgaria. Table 3 shows per capita GDP in certain countries.

Table 3/a Per capita GDP in certain countries

Countries	2003	2004	2005	2006	2007	2008	2009	2010
European Union (27 countries)	20,700	21,700	22,500	23,700	25,000	25,000	23,500	24,400
European Union (25 countries)	21,900	22,900	23,700	24,900	26,200	26,200	24,600	25,600
European Union (15 countries)	25,000	26,000	26,700	28,000	29,300	29,100	27,400	28,400
Belgium	26,600	28,000	29,000	30,200	31,600	32,299	31,500	32,600
Bulgaria	2,400	2,600	3,000	3,400	4,000	4,600	4,600	4,800
Czech Republic	8,300	9,000	10,200	11,500	12,800	14,800	13,500	14,200
Denmark	35,000	36,500	38,300	40,200	41,700	42,500	40,300	42,200
Germany (including former GDR from 1991)	26,000	26,600	27,000	28,100	29,500	30,100	29,000	30,300
Estonia	6,400	7,200	8,300	10,000	12,000	12,200	10,300	10,700
Ireland	35,300	37,000	39,300	41,800	43,500	40,500	35,900	34,900
Greece	15,600	16,700	17,500	19,000	20,300	21,100	20,800	20,400
Spain	18,600	19,700	20,900	22,300	23,500	23,900	22,900	23,100
France	25,600	26,500	27,300	28,400	29,600	30,100	29,300	29,800
Italy	23,200	23,900	24,400	25,200	26,000	26,200	25,200	25,600
Cyprus	16,100	17,000	17,900	19,000	20,300	21,600	21,100	21,600
Latvia	4,300	4,800	5,600	7,000	9,200	10,100	8,200	8,000
Lithuania	4,800	5,300	6,100	7,100	8,500	9,700	8,000	8,400
Luxembourg	57,200	60,000	65,200	71,800	78,100	80,800	75,200	79,500
Hungary	7,300	8,100	8,800	8,900	9,900	10,500	9,100	9,700
Malta	11,400	11,300	11,900	12,500	13,300	14,200	14,100	14,800
Netherlands	29,400	30,200	31,500	33,100	34,900	36,200	34,600	35,400
Austria	27,700	28,700	29,800	31,300	33,000	33,900	32,900	34,100

Table 3/b Per capita GDP in certain countries

Countries	2003	2004	2005	2006	2007	2008	2009	2010
Poland	5,000	5,300	6,400	7,100	8,200	9,500	8,100	9,300
Portugal	13,700	14,200	14,600	15,100	16,000	16,200	15,900	16,200
Romania	2,400	2,800	3,700	4,500	5,800	6,500	5,500	5,700
Slovenia	12,900	13,600	14,400	15,500	17,100	18,400	17,300	17,300
Slovakia	5,500	6,300	7,100	8,300	10,200	11,900	11,600	12,100
Finland	27,900	29,100	30,000	31,500	34,000	34,900	32,500	33,600
Sweden	31,100	32,400	33,000	35,000	36,900	36,100	31,300	37,000
United Kingdom	27,700	29,600	30,400	32,200	33,700	29,600	25,300	27,400
Iceland	33,600	36,500	44,300	43,800	48,000	32,299	27,200	29,900
Liechtenstein	79,300	80,400	84,300	90,700	95,100	97,300	:	:
Norway	43,600	45,400	52,600	57,600	60,200	64,000	55,300	63,800
Switzerland	38,900	39,200	39,900	41,300	41,600	44,500	45,500	51,200
Croatia	6,800	7,400	8,100	8,900	9,800	10,800	10,300	10,400
Former Yugoslav Republic of Macedonia, the	2,100	2,200	2,400	2,600	2,900	3,300	3,300	:
Turkey	4,100	4,700	5,700	6,100	6,800	7,100	6,100	7,600
United States	33,900	32,500	34,300	35,600	33,900	31,900	32,500	35,300
Japan	29,300	29,000	28,700	27,200	25,000	:	:	:

Source: http://epp.eurostat.ec.europa.eu

The highest GDP per capita in the EU, indicated by purchasing power parity, was recorded last year in Luxembourg, and the lowest in Bulgaria, while Croatia has reached 42.6% of the European average. Based on the information of the European statistical office, in 2010 Croatia's GDP exceeded Hungary's, and Croatia is doing better than 7 EU member states. There are many causes of regional inequalities; they can be the result of many years of limited possibilities of development, and social and global economic changes, and most often the wrong concept of development. The impact of such disadvantages is reflected in social impoverishment, poor quality of education, high unemployment level and inadequate infrastructure. Based on these premises and different criteria, regions can be divided into developed, undeveloped, overpopulated and depressed regions (Sofija Adžić, 2011).

1. **Developed regions** are characterised by: above average development level, very developed infrastructure and information and communication technology, high living standard, sustained and dynamic growth of value added and employment;
2. **Undeveloped regions** are characterised by: unfavourable economic structure and technological underdevelopment, weak development, high unemployment level, population decline, undeveloped infrastructure and low living standard;
3. **Overpopulated regions** are characterised by: high level of economic development and an extremely high urban concentration of the population, infrastructure and economic activities. Overpopulation arises from the strong tendency to establish and develop economic activities in developed environments, since in such regions investments are relieved from the costs of infrastructure expansion, which is a characteristic of undeveloped regions;
4. **Depressed regions** show no entrepreneurial or economic activities. Their essential problem is the economic structure. The core regional industries have

lost their driving characteristics over time and have not been timely replaced by new industries. These regions are characterised by: sudden increase of unemployment and fall of the value added (gross domestic product).

The Republic of Croatia is divided in three statistical regions:

1. **Northwestern Croatia** consists of the City of Zagreb and Zagrebačka, Krapinsko-zagorska, Varaždinska, Koprivničko-križevačka and Međimurska counties;
2. **Central and Eastern (Pannonian) Croatia** consists of Bjelovarsko-bilogorska, Virovitičko-podravska, Požeško-slavonska, Brodsko-posavska, Osječko-baranjska, Vukovarsko-srijemska, Karlovačka and Sisačko-moslavačka counties;
3. **Adriatic Croatia** includes Primorsko-goranska, Ličko-senjska, Zadarska, Šibensko-kninska, Splitsko-dalmatinska, Istarska and Dubrovačko-neretvanska counties.

Key determinants of regional competitiveness directly influencing competitiveness of Croatian regions must be the basis for further direction of development, which will result in an increased competitiveness on a national level, and successful coping with the challenges of European and the growing global competitiveness. Competitiveness of economy on a national level is a reflection of competitive abilities on regional levels. Regional competitiveness is measured according to the regional index model, which is shown in Table 4.

Table 4 Regional Competitiveness Index Model

<table>
<tr><th colspan="4">Pillars of competitiveness</th></tr>
<tr><td>Demographics, health and culture</td><td rowspan="4">Business environment</td><td rowspan="8">Statistical indicators (2/3)</td><td rowspan="17">Regional competitiveness index</td></tr>
<tr><td>Education</td></tr>
<tr><td>Basic infrastructure and public sector</td></tr>
<tr><td>Business infrastructure</td></tr>
<tr><td>Investments and entrepreneurial trends</td><td rowspan="4">Business sector</td></tr>
<tr><td>Entrepreneurship development</td></tr>
<tr><td>Economic results – level</td></tr>
<tr><td>Economic results – trends</td></tr>
<tr><td>Locational advantages</td><td rowspan="6">Business environment</td><td rowspan="9">Perceptual indicators (1/3)</td></tr>
<tr><td>Local government</td></tr>
<tr><td>Infrastructure</td></tr>
<tr><td>Rule of law</td></tr>
<tr><td>Education</td></tr>
<tr><td>Financial market and local competition</td></tr>
<tr><td>Technologies and innovation</td><td rowspan="3">Business sector</td></tr>
<tr><td>Clusters</td></tr>
<tr><td>Marketing and management</td></tr>
</table>

Source: Regional Competitiveness Index of Croatia 2010 http://www.konkurentnost.hr 10/9/2011

The competitiveness of a country and its regions is measured in accordance with the criteria, and in 2010 Croatia was very good with respect to its quality of infrastructure, such as motorways, the spread of Internet and mobile phones. According to these criteria, it ranks among the first 40 countries. It ranked worst when it came to the amount and effectiveness of taxes, labour costs, agricultural policy, legal framework for foreign investments and the burden of government regulation. According to these criteria, Croatia fell on the very bottom of the world's rank list, between places 137 and 140. The average is raised by results in infrastructure, education and health care. The years-long fall of competitiveness has moved Croatia away from EU member states and brought it closer to the Southeast European countries. The competitiveness rank for individual countries is shown in Table 5.

Table 5 Countries' ranks on the competitiveness rank list

1.	Switzerland
2.	Singapore
3.	Sweden
4.	Finland
5.	USA
6.	Germany
17.	Saudi Arabia
18.	France
26.	China
38.	Czech Republic
40.	Tunisia
41.	Poland
48.	Macedonia
57.	Slovenia
60.	Montenegro
74.	Bulgaria
76.	**Croatia**
77.	Romania
78.	Albania
79.	Macedonia
95.	Serbia
100.	Bosnia & Herzegovina

The countries' ranks shown above warn that the authorities of certain countries, including almost all the countries of former Yugoslavia, have to carry out reforms, first of all on the labour market and in productivity, as well as public administration reforms and macroeconomic stability reforms. The future will not happen by itself. If we just let it happen, we shall barely subsist. The competitiveness rank of Croatian regions and counties is shown in Table 6.

Table 6 Croatian regions' and counties' competitiveness rank for 2010

Overall rank		Counties	Business environment rank	Business sector rank	Statistical rank			Perceptual rank		
2010	2007				Statistical rank	Business environment	Business sector rank	Perceptual rank	Business environment	Business sector rank
		NUTS 2 – regions								
1	1	Northwestern Croatia	1	1	1	1	2	1	1	1
2	2	Adriatic Croatia	2	2	2	2	1	3	3	2
3	3	Central and Eastern Croatia	3	3	3	3	3	2	2	3
		NUTS 3 – counties								
1	4	Varaždinska	1	1	6	5	7	1	1	1
2	1	City of Zagreb	2	4	2	1	3	7	9	7
3	3	Istarska	7	5	1	2	1	13	13	10
4	2	Međimurska	6	2	3	7	2	6	6	6
5	5	Zagrebačka	3	6	7	4	9	5	5	3
6	9	Zadarska	4	3	10	13	8	3	2	5
7	6	Primorsko-goranska	8	7	5	6	4	12	11	12
8	8	Splitsko-dalmatinska	12	9	4	3	5	14	17	13
9	10	Dubrovačko-	11	11	9	8	10	11	12	9
10	13	Šibensko-kninska	14	13	8	9	6	16	16	20
11	15	Krapinsko-zagorska	13	10	11	10	12	8	10	8
12	7	Koprivničko-	9	8	13	14	14	4	4	4
13	14	Osječko-baranjska	5	12	14	12	20	2	3	2
14	12	Karlovačka	10	14	12	11	11	10	7	11
15	11	Bjelovarsko-	16	17	15	15	17	15	14	16
16	18	Brodsko-posavska	15	16	19	18	19	9	8	11
17	17	Virovitičko-podravska	17	15	17	16	16	17	18	14
18	19	Ličko-senjska	18	18	18	21	13	18	15	21
19	16	Sisačko-moslavačka	19	19	16	17	15	20	20	18
20	21	Vukovarsko-srijemska	20	20	20	19	18	19	19	19
21	20	Požeško-slavonska	21	21	21	20	21	21	21	17

Source: Regional Competitiveness Index of Croatia 2010 http://www.konkurentnost.hr 10/9/2011

4. CONCLUDING REMARKS

Croatia has completed negotiations with the EU. The signing of the membership treaty is expected in December 2011, and the EU accession in mid 2013. The most valuable aspect of the accession to the EU is the fact that in this way reforms are initiated in all areas of life, which should eventually bring bigger economic growth and political stability. Following the accession, Croatia will become an active EU policy maker, which will strengthen its general political position. Furthermore, Croatian EU accession will also have further positive implications for other Southeast European countries. For them this will mean the contribution to the stabilisation of the wider region and continued democratisation in this part of Europe.

Thanks to reforms related to the EU accession, Croatia will become modernised and more reliable for investments, and also more efficient in exercising public authorities. In some areas, such as agriculture, transport and environmental protection, the costs of harmonisation with the EU standards will be high for the government. However, they will be surpassed by the benefits in the mid- and long-term. For Croatian producers, reforms related to the accession mean restructuring costs. But these short-term costs will develop into benefits in the mid- and long-term, because successful restructuring means the increase of competitiveness and revenue, and better standard of the employed. For Croatian consumers, benefits from the accession to the European Union will show in the short-term period. They will provide bigger choice and lower prices of goods and services, as well as better protection and safety. The biggest challenge and competitive advantage to be expected by the EU member states is the usage of its funds. Croatia has not made the best use of this opportunity in the negotiations with the EU, whereas it should have used all of its advantages and opportunities.

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EFFECTS OF THE GLOBAL FINANCIAL CRISIS ON THE STABILITY OF THE BANKING SECTOR IN CROATIA

ABSTRACT

A developed infrastructure is a prerequisite for economic development, and the financial sector may be regarded as the financial infrastructure of a state's economy. Consequently, the level of the financial system's development is a prerequisite of overall economic development. The transition in CEE countries, but also in the SEE countries, has brought significant changes in several areas: ownership structure, loan structure, profitability. The current economic crisis originated within the financial sector. Many banks, as the most significant financial sector institutions, ended up in bankruptcy, and many others have had problems in their operating. The problems of the banks have spilt into the real sector by means of micro and macroeconomic effects causing a contraction in economic activity. It is therefore of utmost importance to maintain the stability of the financial sector and banks, as its most important segments.

Key words: transition, financial sector, stability, CEEC, SEEC

JEL classification: F43, G2

1. INTRODUCTION

The financial stability is defined as the ability to absorb shocks that might negatively affect the financial system. Consequently, managing the banking sector, especially in the "bank dominated" financial systems due to the exclusive economic dependence of the economy on banks as the source of financing its needs, is of high importance. Given the dependency of the economy on banking sector resources, there are numerous proofs of the positive correlation of the banking system openness and national economy's growth.

After the introductory part, the paper analyses the transition process and the changes in the banking sector's role within the economy. The third part deals with the Croatian banking sector and its features such as consolidation, banking intermediation, degree of concentration, ownership structure. Indicators of financial stability banking sector in Croatia are analyzed in fourth part of paper. The effects of the current economic crisis on the stability of the banking sector and the state of the banking sector are discussed in the fifth part. The time series of the basic banking sector indicators and their dynamics in times of crisis represent the base for observing the impact of the economic crisis on the sectoral structure of loans and bank intermediation with the aim to monitor the features of banks' lending policies.

2. TRANSITION OF BANKING SECTOR IN CROATIA

The financial system of Southeastern European countries unitil 1990 has function in central planning economy. In central planning economy, banks had a passive role. Satisfaying plan of national goverment determined the financial transaction of banks. The allocation of loans at that time for banks was only accouting mechanisam for tracking goverment decision to allocate resources to different business and sectors. Banks of Southeastern countries to 1990 operated in mono-banking system, system in which central bank carried out the functions of commercial and central bank. In mono-banking system banks providing payment services, collecting private saving, profits and taxes and transferred them to the state budget or state institutions, reviewed achiving plan and operation of state institutions. Countries of former Republic of Yugoslavia had built a “two-tier” banking system which was consisted of central bank and individual commercial banks.

In all these stages, which the banking in former Yugoslavia countries and other countries of region pass until 1991 are marked by administrative regulation of business, losses in bank operation, negative real interest rate – the inflationary financing, difficulties in maintaining liquidity due to excessive exposure to the economy, lending decisions that were influenced by policy, and addiction of economy at banks. The accumulation of bad loans and inadequate regulation and supervision of the banking system resulted by banking crisis. Rehabilitation of failure banks was carried out in two ways: design different models of bank rehabilitation and by opening the banking sector to foreign strategic partners (privatization). The process of rehabilitation lead to their nationalization, average cost of rehabilitation is about 10% of GDP.

Early stage of banking sector transition in Southeastern European countries supposed restructuring of state banks and abandoning direct financing. Reconstructing leads to bank privatization and growth of financial markets. The period of transition banking sector had significant structural change that outlines some basic features:

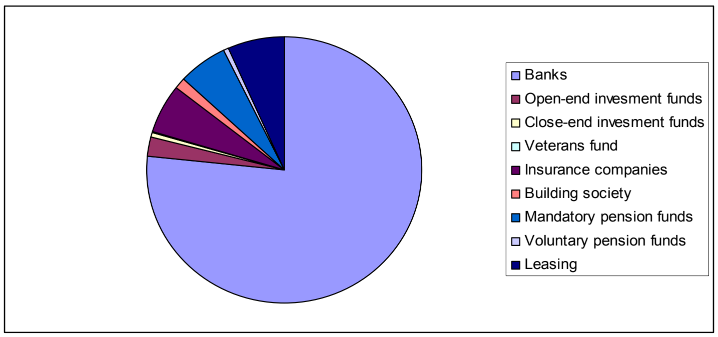
1. Enter of foreign capital into the banking system;
2. Growth in domestic lending in particular household sector;
3. Increasing exposure to foreign currency risk;
4. Increasing profitability and satisfying rate of capital adequacy;
5. Credit expansion and growth of risk assets;
6. Improving the supervisory framework;
7. Implementing of accounting standards.

Total value of merges and acquisitions in the period between 1991-2005 in Central and Southeastern European countries was more than USD 20 billion (Domanski, 2005, 71). Banks in next period must work on revising business policy, improving corporate governance, establishing a reliable system of management and accounting, risk management and internal control and audit.

3. MARKET STRUCTURE OF BANKING SECTOR IN CROATIA

After finishing process of transition in 90ies of last century, the banking sector of Croatia has not recorded any significant changes. Banking sector has record in last ten years growth of performance and significant changes in market structure of the banking sectors (consolidation, concentration, foreign ownership, and competition). Banks are dominant segment of the financial system with low competition from other financial institutions and financial markets. The structure of financial system of Croatia and the importance of banks as financial intermediaries is shown in chart 1.

Chart 1 Structure of financial system in Croatia 2009



Sources: CNB, Annual report, different years

The institutional framework of the banking sector enhanced constantly. EBRD index of banking sector reform (quality of banking regulation and supervision, banking competition and financial depth) review the Croatian banking sector with good prospects.[1]

Table 1 Major indicators of banking sector B&H (in %)

Indicators	2005	2006	2007	2008	2009
Number of banks	33	33	33	33	32
Banking intermediation	110.4	119.4	122.3	105.9	113.9
Foreign capital in total capital	96.6	95.8	90.4	90.6	90.9
CR4	64.9	64.0	63.9	65	65
HHI	1.358	1.297	1.279	1.308	1.366

Source: CNB, Annual reports, different years

After cleaning the bad loans in bank's assets bank start with strengthen the capital for normal operation. The process of capitalization in transition countries was aimed to

[1] EBRD, Transition Report 2009, 2010.

improve capital adequacy and liquidity of banks at the national level. Higher capital requirements put banks in front of process of mergers and acquisitions. Consolidation of banking sector lead to reduction of banks numbers from 43 in 2000 to 33 banks at the end of 2009. Consolidation of the banking industry has a significant impact on the banking market structure and organization of banks, and exposes the market to dominance of large banks. Dominance of large banks as result of consolidation and disappearance of a large number of small banks open question of access to the finance for small and medium enterprises.

Banking intermediation indicates the role of banks in achieving the core functions – the accumulation and allocation of money resources. The share of domestic bank's claims on the private sector of banking sector assets and GDP is the most common approach in the financial literature when we measure and compare degree of banking intermediation. Bank intermediation, together with data on the number of banks, offices, branches of a country is indicators of financial development. Intensive banking intermediation is result of combined structural factors (restructuring and privatization of the banking sector, entry of foreign banks, improving the legal framework, the excess liquidity in the banking market) macroeconomic and financial policies (monetary policy, fiscal consolidation of the sector) and cyclical factors (cost reduction borrowing, the progress in macroeconomic stabilization, lower interest rate in global financial markets and prices of securities). For banking intermediation is equally important „catch-up effect" of countries with lower levels of financial development and economic development with developed countries. Analyzing banking intermediation in Croatia we can see trend of financial deepening and intensive banking activities. Financial crisis has slowed down banking intermediation.

A high share of foreign capital is the result of the privatization process in the banking sector. In attempts to rescue the banking sector a solution was open banking sector to foreign banks (liberalization) for build strong and stable banking sector and help national governments to create legal regulation and institutional infrastructure. According to research conducted in Croatia (Galac, Kraft, 2001) as main competitive advantages of foreign banks in Croatia have been reported: cheaper funding costs of foreign banks, lower interest rates, quality of personal and etc. Also, research conducted in new EU member state (Bulgaria – Bitzenis, 2004; Hungary, Czech Republic, Poland, Slovakia, Slovenia – Mėrő, Valentinyi, 2003) record similar benefits for domestic banking system from the entry of foreign capital. In 2009, 90.9% of total capital in banking sector was in possession of foreign ownership. More than 60% of the banking sector is owned by Austrian banking groups. A high share of foreign ownership determinates a stronger relationship between the "parent" banks and bank "daughter" in Croatia through credit lines. The share of foreign owned banks in total banking sector assets at the end of 2009 was 90.9% which indicates the dependence and sensitivity of the domestic sector to change in business policy and decisions of foreign-owned banks. Researches (Demirguç-Kunt and etc., 1999; Bart and etc., 2002) indicate correlation between foreign ownership and instability of banking sector in period 1990-2006.

Concentration can be defined as mergers, acquiring of control or owner influence through majority shares or voting rights in the assembly of the bank. Concentration is one of the basic elements in the analysis of competitiveness and market structure and market power in banking. The issue of concentration of the banking market is interesting from the stand point of competition. The degree of concentration in the banking sector is usually assessed by the share of assets held by one or three or five largest banks in the banking sector assets (CR3, CR5) or the Herfindahl-Hirschman Index (HHI). Measurement of concentration ratios is carried out for the simple determination of the characteristics of the banking market. However, high values of concentration ratios recorded in the banking market do not necessarily indicate decreasing competitiveness. According to research (Beck, Kunt, Levine, 2003) concentration in the banking market has stabilizing effect. In the banking market with a high concentration is less like hood of systemic banking crisis, i.e. the fragility of the sector. Research has not shown the negative impact of concentration on competition (Claessen, Leavin, 2003). HHI for banking sector in Croatia indicates the growth of concentration and show a significant concentration. Concentration ratios of four largest banks in banking sector indicate exposure of banking sector to small number of banks. Specifically the nation economy depends on the activity of four Croatian largest banks in the sector.

Total assets of the banking sector in Croatia at the end of 2009 amounted to 51.5 billion euro and compared with the situation at the end of 2008 recorded increase of 2.4%. In assets structure dominate loans in amount of 65% (33 billions euro) and increased in compilation with 2008 for 2.3%. Bank in last two year are faced with reduced demand for loans as result of financial crisis which has reduced creditworthiness of existing and potential new customers. During 2009 there has been a weak increase in deposit in amounts of 3.2% and is 34.9 billion euros, in 2008 deposit had increase for 6.3%. The position of borrowings from foreign financial institutions was reduced by 1.6% and amounted 7.2 billion euro.

Table 2 Balance sheet of Croatian banking sector in 2009 (in million euro)

Assets		Liability	
Bank reserves with central bank	6.375,3	Deposits	4.430,5
Foreign assets	6.885,7	Savings and time deposits	5.436,0
Claims on central government	6.145,8	Foreign currency deposits	18.807,0
Claims on other domestic sector	31.925,8	Bonds and money market instruments	189,3
Claims on other banking institutions	94,7	Foreign liabilities	11.161,8
Claims on financial institutions	154,2	Capital accounts	9.209,3
		Other positions	2.888,6
Total	51.581,4	Total	51.581,4

Sources: CNB, Annual report 2009, Zagreb, 2010.

The structure of assets and liabilities indicate importance of loans in assets and deposits in the banking sources in the banking sector of B&H. The loan structure is dominated by loans to other sectors (household), while in the structure of the source dominate deposits in foreign currency. The structure of assets and liabilities are visible sources of risk for banks – credit risk and liquidity.

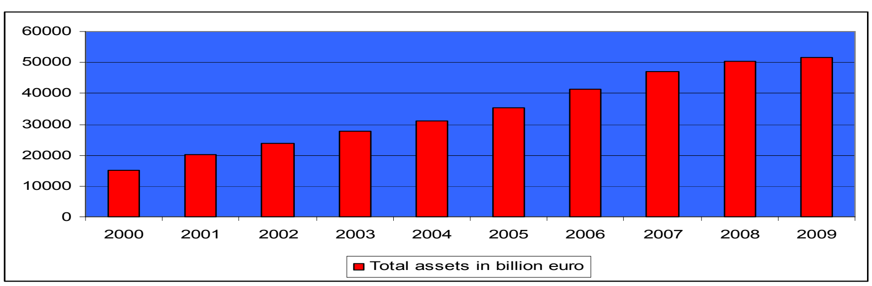
The financial crisis has decrease domestic loans demand due to lost consumer confidence and creating stricter credit conditions. Decreasing activity and worsening credit quality of loan portfolios has impact on banks' profitability. Banks maintain public confidence, aren't faced with withdrawal of deposits, it is important to say how banks part of source obtained abroad. In such conditions for security and stability of banks is crucial relationship and actions of monetary policy, as well as careful management of banks by the owners and managers.

4. INDICATORS OF FINANCIAL STABILITY BANKING SECTOR IN CROATIA

Banking sector with 51.6% share in total assets of financial sector is dominate source of financing through which is satisfied demand from economy and households. So it is important to have stabile banking sector. Stability of banking sector presents possibility that it will not get into a situation of insolvency[2] in the future. So it is important to review distribution of assets and liabilities of the banking sector through different indicators.

Banks lending activities in Croatia was grown in resent years with significant share of loans to household. Rate of credit growth recoded a value of over 25% annually. Banks loan activities shows slow growth in period 2008.-2010. Reason for slow growth is in banks reserving in additional exposure to credit risk (chart 2). Impact of financial crisis on banks loan activities is reflecting on assets quality and share non-performing loans in total loans of the banking sector.

Chart 2 Total loans of the banking sector in Croatia (in billion euro)



Sources: CNB, Annual report 2009, Zagreb, 2010

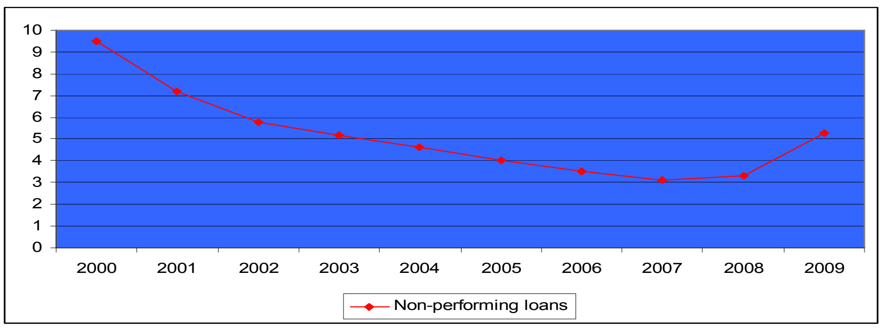
In structure of total loans dominated loans to households which in 2009 record first decline for retail loans in last twelve years. The biggest decreasing recorded consumer loans (personal consumption) as well as loans for car purchase. Only slow growth is

[2] Assets of banking sector aren't enough to cover all liabilities.

recorded in mortgage loans. Banks are in the period before financial crisis, recorded strong growth of the loan portfolio funded foreign sources (the credit lines from bank "parent" to bank "daughter"). In period 2008-2009 growth credit activities of the banking sectors to public sector, to finance budget deficit. Special attention should be given to domestic loans linked to foreign currencies, which may represent a source of risk to macroeconomic stability in case of inconsistency of monetary policy and exchange rate policy. Correlation between banks' credit activities and deepening current account deficit is also important characteristic of banking sector.

Credit risk dominates in banking sector in Croatia and is based source of risk for financial stability. Weak economic activity and increasing unemployment resulting in demand for loans and banks faced with new macroeconomic conditions which determinate banks operating. All this determinates rigorous conditions for loan approval. Financial crisis effect banks assets quality and increase share of bad loans[3] in the total loans of the banking sector and share of bad loans in total assets of the banking sector. Bad loans recorded growth trend in the period 2008-2009.

Chart 3 Non-performing loans in the total loans of the banking sector of Croatia



Sources: CNB, Annual report, different years.

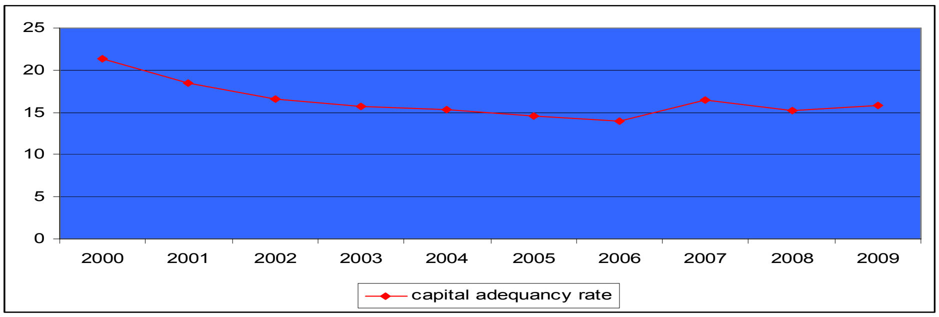
The growth rate of non-performing loans to total loans of the banking sector in Croatia on an annual basis was in 2009 compared to 2008 61%. The reason for the increase is a change in the structure of quality risk assets, with the growth of group B and it subgroup B1 (substandard loans) with probability of loss 1-30%. The increasing in bad loans and provisions can have direct and indirect macroeconomic effects on fiscal side (collection on income taxes) and monetary side (credit to economy).

Total capital of 33 banks in the banking sector of in 2009 amounted 77 million euro and in same year recorded growth for 5.6% due to an increase in retained earnings and increase in position in statutory and other capital reserves. Profit of banking sector in 2009 recorded decline by 25% compared to 2008. The capital adequacy ration shows

[3] There isn't unique definition of bad loans, according to G-10 countries bad loand present all loans with delay 90 days.

bank ability that with their capital cover risk weighted assets. In 2009 the banking sector recorded rise of risk weighted assets on annual level of 2.9%.

Chart 4 Capital adequacy rate of the banking sector in Croatia

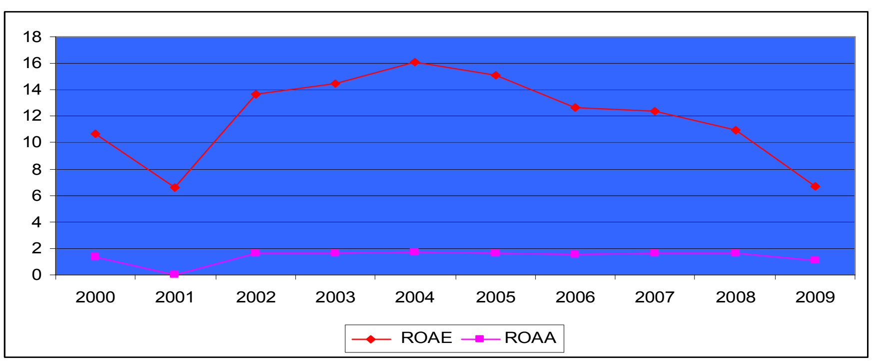


Source: CNB, Annual report, differant years.

The capital adequacy rate in 2009 grew by 0.6% s result of capital increase in banking sector and reducing capital requirement to cover credit and market risks. Banks try to raise capital to absorb anticipated losses in coming years.

Bank profits fell in 2009 and amounted 63 million euros. Decrease in profit reflected deterioration of profitability indicators of banking sector. In 2009, all banks recorded an increase in provision for credit losses as a result of impact financial crisis. Net income of banking sector recorded a growth due to increasing non-interest income, while net interest income decrease as result of increasing cost of funding.

Chart 5 Indicators of profitability in the Croatian banking sector

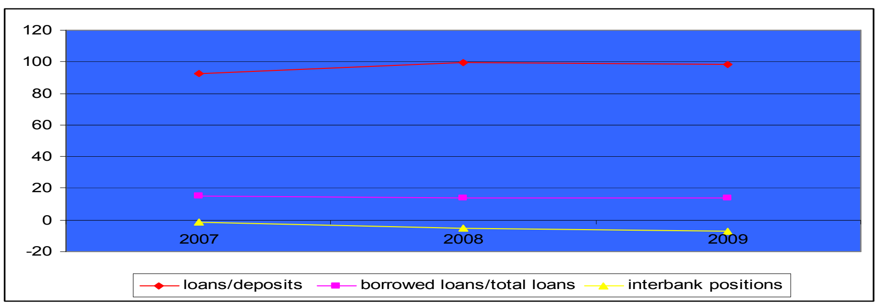


Source: CNB, Anuual report, different years.

Indicators of banks' profitability show the biggest decline in last five years. Research analyses impact of market structure, ownership structure and management, structure of balance sheet and risks related to its position, and macroeconomics (Demirgüc-Kunt, Huizinga, 1998). Deterioration of profitability is result of reduced lending activities and assets quality of banks which had resulted in increasing cost of provision and change in classification of assets. Profitability of banking sector means a safer financial system and better performance of the credit function with positive effects on economy.

In 2009 sources were more expensive for banks in comparison to 2008. Amount of deposit stay stabile, while banks use sources borrowed from foreign banks. In countries with market-oriented financial system banking sector recorded increasing in liquidity because investor direct investments from financial market into deposit in banks insured by state. However, the crisis in banking dominate financial system has the greatest effect on the liquidity in banks, opening the question of deposit security. Although, deposit insurance system exists, it is recorded withdrawn of deposit due to lack of confidence. The reasons for the loss of trust can be founded in limited amount of insurance deposits, withdrawal deposits for healthy banks, the time required to dispose of deposit in failure banks, doubts in credibility of state and etc.

Chart 6 Liquidity indicators for Craitian banking sector



Sources: CNB, Annual report, different years.

Indicators of liquidity recorded decline in Croatian banking sector. The deterioration is result of faster growth in credit activities than the growth oh deposit base. The deterioration in interbank position is consequence of growth foreign liabilities above banks' foreign assets.

5. FINANCIAL STABILITY BANKING SECTOR AND EFFECT ON REAL ECONOMY

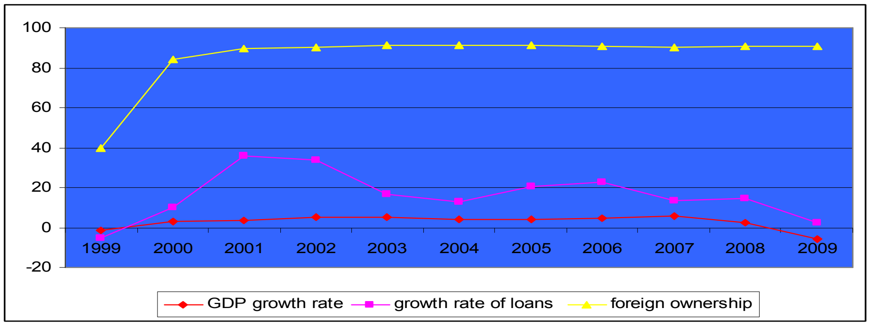
There is significant relationship between macroeconomic variables and financial stability sector. Today, research confirms that financial crisis can be predicted by macroeconomic data. Among macroeconomic indicators that can be taken for assess financial stability are: the economic growth, balance of payments, inflation, interest rate, exchange rate, rising price of financial assets, the effect of contingency (contingent effect, such transmission of crisis through a network of banks and foreign exchange markets) and other factors (Evens, Leone, Gill, Hilbers, 2000, p. 10-12).

The analysis of macroeconomic indicators is particularly important to be able to project certain difficulties, risk and benefits, and possibilities for normal operating banking sector in condition of financial crisis. Decreasing in growth rate of GDP reduce creditworthiness and increase credit risk. Similar effects we record when in some economic sector appear problem. Increasing deficit in current payment balance means increasing inflow of foreign capital which can cause credit boom. Decreasing in ration between reserve and debit of country, changing maturity structures of foreign investments may be valid indicators of financial sector vulnerabilities of individual countries. Volatility has dual effect on financial sector. On the one hand, inflation affects price volatility of financial assets, on the other creditworthiness of borrowers and decline in value of collateral (credit risk), and thus on liquidity and solvency of financial institutions. Exchange rate changes may cause more exposure to foreign currency risk due to currency imbalanced in balance sheet of financial institutions. Interest rate growth or decline could have consequences on outflow of foreign capital or worsening creditworthiness borrowers. Foreign direct investments in emerging economies have strong contribution to GDP growth. Mention macroeconomic risks are typically associated with "overheating economy", increasing in demand, consumption and investment which lead in inflationary process.

Inadequate credit expansion in given macroeconomic environment affects financial stability. In countries of Southeastern Europe is interesting process of increasing banking intermediation by credit expansion to the privet sector. Credit expansion has positive impact on macroeconomic environment through growth of investments and economic growth. Theoretical and empirical researches suggest that credit expansion has positive correlation with macroeconomic risks. Inadequate credit expansion can affect macroeconomic imbalance. Reason for intensive credit activities are: one group of factor affect banks as holder of loans supply, other private sector as holder of demand for loans. Strong foreign capital inflows and external factors (higher interest rate than on international markets) are factors that affect credit expansion on supply side. Primarily optimistic expectation (credit activities increase with pro-cyclical of economy and felling with her drop) and positive shocks (technology) are factors which effect on demand side.

The entry of foreign capital in banking sectors in Southeastern countries is major source of intensive credit expansion. The relationship between foreign capital and bank lending is evident from simple analyses share of foreign capital in ownership structure and growth rate. Financial sectors in countries of Southeastern Europe are no longer just "dominate bank" but "foreign-owned bank dominating" sectors with credit expansion in intensity and direction determinate by ownership in order of profitability.

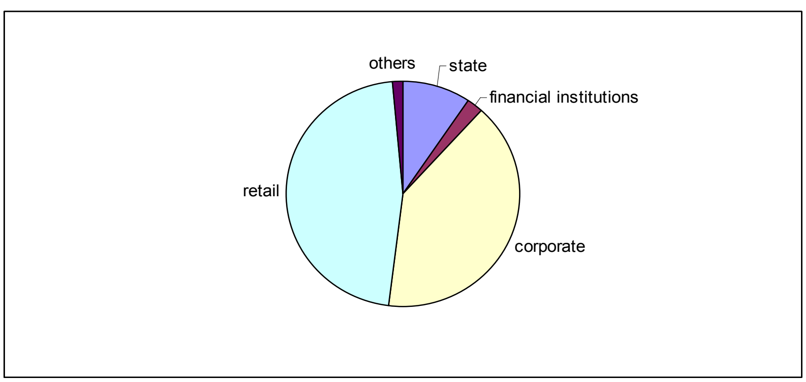
Chart 7 GDP growth rate and growth rate of credit in Croatia



Sources: CNB, Annual report, different years.

From chart 7 we can see pro-cyclical lending behavior of banks. It is also obvious dependence of economic activities on the provision financial resources (lending) by banks. Credit expansion in first years has been financed exclusively from domestic source (deposits) and later borrowing from aboard. Growth in demand for loans by household are affected with: earnings growth expectations of the population, low debit, reduce inflation expectation, migration from village to town, a population boom, a change a lifestyle "living on credit", change in national policy to stimulate domestic demand[4], decreasing interest rates. Inadequate credit expansion creates macroeconomic imbalances by deepening deficit in current account in payment balance (an increase imports as a substitute for the lack of domestic production) and external debit (insuring funds for new loans to banks borrowing aboard).

Chart 8 Sector structure of loans in Croatia, 2010



Sources: CNB

[4] Chances in national policy can have serve forms: preferential tax treatment of mortgage interest rate, preferential program housing, a flexible mortgage loans and promotion culture of using credit cards.

In loan portfolio dominate loans to households. Lending to households in transitional countries ensure better managing credit risk expose:

1. Lower concentration of credit risk in banks' assets;
2. Diversification of credit risk among a large number of borrowers;
3. Earning on those loans are stable and high;
4. The existence of implicit or explicit deposit insurance;
5. Risk of insolvency in economy.

The problems in financing economy and its formal approach to financial sector are determinate by high risk and transaction cost relate to commercial lending. The risk of financing economy is a key element determining the cost of capital. Economic policy makers need to think about solution that will motive banks to finance economy intensive. Additional risk to the economy is making transfer of bank management decision accept in board in bank branch in domestic market. In situation appear problems in complying with local requirements and business condition and difficult access to finance small and medium enterprises.

On the other hand it is necessary to create or reverse macroeconomic policy which must include the credibility of monetary policy and appropriate fiscal policy which will create an environment for economic growth and further improve the business environment to ensure process of capital accumulation and to stimulate research and development.

6. CONCLUSION

As was the case in other CEECs and SEECs, during the transition period in Croatia, the banking system underwent changes due to the strong penetration of foreign capital and changes in the market structure of banking products. The banks' dominance in the Croatian financial system is still crucial to the real sector, despite financial market's development.

The mere origin of the current economic crisis can be found in the financial sector and as a result, the crisis significantly affected the banks as the most important segment of the financial sector. This primarily relates to the management of it assets and the risks associated with the bank's lending activities, capital, liquidity and profitability. The analysis of the data presented within this paper and the conclusions that can be drawn from the available time series suggest that the Croatian banking sector has been exposed to the financial crisis, but that it remained safe and stable regardless the deterioration in all financial stability indicators of the Croatian banking sector. For example, as a result of the financial crisis the bank's profitability declines and its liquidity position deteriorates due to the unfavorable loan-to-deposit ratio and foreign borrowing. Paradoxically, the stability of the Croatian banking sector has its grounds in the low investment function, i.e. in the relatively low investment in financial market securities, as well as in the general confidence in the Central Bank's policy.

In spite of the maintained stability of the banking in conditions of the current economic crisis, the problems that will mark the near future are related to the fact that the banks have no interest in financing the economy. This causes an unfavorable sectoral structure of bank loans which is related to the present risks in business sector investment as well as the bad experience in financing companies in the past. At the same time the real sector is faced with the problem of ensuring funding for investment projects.

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WHAT WOULD JEAN MONNET AND ROBERT SCHUMAN SAY TODAY IF THEY WERE HERE WITH US IN VITEZ?

ABSTRACT

The Dayton-Paris agreement from 1995 ended the war in Bosnia and Herzegovina. Despite the fact that we live in 2011, this sovereign state even today finds itself in a state of neither war nor peace. It is all due to the politicians who have led and still continue to lead the population of this country in the wrong direction. We still attempt to answer, «What are the reasons that this is the case?» In this paper – on the other hand – we want to emphasize the famous politicians who have stepped onto the ruined and devastated scene of Europe immediately after the Second World War. We want to write about the brave, educated and clairvoyants architects of modern Europe. The politicians who have, in fact, even during the Second World War envisioned the necessity of brotherhood among people of all Western Europe countries, even to those that have previously been permanent enemies. We want to write about politicians who have believed that their people cannot look back at the past, but they must look into the future. These politicians, these giants of recent European history are primarily Jean Monnet and Robert Schuman. However, the paper will discuss the role of Sir Winston Churchill and Konrad Adenauer in such a context. In this paper we will therefore try to answer the proposed question listed in the title.

Key words: human rights, civil society, economic growth and social development

JEL classification: A13, D73, D74

1. INTRODUCTION

The essential question being raised revolves around the fact of, “What is the political, economic, and social situation in Bosnia and Herzegovina in 2011?” In this country, which has become a member of the United Nations on May 22nd 1992, country that is composed based on the Dayton-Paris Agreement signed in 1995 that has ended the war. Bosnia and Herzegovina is a complex state made up of two entities, the Federation of Bosnia and Herzegovina and Republika Srpska, plus the Brčko district as a special territorial unit within the country. The answer to this question is, “The political, economic and social situation in this country is poor, depressing, and – under actual circumstances - without any perspective!” Since science must answer all the questions imposed by life, this international conference is supposed to answer the most fundamental question, “Who is to be blame, and how to resolve the situation?” Without any doubt, those responsible for such a tragic situation are Bosnia-Herzegovina politicians.

While completing this text in summer of 2011, it is important to mention that situation in Bosnia and Herzegovina is still extremely volatile. The long awaited establishment of a new government started on October 3rd, 2010. In this interregnum, the existing government worked in the so-called technical mandate. Therefore, from the above-mentioned date to the date of elections, cantonal assemblies had a term limit and needed to elect delegates to the Federation House of People by October 31st, 2010. The delegates were not chosen in three cantons in which *the HDZ Bosnia and Herzegovina* and *the HDZ 1990* have an absolute majority. It is important to underline that the Federation House of People consists of 3 ethnic groups suggests the President and the Vice-President for the Federation of Bosnia and Herzegovina. The Federation House of people also nominates the person that is in charge of forming the Government. By non-establishment of Federal House of People, the two above mentioned HDZs parties delayed the process

The Government of the Federation was formed on March 17th 2011. It included Croatian representatives; however two HDZs parties did not participate. Actually, the two most powerful parties with a “Croatian prefix” have attempted to present themselves as the sole representatives of the Croats in Bosnia and Herzegovina. That does not correspond to the truth. Argument: neither have they won 90 percent of “Croatian” votes, nor are they the true representatives of interests of Croats in Bosnia and Herzegovina. It was obvious that these actions were designed to gain power, and while buying time, they were trying to maneuver out of the process of prosecution by the judicial authorities of Bosnia and Herzegovina. A fascinating fact is that in the negotiations two HDZs demanded all of “Croatian” seats on all levels of government. As a result of the agreement between Dragan Čović (*the HDZ Bosnia and Herzegovina*) and Milorad Dodig, President of Republika Srpska - with two “Serbian” seats in the Government of the Federation of Bosnia and Herzegovina it was obvious that all that was a political galimatias. In fact, all was due to the collision of two concepts. The first concept is an ethnically divided Bosnia and Herzegovina, while the other revolves around a constitutional, democratic and civic concept of Bosnia and Herzegovina.

The so-called “Platformers”, including *SDP Bosnia and Herzegovina*, *SDA*, *HSP* and *the National Party - Working for Progress*, had a power in the Federation of Bosnia and Herzegovina by the end of March 2011. The elected President of the Federation of Bosnia and Herzegovina was Živko Budimir, general of the Croatian Defense Council (HVO). In fact, *the SDP Bosnia and Herzegovina* had formed a government without the participation of two HDZs members and one third of Croatian representatives. However, *SDP* was prepared to give 12 out of 13 seats to *the HDZ Bosnia and Herzegovina* and the *HDZ 1990*. Unfortunately, to the above mentioned two parties, that was unacceptable! In fact, the two HDZs parties were blackmailing. And when the representatives of the international community finally saw what was going on, in order to solve the problem, they have presented their own proposal. This proposal had given 75 percent of “Croatian” seats to *the HDZ Bosnia and Herzegovina* and *the HDZ 1990*.

However, the two HDZ members accepted not even this proposal. And at that moment there was a change of attitude in the international community.

Subsequently on March 24th, the Central Election Commission annulled the election of new leaders of the Federation of Bosnia and Herzegovina. Mr. Valentin Inzko, the High representative of Bosnia and Herzegovina (the Office of the High Representatives in Bosnia and Herzegovina - OHR), suspended the decision of the Central Election Commission. Specifically, the Office made this decision after consultations with the ambassadors of the EU countries, the USA, and Turkey. The Peace Implementation Council (PIC) consists of these ambassadors who are in charge of OHR. The Ambassador of the Russian Federation was the only one to oppose the decision.

What followed was a fierce reaction from the Croatian side. A joint statement by *the HDZ Bosnia and Herzegovina*, *the HDZ 1990* together with a minor Croatian Party assessed that "the OHR with its decision, batters down the constitutional order, and hence imposes a martial law in Bosnia and Herzegovina, legalizing the coup while continuing political ethnocide against Croats in Bosnia and Herzegovina" (Pavelić, 3). After such, the response of a respectable friar Luka Markešić, the president of the Croatian National Council, shouted, "Those who do not like this country, would be best to leave it." The Constitutional Court of the Federation was to resolve the conflict over government formation and bring a decision on March 30th. In fact, it should have answered the question, "Is Croatian majoritarianism permissible through formation of the government without representatives of the parties for whom the greatest number of Croatian electorate voted." However, the Constitutional Court of the Federation, after their meeting on March 30, 2011 declared that they have suspended the proceedings due to the fact that the previous president of the Federation of Bosnia and Herzegovina, Borjana Krišto (*the HDZ Bosnia and Herzegovina*) on Tuesday, withdrew her request for a review of constitutionality. At the same time, Mr. Valentin Inzko announced that the suspension of the Election Commission serves the purpose of canceling the new SDP government which would outlast new measures of the international community. Respectively, the decision remains in force until the PIC decides otherwise. To such, reaction of Dragan Čović in the Nezavisne Novine (Independent Newspaper) from Banja Luka was, "The Croats will start with civil disobedience" (Pavić, 11).

Months have passed without any compromise and tolerance between named parties and their representatives. In mid-July, Bosnia and Herzegovina has had a chance to overcome the crisis. It was the time when the chairman of the Council of Ministers should have been chosen. A candidate for this high post was Slavo Kukić, the distinguished professor at the University of Mostar and the recognized activist for democuiness and human rights, whose reputation exceeds the boundaries of Bosnia and Herzegovina. Two members of the Presidency of Bosnia and Herzegovina, Bakir Izetbegović, and Željko Komšić gave him the highest marks to the mandate. But the heads of the two strongest Croatian parties, Dragan Čović (*the HDZ Bosnia and Herzegovina*) and Dr. Božo Ljubić (*the HDZ 1990*) have refused to support him. Milorad Dodig, President of Republika Srpska, who is also a president of *the Alliance of Independent Social Democrats* (SNSD), at that time said, "Kukić can serve as a chairman to his mommy and daddy, and no one else".

Even so, the politicians continue to act, as they want. They take care of themselves and their positions, not the people who suffer. Reflection is the economic situation among political, legal, social and cultural relations that are still strongly determined by the last war cataclysm. Therefore the hatred “toward others” can still be felt lingering in the air. Much time has passed from the halting of hostilities in this region. It has been, in fact, a long sixteen years, while when it comes to relations between the three groups, the Bosnians, Serbs and Croats, overall situation seems to be unchanged.

Because of the current lack of perspective, but also the necessity of tolerance and coexistence in Bosnia and Herzegovina - which is crucial for the whole area of the Western Balkans - in this paper, we will describe the best historical example of tolerance and coexistence in the history of human civilization. In fact, it revolves around the creation of the European Council, the first inter-governmental political organization and the European Coal and Steel Community - the first intergovernmental economic organization. Both organizations have contributed, that in 1949 - four years after the bloodiest war in human history - the European democratic states were united in an effort “to forget the war and to turn to the tasks of peace.” In this paper we will describe the activism for tolerance and coexistence of the Magnificent Seven, the seven historical figures that after 1945 began to clear a chaotic and tragic environment. Those are in fact, the founding fathers of today’s most powerful economic and political integration in the world, the European Union. This is precisely the reason why all the countries of former Yugoslavia, including, of course, Bosnia and Herzegovina, wish to become a part of European Union (Economist, 25).

Glorious individuals of these historic events in Western Europe should teach us in the Balkans, and especially the citizens of Bosnia and Herzegovina, that it is possible to quickly advance to the future. But in this case, politicians should reject careerism, ethnocentrism, nationalist prejudices and collective consciousness, because it all together leads to barriers that lead toward intolerance, hate speech, economic misery and hopelessness. In this context, it is important to stress that we all know, that *education for human rights* is a key segment to any society. Such education rapidly leads to real democracy, a democracy that creates a climate for optimum economic growth and social development. In fact, solely in democracy, the goal of education is to create an independent citizen who has a habit of questioning, analytically and critically evaluating and observing the social phenomena. Of course, all this, is the task of Bosnian-Herzegovinian politicians.

Glorious individuals of past historical events immediately after the Second World War consolidated Western Europe with a motto, “Throw away diseased personal ambition and hate speech - accept the education for human rights - and turn to the tasks of democracy and the future.”

2. LESSON FROM THE LATEST EUROPEAN HISTORY

It is important to specify a brilliant historical lesson that could also be a great role model on the hate polluted areas of the Western Balkans, particularly in the areas of Bosnia and Herzegovina. It seems that unfortunately, only once in the history of Europe seven visionaries were born, and they are: Victor Hugo, Richard Nikolaus Eijiro von Caudenhove-Kalergi, Jean Monnet, Sir Winston Churchill, Friedrich August von Hayek, Robert Schuman and Konrad Adenauer.

Victor Hugo, chairman of the second Peace Congress, held in Paris in 1849, in his opening lecture titled *The day will come*, among other things said,

"A day will come when your arms will fall even from your hands! A day will come when war will seem as absurd and impossible between Paris and London, between Petersburg and Berlin, between Vienna and Turin, as it would be impossible and would seem absurd today between Rouen and Amiens, between Boston and Philadelphia. A day will come when you France, you Russia, you Italy, you England, you Germany, you all, nations of the continent, without losing your distinct qualities and your glorious individuality, will be merged closely within a superior unit and you will form the European brotherhood, just as Normandy, Brittany, Burgundy, Lorraine, Alsace, all our provinces are merged together in France. A day will come when the only fields of battle will be markets opening up to trade and minds opening up to ideas. A day will come when the bullets and the bombs will be replaced by votes, by the universal suffrage of the peoples; by the venerable arbitration of a great sovereign senate which will be to Europe what this parliament is to England, what this diet is to Germany, what this legislative assembly is to France. A day will come when we will display cannon in museums just as we display instruments of torture today, and are amazed that such things could ever have been possible. (…) Gentlemen, if someone four centuries ago, at a time when war raged from parish to parish, from town to town, from province - if someone had said to Lorraine, to Picardy, to Normandy, to Brittany, to Auvergne, to Province, to Dauphine, to Burgundy. A day will come when you will no longer wage war, when you will no longer raise men of arms against each other, when it will no longer raise men of arms against each other, when it will no longer be said that Normans have attacked the men of Picardy, and the men of Lorraine have driven back those of Burgundy; that you will still have differences to settle, interests to discuss, certainly disputes to solve, but do you know what you will have in place of men on foot and horseback, in place of guns, falconets, spears, pikes, and swords? You will have a small box made of wood, which you will call a ballot box. And do you know what this box will bring forth? An assembly, an assembly in which you will all feel you live, an assembly which will be like your own soul, a supreme and popular council which will decide, judge, and solve everything in law, which will cause the sword to fall from every hand and justice to rise in every heart. And this event will say to you, 'There ends your right, here begins your duty. Lay down your arms! Live in peace!"

In 1851 during the same kind of an event, he said, "A day will come when we shall see those two immense groups, the United States of America and the United States of Europe, stretching out their hands across the sea, exchanging their products, their arts, their works of genius, clearing up the globe, making deserts fruitful, ameliorating creation under the eyes of the Creator, and joining together to reap the well-being of all. Henceforth the goal of great politics, of true politics, is this: the recognition of all nationalities, the restoration of the historical unity of nations and the uniting of the latter to civilization by peace, the relentless enlargement of the civilized group, the setting of an example to the still-savage nations; in short, and this recapitulates all I have said, the assurance that justice will have the last word, spoken in the past by might" (Hugo, 124-126).

Richard Nikolaus Eijiro von Caudenhove-Kalergi, Austrian politician, philosopher, and the count in 1923 published a book titled *Pan-Europe*. In it, the focus was placed onto the need of creating friendly relations among European states, which would be based on the philosophy of Immanuel Kant and perpetual peace. In 1925, von Caudenhove-Kalergi creates a pan-European movement and in his motherland, Vienna, he organizes the first Pan-European Congress. Aristide Briand, French Minister of Foreign Affairs of the Republic was appointed the first honorary president, who will at the end of the same year, received the Nobel Peace Prize for organizing the Locarno pact and for his participation in the creation of the so-called the Kellogg-Briand Pact, which concerned the renunciation of war on a global scale and was to be signed in 1928. A. Briand was grateful to von Caudenhoveu-Kalergi for his vision of creating a new European relationship. Albert Einstein, Thomas Mann and Sigmund Freud undertook participation in the work of the Pan-European Congress as well.

On September 19th 1946, Winston Churchill gave a historic speech to students of the University of Zürich. It was the time when the cannons of the Second World War have not yet cooled down. He was an individual that led the bloodiest war against the Nazi Germans since 1940. Despite that, his words in June 1945 in the ruined Berlin were, "My hatred died on the day when German capitulation was signed. Now we have to clean up the ruins of war." In this historic speech, W. Churchill, among other things, said,

"I wish to speak about the tragedy of Europe, this noble continent, the home of all the great parent races of the Western world, the foundation of Christian faith and ethics, the origin of most of the culture, arts, philosophy and science both of ancient and modern times. Yet it is from Europe that has sprung that series of frightful nationalistic quarrels, originated by the Teutonic nations in their rise to power, which we have seen in this 20th century and in our own lifetime wreck the peace and mar the prospects of all mankind.

Yet all the while there is a remedy which, if it were generally and spontaneously adopted by the great majority of people in many lands, would as by a miracle transform the whole scene and would in a few years make all Europe, or the greater part of it, as free and happy as Switzerland is today. What is this sovereign remedy? It is to recreate the European fabric, or as much of it as we can, and to provide it with a structure under which it can dwell in peace, safety and freedom. We must build a kind of United States of Europe. In this way only will hundreds of millions of toilers be able to regain the simple joys and hopes, which make life worth living. The process is simple. All that is needed is the resolve of hundreds of millions of men and women to do right instead of wrong and to gain as their reward blessing instead of cursing.

I am now going to say something that will astonish you. The first step in the re-creation of the European family must be a partnership between France and Germany. In this way only can France recover the moral and cultural leadership of Europe. There can be no revival of Europe without a spiritually great France and a spiritually great Germany. The structure of the United States of Europe will be such as to make the material strength of a single State less important. Small nations will count as much as large ones and gain their honor by a contribution to the common cause. The ancient States and principalities of Germany, freely joined for mutual convenience in a federal system, might take their individual places among the United States of Europe. (…)

I now sum up the propositions, which are before you. Our constant aim must be to build and fortify the United Nations Organization. Under and within that world concept we must re-create the European family in a regional structure called, it may be, the United States of Europe, and the first practical step will be to form Council of Europe. If at first all the States of Europe are not willing or able to join a union we must nevertheless proceed to assemble and combine those who will and who can. The salvation of the common people of every race and every land from war and servitude must be established on solid foundations, and must be created by the readiness of all men and women to die rather than to submit to tyranny. In this urgent work France and Germany must take the lead together. Great Britain, the British Commonwealth of Nations, mighty America — and, I trust, Soviet Russia, for then indeed all would be well — must be the friends and sponsors of the new Europe and must champion its right to live. Therefore I say to you "Let Europe arise!" (James, 236-238).

Despite the Cold War, initiated by the USSR even before the capitulation of Nazi Germany on May 9, 1945. W. Churchill in the aforementioned speech to the USSR has offered them to join the "European family of nations". He specifically stated, "In this urgent work, France and Germany must take the lead". This leads to the two circumstances. First: France and Germany in the past had remained in a constant war, a war lasting over 1000 years. And almost always, the Germans were first to start. Three last wars, 1871, 1914 and 1939 were especially brutal, always at the expense of France, who endured the ultimate sacrifice. Second: W. Churchill, in fact, asked to remove the iron curtain - which divided their people, because of "the need to jointly take the lead" in a modern and peaceful Europe, and to "turn to the tasks of peace".

At the meeting in Zürich, W. Churchill, expressed all the ingenuity that was on his mind. Since he became prime minister of Great Britain in 1940, he had many reasons to hate the Germans forever. Hence this man had offered Germans a friendly hand sixteen months after the end of the Second World War - the largest slaughterhouse in the history of mankind. This man of such mental ability, led democratic nations of Europe. It is important to know that even after his famous speech, W. Churchill continued his crucial role in promoting democracy and human rights in the Western Europe. In 1947 and 1948 he continued working on the project for United Europe. On May 10th 1948 while the cold war was reaching the boiling point, he organized the European Convention in the Hague. About 800 individuals attended the event from all of the Western states, including figures from the defeated Germany. All were invited to support and develop "the creation of the European family of nations". Thus, most educated people in Europe, without having to "return to the past", engaged in creating a future-united Europe. On May 5th 1949 in London the Council of Europe was established with his maxim, “Forget the war and turn to the tasks of peace.” The founders were the following ten countries: Belgium, France, Luxembourg, the Netherlands, the United Kingdom, Ireland, Italy, Denmark, Norway and Sweden. Germany did not take part, because it was only in September of 1949 that two German states were established. Of the three western occupation zones, first to be formed was the Federal Republic of Germany. In the Soviet Zone of Occupation, German Democratic Republic was formed. May 5th is celebrated as the “Council of Europe’s Day”.

In 1947 famed Austrian professor Friedrich August von Hayek, of political and economic sciences become involved in the creation of “European family of nations”. In the Swiss village Mount Pelerin, he established the Mount Pelerin Society. The association had an aim to bring together the world's intellectuals, i.e. economists, historians, philosophers and other researchers of social problems in Europe and the USA, to discuss the crisis that has convulsed Europe and the world. The discussions included questions about the future development of European democracies. Otherwise, F. A. von Hayek had participated for twelve years as a head of the association and during that time he gave an immeasurable contribution to the creation of democratic European institutions and the encouragement of German rapprochement with the French and the British people.

Even after the First World War, Jean Monnet, a great French visionary, politician and economist, was known throughout Europe. It is important to know that during the action of the League of Nations, that was global umbrella organization, J. Monnet held a high position as an Assistant Secretary General. At the beginning of the Second World War he was sent to London, in order to coordinate the Joint management of goods of anti-Hitler coalition. He was appointed as the member of the British Council for the purchase. In London, J. Monnet proposed the establishment of the federal union between France and Great Britain to General Charles de Gaulle, President of the French government in exile, and to the British Prime Minister W. Churchill.

After the war, J. Monnet becomes the chief architect of France's economic policy. In 1947, the Monnet plan designed to economically revitalize France begins to act. However, in the following year, 1948, it was obvious that the friction between France and Germany about control of the Ruhr (the rich coal and an important center of production of steel) imposed a threat to peace. J. Monnet was convinced that such “tense situation” might lead to new war. Indeed, this area has been portrayed as “the seeds of war” ever since the First World War. He sketched the blueprint by which the coal and steel production was placed under the jurisdiction of a joint Franco-German body, which would be open to other countries - despite the fact that the French and Germans fought constantly over 1000 years.

Robert Schuman, French Prime Minister at that time received the draft from J. Monnet. He was convinced that the friendship between war torn French and German people is crucial for the people of Europe. R. Schuman accepted and worked on a draft from J. Monnet. On 9th of May 1950 in his famous speech held in Paris, R. Schuman suggested that “France, Germany and any other European country that wish to join should unite their coal and steel resources." It was a day that is celebrated as "Europe Day".

On April 18, 1951, according to the Schuman Plan the first regional inter-governmental supranational economic organization in the world was created with headquarters in Luxemburg. The organization became known as the European Coal and Steel Community. In addition to France and Germany, organization was joined by Belgium, Italy, Luxembourg and the Netherlands. The organization has begun functioning in 1952, with the aim of creating a common market for coal and steel markets of the Member States. By doing so, they would eliminate all import and export duties, as well as non-tariff, i. e. quantitative restrictions such as bans, quotas, import licenses, export subsidies, etc. Such community has therefore had characteristics of supra-nationality. This means that a proportion of its national sovereignty in the field of coal and steel production was given to the Germans by the French, and *vice versa*. Of course, situations such as these have reciprocally been performed by other Member States. Joint bodies, such as the High Authority, the Council of Ministers, the Assembly, the Advisory Committee, and the court community have been established. The High Authority decisions and all decisions of other organs, including the decision of the Court, was an executive for the entire area of the community, which were to follow. J. Monnet was the first president of the High Authority of the European Coal and Steel Community in the period between 1952 and 1955. In the period between 1956 and 1975, J. Monnet has served as the president of the Action Committee for the creation of the United States of Europe.

Konrad Adenauer, West German politician, who was in power from 1917 until 1933, during the period of Nazis, had served as mayor of Cologne. He was also a member of the National Council of the Federal Rhine country. In 1934, he was arrested and imprisoned. At the end of the Second World War, in 1944, K. Adenauer became the co-founder and champion of the Christian Democratic Union (CDU). Since 1948, he remained in intense contact with R. Schuman. In 1948, in the occupied territory of Germany the foundation of the Federal Republic of Germany came into effect. K. Adenauer became the first postwar federal chancellor. With membership in the European Coal and Steel Community, K. Adenauer leads West Germany out of its isolation, towards the path of economic growth and social development.

In addition to the Paris Agreement of 1950, Europe's second key event happened on May 25th, 1957. It happened only 12 (in words - twelve) years after the Second World War - with the signing of the Rome Treaty establishing the other two European communities, when the European Economic Community and the European Atomic Energy Community came into affect. Certainly, these communities are to function under supranational model. However, it is important to note that in those years all of the six countries established a free trade zone. Wholesale market gave an unprecedented impetus to progress. It was clear that the ruling elite of warring states in the Second World War, especially France and Germany had officially forgotten the war and turned to the tasks of peace.

In this section, we discussed two facts. R. Schuman who regardless of being German by birth and a German citizen until his 32nd birthday, after the Second World War, in his new home country, France, became a politician who occupied the highest position in the political hierarchy. The French did not mind to put someone who is not French by birth at the highest position in the political hierarchy. But who is the best by the general objective assessment. Thus, an ethnic German, R. Schuman becomes the head of postwar France. Consider just how much we in the Balkans in 2011 are far from such concept. We now mention two topics for one to reflect on. Specifically, one should ask if it is possible that even a Serb born in Croatia, could become a head of the executive power in Croatia? Of course, we should remind ourselves that the previous example, referring to the end of the 1940s, should be used as an extraordinary example. Nor should we repeat the fact that the French, German and British constantly fought over the millennia.

The other topic applies to the initiative of France to Belgium, Luxembourg and the Netherlands, to create a supranational organization in which the Italians would be involved, as well as the Germans, that shed blood for centuries. Do not forget that during the 1948th and according to the Marshall Plan, the Organization for Economic Cooperation (OEEC) was established. All the democratic countries of Western Europe gathered around a common goal: to forget about the war as soon as possible, and turn to the tasks of peace.

3. THE COUNCIL OF NGOs OF DUBROVNIK AND TREBINJE

Bearing in mind the seven historical figures and the events in the war torn Europe, we decided to try to plant those seeds of future to Dubrovnik and Trebinje. Dubrovnik, the Croatian and Trebinje, the city of Republika Srpska. We need to specifically explain the situation in Bosnia and Herzegovina and the reflection of the situation in the countries that surround it. In the attempt to sew the seeds of the future for Dubrovnik and Trebinje, and guided by the experience of European democracies, we had in mind that in emergencies the optimal key in defusing the situation could be a civil society with its initiatives. So, not only politicians but also civil society activists! To this end, in fact, we tried to apply the theory of the seven major European figures that had previously been discussed. With their theory in mind, we tried to adjust it in this time and space. The first fact is that the war was over sixteen years ago. Secondly, despite the time frame of sixteen years, until today there is no policy of political communication between Dubrovnik and Trebinje. And what should be noted is that the inhabitants of Dubrovnik and Trebinje had a history of over 1000 years, a history of relatively harmonious relationship and constant referral to each other. They lived in tolerance and coexistence.

Since 1995, when the was ended in the Western Balkans, we had the idea for the necessity of political and other communications between Dubrovnik and Trebinje, in the same context of the egregious acts that occurred establishing the European Coal and Steel Community. We had a chance to talk about this issue in April 2006 on the occasion of Orthodox Easter, when we attended the reception led by Mr. Grigorije, Bishop of Zahumlje, Herzegovina and Littoral and Goran Spaić, the Rector of the Ortodox Church in Dubrovnik. After the official ceremony, we encouraged conversation about the philosophy of tolerance and coexistence, and talk focused on the unsatisfactory pace of rapprochement of Dubrovnik and Trebinje. We underlined that no initiative has been taken neither by the government nor the NGOs, despite the fact that war ended more than ten years ago. On the question of how they could help us to get things moving from the dead end, we suggested for them to organize a public discussion on human rights in the region of Trebinje. We underlined that peace, tolerance and coexistence are the first generation of human rights. We mentioned to them Jean Monnet and Robert Schuman, and said that we are willing to go to Trebinje and give a lecture on the above topic.

Thanks to our hosts, who got connected with the director and owner of Radio-Korona in Trebinje, and they connected with EastWest Insitute - Dubrovnik, a public debate in the Cultural Centre in Trebinje was scheduled for May 24th. It was titled, "Human rights in our region". We immediately informed the Croatian Helsinki Committee for Human Rights (CHC) about it. We received unreserved support from Zagreb about it. And we knew that this task would not be easy. Dubrovnik remembered that from 1 October 1991 to mid-1995 under the political jurisdiction of Trebinje, Dubrovnik was shelled. On this panel about a hundred citizens of Trebinje attended, the attendees included Dr. Dobroslav Čuk, Mayor of Trebinje, Ervin Pobrić, his deputy and Dragan Sekulović, president of the Municipal Assembly. We began our presentation with our motives, and told a story about the historical role models who encouraged us to appear before them. We told them about peace and harmony that was created by these magnificent Europeans, about the European Coal and Steel Community that paved the way for the most powerful economic and political integration of today. We pointed out that the main motive of our arrival in Trebinje is the struggle for peace, tolerance and peaceful coexistence, and that we hope for normalization of relations between the two cities that were good neighbors for 1000 years. We stressed the importance of strategy of reconciliation by W. Churchill, who in the aforementioned speech to students from Zürich was a guideline for change and initiated creation of the Council of Europe - the cornerstone of the European Union. Then we said that we should all try to remove the "iron curtain" that separates these two ancient cities, which at the border crossing Brgat can almost be in sight. We have stressed all along that we are more tolerant and willing to develop friendship and good neighborliness. We underlined that, "There is no safety for Dubrovnik with unsafe neighbors and Trebinje has no chance of prosperity without the access to the sea." However, we have listed, it is possible to reverse the trend only by using two levels of communication. The first is a governmental or political level, while other is non-governmental, or level of a non-governmental organization should be immediately established. With the same objectives with which in the 1950, just five years after the bloodiest war in history of Europe - the French and Germans established the European Coal and Steel Community. The French and Germans, who had a history of constantly fighting over 1000 years. We stressed that four Western European countries in negotiations soon joined them, and they all established the first supranational economic integration in the world. In particular, we noted that all portion of French coal and steel was available to be managed by the Germans and *vice versa*. Other countries repeated what French and Germans did as well.

We mentioned that we cannot influence politicians, who were interest-coded and that all seem to indoctrinate their own people and if they don't have to, they make no moves. It is all due to personal interest and mainly because of the lucrative possibilities of the future evaluation of their position. We mentioned that this area could indirectly be affected by our representatives and directly only through the ballots in the days of the election. We added that in the name of peace, tolerance and coexistence, we must together educate for democracy and human rights and create a climate that will allow political change through political dialogue with Dubrovnik. We mentioned that from mid-1992 we teach students and citizens about peace, tolerance and coexistence towards Trebinje, and the famous example of these great politicians of Western Europe, which only few years after the Second World War created the conditions for peace, tolerance and coexistence. We informed them what we did in Dubrovnik and the Dubrovnik-Neretva County for their, Serbian people who stayed in Dubrovnik after 1992. We underlined the fact that it is necessary to heal from the hatred. We also talked about the practical hatred of those who have interest to hate, because they intend to, or are already in a property of a person who is the target.

So the second level of communication is related to non-governmental sector. Therefore, we have pointed out that evening that we should start groundwork for future council of NGOs of Dubrovnik and Trebinje by the same principle as W. Churchill said in his famous speech, which was founded by the Council of Europe. We underlined that the Council of Europe was the first inter-governmental political organization in the world whose task was to encourage the creation of harmonious interpersonal relations among citizens of member states, and promoting the protection and promotion of human rights - without those there is no peace, progress and future. We suggested that the Council should be established in Dubrovnik last Saturday of next month. Representatives of Dubrovnik and Trebinje NGOs would attend inaugural session. We would invite journalists and broadcasters, who would by attending the party, spend time with everyone, especially our guests from Trebinje. We underlined that the presence of the media is the key. Not only will they meet our guests from Trebinje, but they will also publish and broadcast what they saw. We also noted that after the founding, the next meeting should be held in Trebinje on the last Saturday in July under the same scenario. This means, in Trebinje local journalists will socialize with their colleagues from Dubrovnik. With a break in August, the next meeting would be held again in Dubrovnik last Saturday in September, and so on: Dubrovnik - Trebinje - Dubrovnik - Trebinje etc. I mentioned that citizens need to start a civil initiative that leads to peace, tolerance and coexistence - when politicians cannot. At the end we said that when it comes to the political level, the City of Dubrovnik has to get an apology from Trebinje for all shelling that came from there.

But the reaction of the enemies of tolerance and coexistence in Dubrovnik came right away. The next day, on 26th of May Slobodna Dalmacija published a text with a subheading, "Divided Dubrovnik - While Mayor Dubravka Šuica supports the idea of prof. Bazdan about excuse from Trebinje, war invalids protest." Title was, "The Croatian Disabled Homeland War Veterans Association (HVIDRA): To build Chinese wall on Brgat". They rejected our idea.

Two days later, Slobodna Dalmacija published the text with a subheading, "Reply to Dubrovnik - Dr. Dobroslav Cuk, Mayor of Trebinje municipality". Title was, "People from Trebinje are not guilty, but we are ready to apologize because of cooperation". The subtitle read, "I support the initiative. We are sorry for what happened, and although the citizens of Trebinje and the current leadership do not bear the blame, if they insist on apologizing, and if this condition is to start cooperation, I agree. I will support any initiative that will contribute to the beginning of cooperation between Trebinje and Dubrovnik". In the article N. Sekulović states that such a statement has already been made, and that municipal councilors need to adopt it. This text headline was, "The text of apology to Dubrovnik 'Sorry and Forgive us'" and it reads as follows, "With regret, that part of the evil and suffering to Dubrovnik came from Trebinje, we the Municipal Assembly of Trebinje, express regret that it happened. To make a mistake is human, but it is more human to acknowledge the mistake and to try to correct it. That's why we use those tough, but kind words that we are sorry and ask for forgiveness. We should not forget the past, but in the interest of the citizens of Trebinje and Dubrovnik, as well as future generations we must look to the future". Those statements are followed by another sentence, "That was written in the text of Trebinje's apology that would soon be presented to the members of the Municipal Assembly" (Mrvaljević, 5).

In an effort to realize the initiative that we have brought out in Trebinje, we asked Dr. Stanko Buha, a doctor from The General Hospital in Trebinje, and a prominent activist NGOs to come to Dubrovnik. With him, we had a long and pleasant conversation and we agreed on attitudes about the steps to be taken. We also spoke about possible barriers in Dubrovnik. However we obviously underestimated the obstacles. Because time will, in fact, show that they were overwhelming. First we met with problems of finding a location for such meeting. The owners of any space rejected to help when they heard what was going on. Then we prolonged everything to the end of the summer.

On 12th July 2006, and on his request, we spoke in Dubrovnik with Mr. René van der Linden, President of the Council of Europe about the difficulty of trans border cooperation between Dubrovnik and Trebinje, and *vice versa*. On this occasion we have him and his team of experts the report on the initiative of creating a non-governmental organization that could "break the ice" of tolerance and coexistence, and be a factor of trans-border cooperation in this part of the Western Balkans. Mr. van Der Linden supported the initiative, and asked if he could help. We asked him to encourage the trans-border cooperation with politicians in Zagreb and Banja Luka - the ones that in Brussels agree with the declaration, and when they are on homeland - they sabotage because of their personal, egoistic and particularistic reasons. We presented him with the fact that because of the behavior of political elite, the entire Western Balkans lives in conditions of political vicious circle.

So, when air and sea temperature dropped slightly in September, we returned again to the Churchill's idea of removing the "iron curtain", and promoting tolerance and coexistence to hatred poisoned area. Unfortunately, the HVIDRA rejected our idea again. N. B. - with organized protest.

4. CONCLUSION: *THE RULE OF RELATIVE HOPES – 1:2:4*

Back in the history we analyze seven major figures and historical relationships that were established in Western Europe between the French, Germans and British, who fought with each other more than 1000 years. And what is going on with my fellow citizens, residents of the City of Dubrovnik? In fact, all the rational and educated people, not only in Dubrovnik, but also in Croatia, Republika Srpska and Bosnia and Herzegovina, as well as all the people from former Yugoslavia should know the brilliant historical lesson about the reconciliation of three mortal enemies only three years after the Second World War. Two great politicians - R. Schuman, and K. Adenauer, "forgot war, and turned to the tasks of peace" three years after the bloodiest war. These *three post-war years* should always be a lesson for everybody.

We, the Croatian citizens were obliged to promote trans-border cooperation under the Stability Pact for South Eastern Europe from 2001, which is a key instrument of comprehensive preparation for the Croatian membership in the European Union. In section 5 titled "Regional Cooperation", the focus is "to establish a political dialogue" at all levels. And here, we are talking about "the experience of European Union with coal and steel – ground rule of the process of European integration". The elite politicians in Zagreb, Sarajevo, Banja Luka and Belgrade, as well as local politicians in Dubrovnik and Trebinje should analyze this experience of the European Union. It seems that unfortunately, only once in the history of Europe seven visionaries were born.

Coming back to the subject and trying to answer the proposed question listed in the title, we think that Jean Monnet and Robert Schuman would shout to politicians of Bosnia and Herzegovina – «**Shame on You!**».

At the end of this paper, we are asking a key question of how to resolve the political, economic and social crisis in Bosnia and Herzegovina? The resources remain in educating people about human rights because human rights are the most fundamental essence of democracy. Without democracy, there is no national, optimal and long term economic growth and social development. Therefore, it is crucial to comprehend, and promote human rights. The importance of this subject can be ilustrated with the *Rule of relative hopes – 1: 2: 4*. It is, «Whatever the role in development of democracy has a man that is not interested in human rights, the one that *comprehend* human rights has double credit, and the person that *promotes* human rights has quadruple credits for the development of democracy».

Finally, two messages to the Bosnian and Hrzegovinian politicians as well as to all the politicians in Western Balkans: (1) The only legitimate political power is the one that guarantees and protects universal human rights. (2) They should all reffer to the Universal Declaration for Human Rights – the most translated document of the United Nations – where in its first article it is written, «All human beings are born free and equal in dignity and rights. They are endowed with reason and conscience and should act towards one another in a spirit of brotherhood».

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ADJUSTMENT OF THE SOCIAL SYSTEM OF BOSNIA AND HERZEGOVINA TO THE EU SOCIAL POLICY

ABSTRACT

The European Social Area, as a result of the ongoing integration process in Europe, is set to expand to the South-Eastern European area. Besides Croatia, which recently finished negotiations for EU membership, adjustments of social systems are going on in all Western Balkan countries as well as in Turkey. Bosnia and Herzegovina (B&H) has a lot to catch up, especially because of its difficult political and economic situation.
The 1990s war, its consequences like deindustrialization, poverty, social exclusion and huge unemployment (27.2% in 2010, as well as thousands of refugees overburdened the social system of B&H. More than 1.7 million beneficiaries are included in social security schemes, which is more than a half of its total population. However, social security is not yet accessible to all who need assistance, especially in rural areas. Besides that, social policies are conducted on entity and/or regional levels.
GDP per capita in B&H (PPS; 2010) amounted for 3,258 EUR, which equals just 30% of the EU average. Lagging behind the EU is also emphasized with the problem of a high poverty rate. Accordingly, major problems related to social issues in B&H are:

1. *High unemployment – but also high inactivity rate, "bad jobs" and high frequency of unreported labour;*
2. *High rate of population with lower levels of education;*
3. *Exclusion and discrimination on ethnic or gender grounds, as well as discrimination of former refugees;*
4. *Inadequate social security system with a low range and coverage.*

Key words: social system; Bosnia and Herzegovina; EU Social Policy

JEL classification: H5

1. INTRODUCTION

Social policy and employment are important part of the EU acquis although most of the laws and regulation fall under national competences subsidiarity. Over the past few years, because the reasons of current world economic crisis, the importance of social policy has increased. According to that, when we asked the EU citizens about the areas or policies in which the European Union should act, these issues are often cited as a top priority.

The same situation is in Bosnia and Herzegovina. However, it should be pointed out that the starting positions of the social policies in Bosnia and Herzegovina and the EU are quite different. Namely, there is huge difference in the level of development, rate of employment and unemployment, governments' capacity to act quickly in order to improve social conditions.

Social situation, policies and labour market significantly differ in the EU. Balkan countries aspire to reach the "western" standards of social policy, labour market conditions and institutional/administrative capacity. But the key question is how feasible?

2. SOCIAL POLICY AND EMPLOYMENT IN THE EU

As explained to Croatian citizens after the completion of official negotiations for EU membership:

1. The EU Social Policy aspires to achieve high rates of employment and safe and sustainable incomes. Among other things, it defines and protects workers' rights in cases of collective redundancy, relocation and business bankruptcies, as well as rules on working hours and occupational safety and health;
2. Membership of the Union facilitates easier employment on the European Internal Labour Market;
3. European legislation aims to create equal opportunities for all including the protection of the principle of 'equal pay for equal work', and the prohibition of any possible discrimination;
4. As to increase the competitiveness of the European economy, besides employment security and social security, it encourages lifelong learning, while European strategies and funds encourage the employment of those groups affected by the long-term unemployment, as well as the expansion of networks for social services for children, elder people and persons with disabilities.

2.1. "Social Europe"

"Social Europe" is evolved with the development of market integration and the strengthening of solidarity among different European nations. EU members have agreed on the basic principles of joint actions in order to encourage employment, mobility of workers, higher levels of training, equal opportunities for all, and generally higher levels of well-being for European citizens. "Social Europe" is answer on significant social, economic and especially demographic challenges of the 21st century. Naturally, the **modernization of the European social model** is necessary because of the aging European population which threatens the financial viability of social systems, and due to globalization, which presents a challenge to European competitiveness

2.2. Institutional framework

Institutional framework is made of the main institutions of the Union which have decisive legislative, executive and judicial functions at the supranational level. They are Council of Ministers, European Commission, European Parliament and European Court of Justice. Furthermore, numerous advisory and subsidiary bodies at European level, among which the most representative is the European Economic and Social Committee (EESC) have been established in order to achieve the EU social policy goals. In view of the fact that social differences are very often related to regional differences, the Committee of Regions (CoR) is also deals with the differences in the level of regional development. Apart from these institutions, there is a number of decentralized EU agencies involved in creating the social policy, such as the European Centre for the Development of Vocational Training (CEDEFOP), European Foundation for the Improvement of Living and Working Conditions (EUROFOUND), The European Agency for Safety and Health Protection at Work (EU-OSHA), The European Training Foundation (ETF), The Agency for fundamental rights (FRA), The European Institute for Gender Equality and other specialized bodies such as EURES; European industrial relations observatory.

2.3. What is important especially for the Balkan countries?

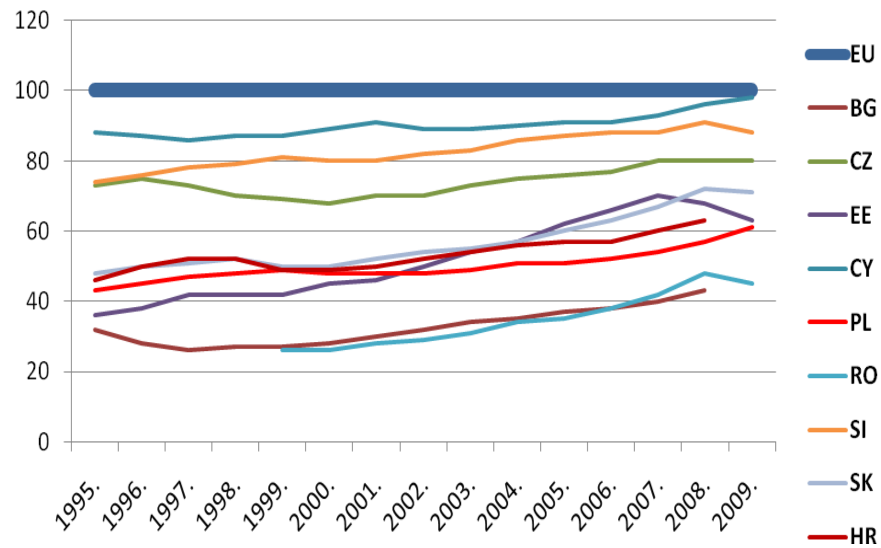
The achievement of social and economic development is possible only through the realization of the following three parallel processes:

1. The increase in gross domestic product per capita;
2. The reduction of unemployment and increase of employment;
3. The reduction of poverty and income inequalities.

It is a well known fact that the increase in the gross domestic product *per capita* is a precondition of social and economic development. However, the common feature of all Balkan countries is the high level of corruption at all levels which leads to a low competitive index. An insecure business environment increases the price of capital, which, alongside individual weaknesses, has resulted in the low growth rates during the last decade.

Moreover, economic growth has been founded on increased consumption out of foreign accumulation and has not resulted in the reduction of unemployment and increase of employment. A very specific issue is the low employment rate. All these factors have not formed the economic foundation that could lead towards a more significant reduction of poverty and income inequalities. This is especially so in the case of B&H.

Chart 1 GDP per capita PPS (EU27=100) for selected NMS and Croatia



Source, Eurostat, 2010

All NMS had lower GDP than PPS in the period 1995 - 2009. The only exception was Cyprus which came close to the EU average in 2009. The countries in the immediate B&H surrounding achieved over 60% of EU GDP PPS (e.g. Croatia), whereas Slovenia came very close to the EU average with a 90% of GDP PPS. On the other side of their relative development success is B&H with a 3,258 EUR GDP per capita PPS in 2010. Calculated in average value, it results in a 31% of average EU GDP PPS.

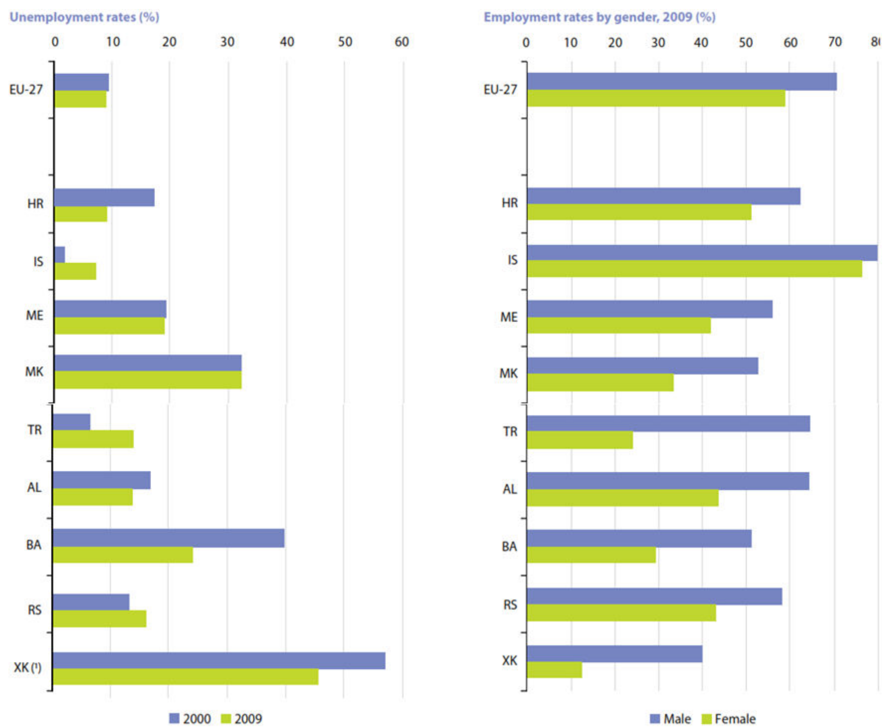
The development problems reflect themselves in the high rate of unemployment. These unemployment rates are even not that high if we take into consideration the low employment rate (Chart 2).

The average rate of unemployment in the EU is under 10%, but there are evident oscillations between individual Member States. For example, Spain had a 23% unemployment rate at the end of 2009, whereas in the same period, Luxembourg and Germany had 4.9% and 5.5% respectively. The rate of unemployment had significantly fallen, from almost 40% in 2000 to 24% in 2009. This definitely is a success, but the structure of the new jobs, which are mostly opened in state administration area, brings into question the sustainability of such a policy.

This situation varies in comparable economies such as Croatian or Serbian economy. Namely, Croatia had better starting grounds than B&H. It founded its economic growth on domestic consumption financed through foreign borrowing and sale of shares in state owned companies. This led to a significant reduction of unemployment. However, after 2009 there has been a significant increase in the number of unemployed, especially in the private sector according to data. In Serbia, the increase in unemployment was impacted by the effects of the last crisis as well as the lack of structural reforms.

Employment rate or proportion of population aged 15 to 64 that are employed, is an indicator of the success of the employment policy. The states with a regulated system of social protection and an implemented flexicurity model have rather high rates of employment, e.g. Denmark and Island have a 77% or 78% employment rate. On the other end, there are the Western Balkan states whose overall rate varies from 56% in Croatia to even less than 40% in B&H. This means that there was a big reservoir of population outside the workforce in the observed period.

Chart 2 Unemployment rates in 2000 and 2009 and employment rates by gender (year 2009) in EU27 and selected Western Balkan states



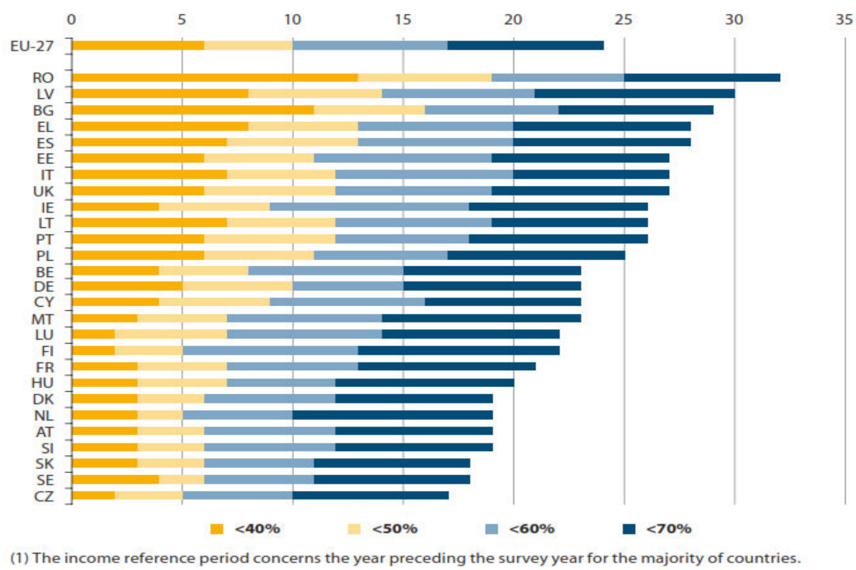
Source: Eurostat, 2010

Note: Unemployment rate: persons aged 15to 74 who were note employed, had actively sought work during the past four weeks and were ready to begin working within two weeks, as a proportion of the total number of active persons of the same age
Employment rate: the proportion of population aged 15 to 64 that is in employment.

European Council (1975) '*... people are said to be living in poverty if their income and resources are* ***so inadequate*** *as to preclude them from having a standard of living considered acceptable in the society in which they live. Because of their poverty they may experience* ***multiple disadvantages*** *through unemployment, low income, poor housing, inadequate health care and barriers to lifelong learning, culture, sport and recreation. They are often excluded and marginalized from participating in activities (economic, social and cultural) that are the norm for other people and their access to fundamental rights may be restricted*'.

The at-risk-of-poverty rate is the share of people with an equivalised disposable income (after social transfer) below the at-risk-of-poverty threshold, which is set at 60 % of the national median equivalised disposable income after social transfers. This indicator does not measure wealth or poverty, but low income in comparison to other residents in that country, which does not necessarily imply a low standard of living[1]. Chart 3 shows the at-risk-of-poverty rate in EU countries.

Chart 3 At-risk-of-poverty at various thresholds, 2007 (% of population)



Source: Eurostat, 2010.

As can be seen from Chart 3, the EU Balkan states have the highest at-risk-of-poverty rate. Aside from the at-risk-of-poverty, we can also observe the material deprivation rate. It describes social exclusion in more absolute terms. The material deprivation rate is the enforced lack of at least three of nine items. In year 2008, almost 17% of the EU27 population was materially deprived. The lowest levels were registered in

[1] Eurostat glossary, available at http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Glossary:At-risk-of-poverty_threshold

Luxembourg (4%), the Netherlands (5%) and Sweden (5%) and the highest levels in Bulgaria (51%), Romania (50%), Hungary (37%) and Latvia (35%).

Integrating the NMS and candidate countries for membership in the European Union represents a great challenge for the Union, and especially for the social systems of individual countries:

1. Variety of social systems;
2. Variety of socio-demographic features.

Table 1 depicts earnings in the business economy (average gross annual earnings full-time employees) in EUR during the year 2008.

Table 1 Earnings in the business economy
(average gross annual earnings full-time employees) in EUR

	2008	% of EU average*		2008	% of EU average*
EU-27	**25,994**	**100**			
Belgium	40,698	157	Bulgaria	3,328	13
Denmark	55,001	212	Czech Rep.	8,284	32
Germany	41,400	159	Cyprus	21,310	82
Ireland	39,858	153	Latvia	8,109	31
Greece	25,915	100	Lithuania	7,398	28
Spain	25,208	97	Hungary	9,805	38
France	33,574	129	Malta	16,158	62
Luxembourg	51,392	198	Poland	10,787	41
Netherlands	43,146	166	Romania	5,464	21
Austria	39,061	150	Slovenia	15,997	62
Portugal	16,691	64	Slovakia	9,677	37
Finland	37,946	146			
Sweden	37,597	145			
U. Kingdom	46,051	177			

Source: Eurostat, available at http://epp.eurostat.ec.europa.eu/statistics_explained/index.php?title=File:Earnings_in_the_business_economy_(average_gross_annual_earnings_of_full-time_employees),_2000-2010_(1)_(EUR).png&filetimestamp=20120104091726

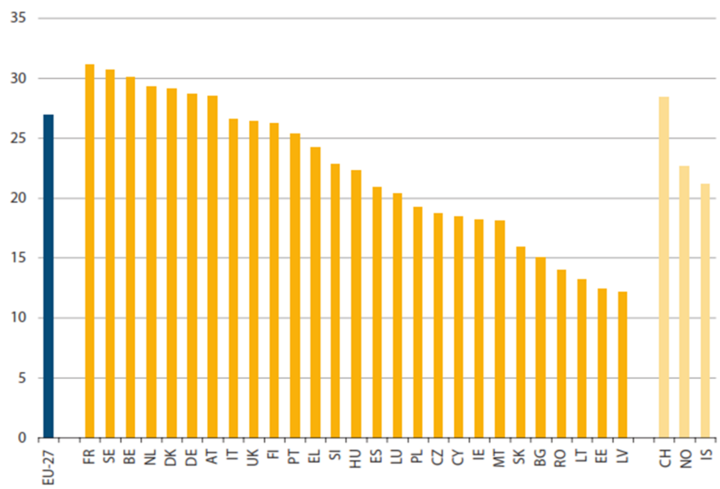
3. SOCIAL PROTECTION IN EU AND B&H

Social protection is a form of 'safety net' for the vulnerable, poor and needy, the effectiveness of which relies on the amount of resources being redistributed and their allocation.

Social protection measures can be used as a means for reducing poverty and social exclusion

Chart 4 shows the total expenditure on social protection in 2006.

Chart 4 Total expenditure on social protection, 2006 (% of GDP)



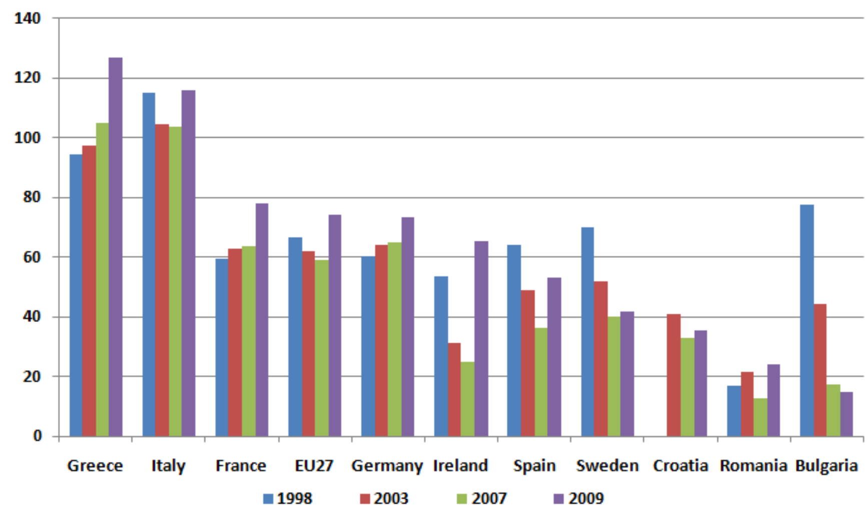
Note: EU27, Germany, Spain, France, Italy, Latvia, Lithuania, the Netherlands, Slovenia, Slovakia, Sweden and the United Kingdom, provisional

Source: Eurostat (tps00098)

According to available data (Chart 4), the social transfers in B&H in 2008 were 14.6% GDP in 2008, which is at the level of the poorest EU states, i.e. almost twice below the EU27 average.

The level of social protection within the EU is related to the traditional model of the welfare state that directs a significant portion of its budget towards social transfers. However, the fact is that pronounced orientation towards social transfers piles-up public debt. Naturally, this is not the sole and exclusive reason for the creation and growth of debt. This especially applies to the period of crisis after 2008 (Chart 5).

Chart 5 General government gross debt, % of GDP



Source: Eurostat, 2010

In comparison to EU states, Bosnia and Herzegovina has a rather small government debt, which in 2005 amounted to 25.3% of GDP, and in 2009, even lower, at 21.8% of GDP. This leaves room for a higher involvement of the state in resolving social issues, whether directly or indirectly i.e. by actively stimulating economic growth.

3.1. Financial support for employment and other social objectives in EU

The EU social policy is supported through the following funds: European Social Fund (ESF), the PROGRESS programme and European Globalisation Adjustment Fund (EGF)

Departing from the fact that EU states are traditionally social states, in 1957, the EU established the European Social Fund (ESF) with a budget of 77 billion EUR for the period 2007 – 2013.

Like one of the EU Structural Funds, the European Social Fund (ESF) is created to reduce differences in prosperity and living standards across EU Member States and regions. Main goal of the ESF is promoting economic and social cohesion. The benefit for the EU citizens are in creating Europe's workforce and companies better equipped to face new, global challenges. In short[2]:

[2] http://ec.europa.eu/esf/main.jsp?catId=35&langId=en

1. Funding is spread across the Member States and regions, in particular those where economic development is less advanced;
2. It is a key element of the EU 2020 strategy for Growth and Jobs targeted at improving the lives of EU citizens by giving them better skills and better job prospects.

The PROGRESS programme is a financial instrument supporting the development and coordination of EU policy in the following five areas: employment, social inclusion and social protection, working conditions, anti-discrimination and gender equality The financial envelope for PROGRESS for the 2007-2013 period amounts to 743,25 million EUR[3].

The European Globalisation Adjustment Fund (EGF) is aimed at helping employees find new jobs in times when they have lost their old ones due to global economic trends, i.e. when, for globalization reasons, a company goes bankrupt or when production is moved outside the EU. Likewise, acceptable reasons are also the negative trends brought about by the financial and economic crisis. The EGF means are allocated on the 65% and 35% basis i.e. 65% is provided by the EGF and 35% by the national state. As a result, up to 2011, the EGF has provided for 415 million EUR, whereas the member states accounted for 260 million EUR.

3.2. The economic position of B&H

In 2010, GDP per capita in B&H according to PPS was just 30% of the EU average. The economic, as well as the B&H social policy was strongly influenced by the 1990s war and its consequences like deindustrialization, poverty, social exclusion and huge unemployment (27.2% in 2010), as well as thousands of refugees overburdened the B&H social system. Out of the total c.a. 4 million inhabitants, more than 0.5 million beneficiaries are included in the social security schemes + veterans! However, social security is not yet accessible to all who need assistance, especially in rural areas. In addition, leaving the social policy on entity and/or regional levels is an issue in itself.

Lagging behind the EU is also emphasized with the problem of a high poverty rate, which was between 17.9 and 19.5% in the period 2001 to 2007. Furthermore, B&H has a rather high at-risk-of-poverty rate, which was 22.9% in 2007. This actually implies that during the first decade of the 21st century more than 40% of the population was socially vulnerable. If we add this to the data on the social exclusion in 2006 when 50.32% were identified as socially excluded, and the long-term exclusion risk of the employed of 47.31%, it is evident that there is a need for a redefinition of the social policy in B&H.

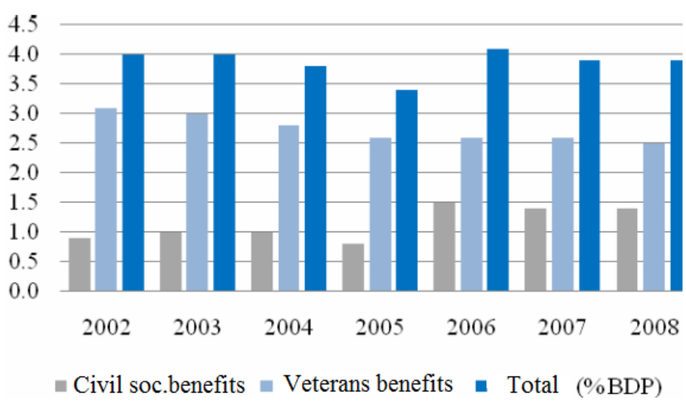
The problems of high poverty, at-risk-of-poverty and the rate of socially excluded are close connected to the following macroeconomic issues in B&H:

[3] General guidelines for the implementation of the Community action programme for employment and social solidarity PROGRESS (2007-2013)

1. High unemployment – but also high inactivity rate, "bad jobs" and high frequency of unreported labour. Youth unemployment was at a high 48.9% rate in 2009 while the only 0.11 % of GDP was allocated for the active measures of employment, which is more than four time less than in the EU states (EU27: 0.53% of GDP) which are faced with a significantly smaller problem of unemployment;
2. High rate of population with lower levels of education. The incapacity to adjust to the labour market demands due to having almost 45.3% people with elementary education or even lower in 2009;
3. Exclusion and discrimination on ethnic or gender grounds, as well as discrimination of former refugees;
4. Inadequate social security system with a low range and coverage.

Structure of main components of expenditure on social benefits in B&H is depicted in Chart 6.

Chart 6 Expenditure on social benefits in B&H (% of GDP)



Source: Social Inclusion Strategy of Bosnia and Herzegovina, Council of Ministers, Directorate for Economic Planning, Sarajevo, 2010, p.44

Unlike the EU states, B&H allocates a big percentage of its GDP for veterans benefits (Chart 6), leaving the rest of the socially vulnerable population is in an inferior position. By doing so, it deepens social inequality rather then diminishing these differences.

Resulting from the analyzed problems, the priorities of the Social Policy in B&H should be to:

1. Ensure the inclusion of socially excluded groups in the active labor market. Aside from the usual issues such as the inclusion of the young population into the labour market, B&H should try to resolve the specific problems arising from its internal organizational structure, i.e. it should overcome its ethic divisions which are also evident on the labour market. In another

words, B&H must increase the education coverage of population, especially of vulnerable groups, increase the efficiency of the education system & align the education system with the labor market needs as well as the needs of economic and social development;
2. Provide access to all goods, services, resources and rights that will enhance participation in the labor market. The increase in the employment rate is not possible in the short run. Namely, it is necessary to adjust the education system to labour market needs and to enhance education for all age group levels;
3. Strengthen mechanisms for social dialogue and develop partnerships and participation of all relevant stakeholders at different levels, which is lacking as a result of the (dis)functioning of B&H as a state;
4. Improve better targeting of social transfers to the poor and vulnerable population groups. The social policy should serve to decrease social differences and create an acceptable level of minimal income. It should be formed in such a way, that it does not lead to creating differences among various social aid users.

In addition to these fundamental problems, B&H is faced with the emigration of economically active population. Therefore, it is necessary to improve the position of families with children, increase coverage of population with health insurance and improve financial stability and adequacy of pension systems.

As a civilizational accomplishment, it is necessary to develop a general policy and budgets sensitive to people with disabilities regardless its origin.

This was also concluded by the European Commission: "As progress is made on stabilisation and status issues are addressed, the Western Balkan countries will increasingly focus on the reforms needed to approach European standards. The economic and social agenda will come to the forefront, as weak economies, high unemployment and inadequate social cohesion are major problems throughout the area. EU policies in the region should focus more on equitable and sustained development and on extending the benefits of economic growth to vulnerable groups and communities by combating unemployment, social exclusion and discrimination and promoting social dialogue" (EC 2006).

4. CONCLUSION

B&H, as other countries of the Western Balkans, share numerous social problems, high unemployment, low participation rates, falling birth rates, aging populations, severe poverty, migration of many young and skilled people. Social protection systems have been weakened by efforts to cut public expenditure and reduce budget deficits.

The post-communist social security systems that have been put in place are relatively weak due to lack of resources and the deterioration in the capacity of many of the institutions of public administration. Limited ability of governments to increase public expenditure for the alleviation of poverty, and the high levels of unemployment have

led to a drastic increase in poverty during the transition period and following the various wars and conflicts in the region.
Generally, the Western Balkan countries have been converging on rather different welfare models. At first, a group of countries with relatively high expenditure on social security and social protection are Croatia, B&H, Serbia and Montenegro. Second, a group of relatively low spenders are Albania, Kosovo and Macedonia

The effects of the current economic crisis are related with the following risks:

1. Risk of a social “race to the bottom”;
2. Risk of the accelerated harmonization of social benefits and wages which is accompanied by rising unemployment!?
3. Support (financial & other) that encourages convergence at the national and European level;
4. Based on the experience of individual EU states in overcoming critical situations, i.e. social and economic crises, B&H should do as follows:
5. Provide quality assessment of different effects and the dynamics of social (and economic) reforms, which will enable a greater level of social convergence;
6. Evaluate the effectiveness of the national social policy/ies, particularly in the context of their impact on the labour market;
7. Assess its ability to adapt to the contrasting demands of social security and employment, on the one hand, and economic growth and development, on the other.

The specific features of the social policy in the context of integration lie in the following: Economic convergence leads to social convergence, but not necessarily to the harmonization of social systems of different countries.

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CURRENT PROGRESS IN CREATING EU INTERNAL ELECTRICITY MARKET – WHERE IS EU NOW?[1]

ABSTRACT

Electricity market liberalization in the EU began in the early 1990's with the belief that introduction of competition will result with strong and flexible markets where competence and effective regulation will lead to cost-efficient production and lower electricity prices. Other expected advantages were competition increase among market participants, significant cross-border trade and interconnection capacities as well as diminishment of market concentration. Nevertheless, liberalization process of the EU electricity market still has not resulted with the creation of a fully integrated, unified and uniform market. Barriers that prevent the establishment of competitive electricity market in Europe are recognized in a form of insufficient interconnection capacity between member states, weak enforcement of EU electricity directives, differences in electricity prices among member states, varying switching rates, end-user price regulation, increased market concentration (or market power strengthening) through mergers and acquisitions. These obstacles are the reason why the convergence towards fully functional internal electricity market remains a work in progress. In order to further and finally liberalize the internal electricity market, resolve structural failings, promote infrastructure investments, enhance competitiveness and consumer protection, in April 2009 a third package of legislative proposal has been adopted amending the previous, second package and its directives. The third energy package, primarily Directive 2009/72/EC and Regulation (EC) No 713/2009, is focused on issues related to: new unbundling regime, improving the functioning of the internal electricity market, regulatory oversight and cooperation (namely, establishing the Agency for the Cooperation of Energy Regulators), enhancing the powers and independence of national regulators, measures to reinforce security of supply, efficient network cooperation and transparency. This, however, comes with the belief by the European Commission that fully opened electricity (and gas) market will have positive effects on EU GDP, employment, inflation, investments as well as it will contribute to the overall competitiveness of the European Union.

Key words: European Union, internal electricity market, liberalization effects, Directive 2009/72/EC, Regulation EC/713/2009

JEL classification: L16, L94, Q43

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1. INTRODUCTION

The creation of the EU internal electricity market began in the early 1990's. At that time, the EU member states started to organize their electricity sectors in accordance with concurrent political and economical developments since common rules for electricity market were not adopted until 1996 and the first Electricity Directive. This, in turn, formally marked the creation of necessary preconditions for the liberalization of the electricity sector within the EU.

From the early phases of the European integration process, electricity has been an important issue and the creation of the internal electricity market still represents a significant objective. Looking back in time, the development of the EU electricity market can be divided into three periods. The first one refers to the introduction of electrical systems on densely populated areas. After that came the expansion and the completion of the electrification of rural areas. The last and still ongoing developmental stage is related to the European electricity sector integration on the supranational level which was initiated with the Single European Act and the introduction of competition on the European market. The latter is progressing slowly and unevenly across the EU which makes it necessary to analyse all the obstacles to the EU electricity market liberalization process, especially when it comes to economic effects that can be expected upon the final creation of the European energy market.

The paper consists of four parts. After the introduction, second part briefly reviews expected advantages from the creation of the internal electricity market and gives an overview of several positive developments registered on the EU energy market in the recent years. Also, it describes in detail the current status and barriers to open, integrated and competitive electricity market in Europe. The third part analyzes some aspects of the Third energy package, namely Directive 2009/72/EC and Regulation (EC) No 713/2009 and its stipulations aimed at improving the functionality of internal electricity market. The emphasis is especially put on the new Transmission System Operator unbundling regime, consumer welfare, effective regulatory supervision and stronger regulatory powers coming from truly independent national energy regulators together with the establishment of the European Agency for the Cooperation of Energy Regulators. The fourth part draws concluding remarks.

2. RESULTS OF THE EU ELECTRICITY MARKET LIBERALIZATION PROCESS

2.1. Introductory remarks

Liberalization of energy markets is a long process characterised by free access of competition where one of the total aims of this unavoidable and irreversible process (Majstrović, 2008; 546) is efficiency increase. Greater efficiency leads to lower costs and prices which is crucial for the improvement of competitiveness. As this process is becoming widespread across Europe's energy sector, it should lead to further efficiency gains, cost reduction and lower prices (Ilie et.al 2007). Completely opened EU energy market will then allow all consumers to benefit from the cheapest available resources of energy. Domanico (2007; 5073) on the other hand also states several advantages that are to be expected from the creation of the EU internal electricity market. First, there will be an increased interaction among competitors due to increased competition supported by cross-border trade. Also, fully implemented internal electricity market will increase competition because of significant interconnection capacities as it will reduce the possible negative effects coming from the high level of market concentration. With more interconnection the need for spare capacity will decrease. This will be a major contribution to efficiency enhancement and possible black-outs diminishment which will, in the end, lead to utilisation of less costly power plants available at the moment of peak demand resulting in lower prices for electricity consumers.

Although several positive developments were registered on the internal energy market in the recent years (ERGEG, 2010), for example:[2]

1. Increased trade in energy with 6.000-10.000 wholesale energy transactions taking place every day making EU energy market (in the year 2008) worth around 620 billion € (5% of EU GDP) where 71% of this sum refers to electricity market value;
2. Electricity generation capacity in the EU increased by 28 GWh (approximately 3,5%) in 2009;
3. Network interconnection capacity slightly increased, by 2,5%; the 2009 data shows total network interconnections of 95.000 MW, which corresponds to 11,5% of total generation capacity (840.000 MW);
4. Market participants continued to trade actively on spot markets despite the reduction of industrial demand caused by the economic crisis and slow recovery;
5. Increased spot and futures trading at power exchanges slightly contributed to wholesale market liquidity and transparency; the volume of electricity traded at power exchange spot markets (day-ahead) rose by 14 TWh or 1,3 % meaning that one third of total generation was traded on the spot market;
6. Convergence of wholesale prices, particularly on the electricity markets in Northern and Central Western Europe where a coupling of markets involving 10 different countries was realised as from November 2010.

The overall liberalization process has been progressing rather slowly and unevenly across the EU (Vlahinić-Dizdarević et.al 2009; 8), and is still far from being completed, resulting in low level of competition, increased market concentration, differences in electricity prices and modest cross-border interconnection capacities which represent a barrier to cross-border electricity trade. The existing mutual diversity of electricity industry in all 27 EU member states is mostly due to the fact that every country in the process of restructuring and opening of their electricity market is trying to protect its economic interests to the greatest possible extent (Tominov, 2008). Although there is a considerable high-voltage connection between the neighbouring

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[2] See further: The internal energy market – time to switch to higher gear, http://ec.europa.eu/energy/gas_electricity/legislation/doc/20110224_non_paper_internal_nergy_market.pdf (retrieved on April 28, 2011)

countries, the number and transmission power of these connecting lines were not significantly increased which, at the end, did not contribute to the development of the electricity market as it was expected in 1996 when the first Electricity Directive was published.

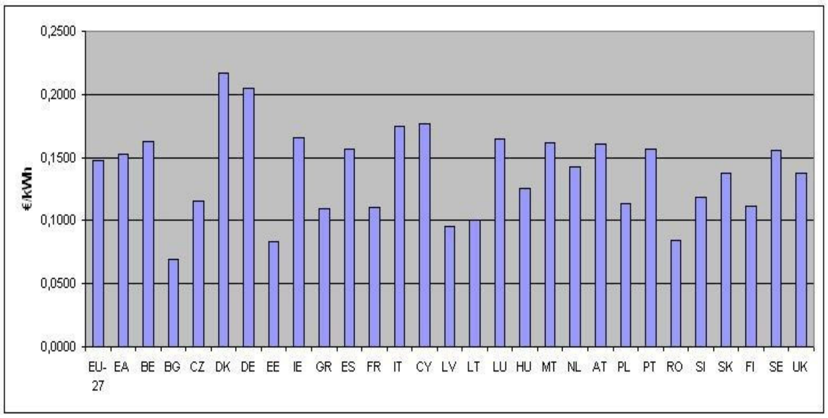
Since there exists a number of obstacles to the EU electricity market liberalization process and since this process, which now has no alternative, started with no previous experience and without prior understanding of all the problems that could encounter during the process (Majstrović, 2008), it seem necessary to point out these significant barriers to open, integrated and competitive electricity market in Europe.

2.2. Barriers to fully functional internal electricity market

Internal electricity market in the EU is mainly limited by the existing and planned generation and transportation infrastructure. The cross-border energy transportation facilities built before the liberalization process are the result of historical, political, geographical, legislative and social relations inter and between states. Since countries have established a balance within their borders, the cross-border interconnections for electricity transmission were not being developed with the goal of achieving substantial cross-border trade. The availability of electricity network capacity for cross-border transactions is not satisfactory both in terms of new investments and the way in which the existing capacities are allocated. Due to insufficient interconnection capacity between member states certain regions, such as the Baltic States, the Iberian Peninsula, United Kingdom and Ireland remain isolated. In 2002, the European Council set the target for all Member States to have a level of electricity interconnections equivalent to at least 10% of their installed production capacity by 2005. In 2010, nine member states still did not meet this target. The lack of coordination in network management harms the creation of the internal market and this clearly limits the degree of competition. Therefore, the European electricity market is still composed of national markets with weak bilateral connections and limited cross-border exchanges. The thing that concerns all EU member states is the fact that, in reality, the existing capacity are not used effectively while many states (especially those with an adverse national market structure) do not possess a sufficient amount of capacity available for cross-border transactions. In the future, the priority should be given to the development of interconnections between each country and its neighbours as well as interconnections towards other areas and regions of energy sources, for example Turkey, North Africa, Southeast and Southern Europe (Višković, 2009; Prša, 2009; Granić et.al 2008).

In theory, the European electricity policy seems well designed but there are several elements that prevent full integration of EU's electricity market. For instance, the prime reasons for the policy failure to create a competitive electricity market can be found in deliberate state interference motivated by a desire to support the so-called national champions endorsed by weak enforcement of EU directives at a country level. Lack of market integration and interest by dominant players or governments to enhance and/or build up the existing insufficient and inadequate interconnection infrastructure poses a problem. Electricity consumers have not received the promised lower prices which are above relevant generation costs (due to increase in prices of oil and gas and especially due to lack of competition). Also, great disparities still exist in electricity price levels among member states for both households and industrial consumers (see Figure 1 and 2). New monopolies are being created with the majority market share which results in high degree of market concentration and greater markups. At the end, the very market dominance of few electricity suppliers limits real competition and competitive prices. Different powers and competences of national regulators, still existing vertical integration, lack of independence of system operators as well as lack of transparency keep the EU internal electricity market far from being completed (Sioshansi, 2006; Dekanić et.al 2006; Domanico 2007; Tominov, 2008; Anderson, 2009).

Figure 1 Electricity half-yearly prices for households (in €/kWh), excluding VAT, second half of 2010[3]

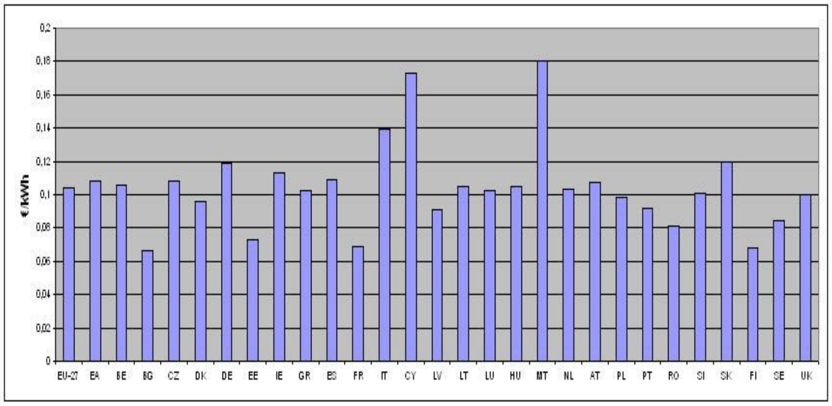


Source: Eurostat, 2011

As for household electricity prices, Denmark, Germany, Cyprus and Italy had the highest price levels in the second half of 2010 while the lowest electricity prices in this consumer category were registered in Bulgaria, Estonia and Romania. According to the data available on Eurostat and ERGEG (2010), the total price level for households ranged from 0,0692 €/kWh in Bulgaria to 0,2166 €/kWh in Denmark.

[3] Consumer band DC (household consumers with an annual consumption between 2.500 and 5.000 kWh) was taken into consideration.

Figure 2 Electricity half-yearly prices for industry (in €/kWh), excluding VAT, second half of 2010[4]



Source: Eurostat, 2011

When it comes to electricity price levels among member states for industrial consumers it can be noted that the highest electricity prices are present in Malta, Cyprus and Italy where, on the other hand, Bulgaria, Estonia, France and Finland have the lowest prices of electricity for industry. In the second half of 2010, the lowest level of electricity price paid by industrial consumers was 0,0664 €/kWh in Bulgaria and the highest was 0,1800 €/kWh in Malta.

Despite the electricity market being fully opened, competition is almost non-existent. The reason lies in factors such as narrow geographical markets on which the apparent absence of market rules harmonisation results in highly concentrated retail and wholesale markets where the incumbent suppliers retain a high-level of market power. High level of concentration on the electricity market can be evidenced by the fact that in only seven EU member states (Finland, Poland, United Kingdom, Spain, Italy, Netherlands and Austria) market concentration in the year 2009, in terms of Herfindahl-Hirschman Index, was reported as moderate. This, in turn, constitutes entry barriers especially for small, independent suppliers. The mentioned failure by EU member states to properly implement unbundling requirements causes an obstruction for competition and security of electricity supply. Artificially-low regulated prices (as opposed to free-market prices) that are below market prices hamper competition especially if these regulated prices are not well targeted and/or set at a level that does not allow costs recuperating. In the year 2009, end-user price regulation continued to exist in 19 countries for households. Regulated prices for non-households were registered in 16 countries but while Spain removed them, Slovakia introduced price regulation. The three countries that applied regulated electricity prices exclusively for

[4] Consumer band IC (industrial consumers with an annual consumption between 500 and 2.000 MWh) was taken into consideration. Electricity prices for industrial consumers in Italy are listed as provisional value whereas electricity prices for Austria refer to the second half of 2008.

household consumers were Latvia, Poland and Spain. The share of households supplied at regulated electricity prices was around 57% while the share of non-household consumers with regulated prices was 17%. These figures, especially the ones for European households, indicate that regulated end-user prices still apply to a significant share of electricity consumers. Political interference regarding regulatory independence[5] (namely, using political control through increased influence by ministries or parliaments on national regulatory authorities regarding electricity prices, staff appointments or even individual decisions) and lack of choice for households and commercial consumers regarding electricity suppliers selection also becomes harmful for the development of a competitive electricity market (ERGEG, 2010; ERGEG 2008).

The problems of market liberalization in EU's electricity sector as stated by Vlahinić-Dizdarević et.al (2009; 10) lie in an inefficient separation of certain activities, high fees of network access, the need of balancing supply and demand, the lack of power of regulatory authorities, very strong position of production companies and transit fees. The broad autonomy given to the EU member states regarding the choice of electricity sector's organizational models has led to different market organization approaches and varying degrees in actual market opening. Permanent pressures coming from the European Commission in order to reduce such asymmetry and to ensure equal conditions of market entry, while trying to neutralize the advantage of former monopolists, have not achieved the intended objectives. Instead, the majority of electricity consumers still use the services of those suppliers who hold strong monopoly on the national market. According to the European Commission (2010), the average wholesale market share of 3 biggest companies (by capacity) was around 76% while the total number of electricity generators with more than 5% share of generation capacity was 90 (or 96 if Norway is included). In the electricity retail market, the market share of three largest companies was around 80% with the total number of nationwide suppliers of 1155 (namely, 1181 if Norway is included). Contrary to designated goals, national monopolies were replaced by new private mega-monopolies, namely oligopolies. This does not come as a surprise if it is being observed from the suppliers' point of view. More specifically, as the logic of liberalization and free market indicates freedom of consumers to choose their own electricity supplier it also signifies the freedom of suppliers to meet their own interests and to sell the electricity in time and place when market circumstances and opportunities are profitable and cost-effective (ERGEG, 2010; Višković, 2009; Majstrović, 2008).

In addition, Tešnjak et.al (2009) argue that when it comes to competitiveness on the European electricity market there are still certain irregularities. For instance, in member states with monopolistic electricity market structures there are very little prospects for the entry of new producers. Also, a large majority of electricity consumers did not embrace the possibility to select (switch to) another electricity supplier due to either lack of interest or absence of real competition in the supply segment. Less the 50% of industrial electricity consumers have changed their supplier and these new suppliers

[5] Regulatory authorities at national level do not have necessary power and resources to effectively enforce the applicable rules or to impose penalties when electricity (and gas) regulations are violated (European Commission, 2010).

where selected mostly on the domestic market. However, households had a considerably low switching rate due to high market concentration which leaves the possibility to choose between only few electricity suppliers. Majstrović (2008) states that less than 20% of all buyers on average by country have changed their supplier. Even the European Commission (2010; 11) indicates that „it is difficult (...) to gain an overall picture of switching across member states“ and that „switching levels vary considerably across Member States, with some mature markets – such as the UK – experiencing relatively high rates and a number of others showing little or no activity.“ Specifically, the annual switching rates in United Kingdom are around 19% while, for instance, Bulgaria, Latvia, Lithuania, Romania, Slovakia and Slovenia are dealing with switching rates that amount to no more than 1% on a yearly basis. Majstrović (2008) goes even further and mentions the fact that there exists a disproportion between long periods of return on investments and dependence of project profitability on everyday market risks which delays the construction of minimally required transmission and production capacities and which threatens the security of electricity supply. It is also worth mentioning that the achievement of using renewable sources in electricity production (20% by 2020) through incentive based system endangers the market postulates by clearly favouring one group of market participants. Also, greenhouse gases emission quotas reduce the possibility for market development especially when it comes to producing electricity in order to satisfy the (growing) demand in other countries.

Probably the best overview on the development of the internal electricity market was given by the European Commission (2010; 2) where it states that it is essential to correctly implement the rules of the current Electricity Directives in order to make market opening fully effective in terms of the lowest possible electricity prices, security of supply and sustainability. However, due to improper implementation of the required legislation, in June 2009 the European Commission initiated infringement procedures against 25 member states for electricity (and against 21 member states for gas; this currently makes over 60 infringement proceedings underway on the Second energy package alone) where „key violations identified lack of transparency, insufficient coordination efforts by transmission system operators to make maximum interconnection capacity available, absence of regional cooperation, lack of enforcement action by the competent authorities in member states and the lack of adequate dispute settlement procedures.”

It looks as though the European internal electricity market is neither unified nor uniform as there is no real convergence towards a single model (Vlahinić-Dizdarević and Galović, 2007; 358). The European electricity market liberalization process, as said by Percebois (2008), is characterized by two trends: an increase in price paid by the end user and reinforcement of the incumbent operators’ market power. The increases in electricity price are widely a result of rising oil and gas prices on the international market[6], especially in the year 2008 when the price of oil peaked at 147$ a barrel. Although the increased electricity prices are mostly a result of changes in the price of

[6] The changes in the oil price have a direct impact on gas wholesale prices, given the link between oil and gas prices in many long-term gas supply agreements. These gas wholesale prices in turn influence electricity wholesale prices (European Commission, 2010).

fossil fuels[7], one cannot ignore a bigger problem that distorts the liberalization process and its substantial impact on the electricity prices. More precisely, it is the problem of aforementioned strengthening of the market power of some operators through mergers and acquisitions (European Commission, 2010; Osmanbegović and Kokorović, 2009; Vlahinić-Dizdarević et.al 2009).

The rationale for mergers and acquisitions lies in limited prospects for growth of electricity companies on their national markets. Therefore, Europe's larger electricity companies have mostly sought to acquire firms in other markets (Green, 2006). According to Kennedy and Stanić (2007; 279), the main reasons for merger and acquisitions seem to be the following: to increase the number of countries in which the consolidated company operates (with the aim to deploy the risk of interventions by national regulators and government), to improve the negotiation position with wholesale suppliers of primary fuel (for instance, Russian gas) and to reduce the costs through business expansion (i.e. to achieve the overall economies of scale).

Mergers and acquisitions could be used to compete aggressively across Europe. But since the markets are mainly national and since there are only few large dominate companies which make the market highly concentrated, it becomes clear that they have little incentive to compete too actively with each other. As stated in Green (2006), many European electricity companies were already vertically integrated at the time when restructuring started and national regulators prevented them from growing on their home markets. Their answer to this new situation was to expand across national borders. The abovementioned high concentration and lack of incentives for mutual competition indicate that it is better to specify EU's electricity sector as an industry rather than as a market.[8]

In order for the electricity liberalization to work in favour of consumers rather then producers, the competition authorities and decision makers need to promote the extension of regional markets[9] and interconnector capacity, unbundle networks and regulate access arrangements, block anti-competitive conduct and further market concentration as well as secure reserve capacity. Also, transparency enforcement, collection and publication of new types of data in order to better monitor the liberalization process are also needed (Jamasb and Pollitt, 2006; 22).

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[7] See also European Commission (2011) and ERGEG (2010).

[8] The review of corporate changes in electricity sector leads to a conclusion that the largest European electricity companies by far are Edf (France), E.ON and RWE (both Germany). This can also be confirmed according to their sales volume (Edf – 580 billion kWh a year; E.ON – 356 billion kWh a year; RWE – 315 billion kWh a year) as well as their market capital (Edf – 88,9 billion €; E.ON – 66,3 billion €; RWE – 46,6 billion €). The essential and more detailed features regarding corporate changes on EU's electricity market (industry) can be found in Tešnjak et.al (2009; 12 – 15) as well as in Kennedy and Stanić (2007).

[9] Regional cooperation is a possible step and the most plausible route towards establishing an integrated internal market for electricity. There are eight regional markets in the EU (the Nordic, UK-Ireland, Baltic, east European, west European, southeast European, Iberian and Italian zonal market) which vary in degree of internal integration. For instance, the Nordic market is the most advanced in terms of market rules and price convergence. The Iberian market is still taking shape (the integration of the Portuguese and Spanish electricity markets came into force on the July 2007) while the west European market consisting of France, Germany, Belgium, Netherlands, Luxembourg and Switzerland represents the largest regional market where its own development (due to its central geographic position) dictates the further development and progress in creating an integrated EU electricity market (Jamasb and Pollitt, 2005; Glanchant and Lévêque, 2006).

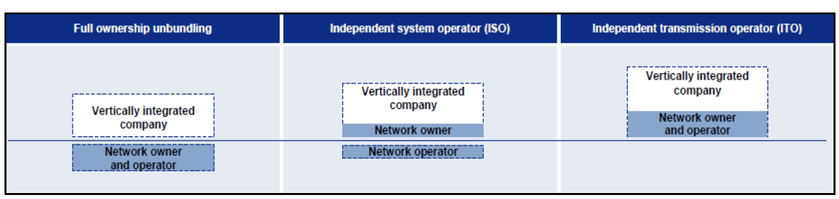
3. THIRD ELECTRICITY DIRECTIVE AS A FINAL STEP

In particular, these requirements are to be resolved with the implementation of the so-called Third energy package, namely with the new Directive on electricity. The Directive 2009/72/EC[10] by its definition establishes common rules for the generation, transmission, distribution and supply of electricity. Together with consumer protection provisions, it represents a way of improving and integrating competitive electricity markets in the Community. It lays down the rules relating to the organisation and functioning of the electricity sector as well as open access to the market. It sets the criteria and procedures applicable to calls for tenders and the granting of authorisations and the operation of systems. It also lays down universal service obligations and the rights of electricity consumers as well as it clarifies competition requirements. It is recognized that a secure supply of electricity is of vital importance for the development of European society, for the implementation of a sustainable climate change policy and for the fostering of competitiveness within the internal market. In addition, cross-border interconnections should be further developed in order to secure the supply of all energy sources at the most competitive prices to household and industry consumers within the Community.[11]

One of the most important features of this third Electricity Directive is the new Transmission System Operator (TSO) unbundling regime due to the fact that up to now legal and functional unbundling have not led to effective unbundling of the TSO's. Glanchant and Lévêque (2006) argue that TSO's are the ones who define and determine the success or failure in constructing the internal electricity market since they manage vital and key facilities. Also, there can be no credible internal electricity market if all TSO's are not truly independent from other interests in the sector.

Therefore, the Directive 2009/72/EC is set to regulate transmission network ownership (Figure 3) by ensuring a clear separation of supply and production activities from network operation through three models of organisation.

Figure 3 Requirement of the Third Energy Package in relation to the Transmission System Operators



Source: Brázai (2009)

[10] Original name of the directive: Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC.
[11] For more details see Official Journal of the European Union L 211/55, 2009.

The full ownership unbundling model refers to the situation where transmission system operator and network owner must be completely separated from the vertically integrated company. In the independent system operator model the ISO is responsible for the maintenance of the networks. The ISO is separated and not subjected to the control of vertically integrated company and the network owner, it accepts full responsibility of a transmission system operator but its assets remain the property of the integrated company. In the end, the third model or the so-called independent transmission operator (ITO)[12] is designed as a system of detailed rules ensuring the autonomy, independence and necessary investments in the transmission activity where the transmission system operator remains within the vertically integrated company but with the related asset in its own possession. Under this regime the transmission system operator must not have shared services with the parent company nor should it transfer confidential and sensitive information to the generation and supply branch of the integrated company. It is expected that TSO's in the EU will establish further cooperation which includes regional solidarity, reporting, development of commercial and grid codes, coordination of grid operation, investment planning as well as the expansion of cross-border capacities (Bukša, 2010; 785).

In addressing the consumer welfare, this Directive will reinforce consumer protection and ensure the protection of vulnerable consumers. In terms of consumer protection, it will empower consumers, provide adequate, user-friendly and frequent information about their actual electricity consumption and costs. It will raise awareness of the existence of alternative offers, facilitate price comparison and switching and provide redress. The Directive 2009/72/EC will also ensure more effective regulatory supervision coming from truly independent national energy regulators. This will be done through strengthening and harmonising the competences and the independence of national regulators in order to ensure an effective and non-discriminatory access to the transmission networks.

According to Regulation (EC) No 713/2009[13] and in order to strengthen the regulatory powers and to solve the gaps in cross-border projects regulation, a European Agency for the Cooperation of Energy Regulators (ACER) is being established as a new body to complement the regulatory task of the national level. This new body with special expertise on technical issues is independent from the European Commission, national governments and energy companies. The Agency[14], which is based on previously established European Regulators Group for Electricity and Gas (ERGEG), will be responsible for ensuring and promoting effective cooperation between national regulatory authorities at regional and Community level and to take decisions on cross-border issues if national regulators cannot agree or ask ACER to intervene. Also, it will have to review the implementation of the EU network development plans as well as

[12] This third option is a result of a political pressure that came from several EU member states (France, Germany, Austria, Bulgaria, Latvia, Luxembourg, Slovakia and Greece) criticizing the requirements for ownership unbundling or the creation of an independent system operator (ISO). The new unbundling regime as stated in the third Electricity Directive is no more than a mere political compromise consisting of three different options (Anderson, 2009).

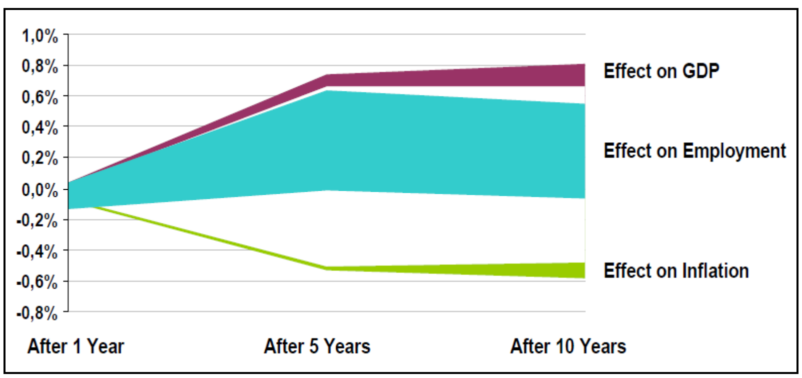
[13] Original name of the regulation: Regulation (EC) No 713/2009 of the European Parliament and of the Council of 13 July 2009 establishing an Agency for the Cooperation of Energy Regulators.

[14] For more details see Official Journal of the European Union L 211, 2009

national network development plans and monitor the functioning of the internal market, including retail prices. Available network access, especially for electricity produced from renewable energy sources and compliance with the consumer rights is also within ACER's jurisdiction (European Parliament, 2009; ERGEG, 2009).

Possible final convergence towards united and uniform internal electricity market, judging by the stipulations contained in the third Electricity Directive, still remain to be seen and thoroughly analysed since the implementation deadline for Directives and Regulations of the Third energy package was not until March 2011. On 1 February 2011, not a single EU member state had yet notified its transposition measures to the European Commission.[15] After that it still will not be possible to give a possible passing grade regarding the internal electricity market creation due to the implementation deadline for TSO unbundling which is not until March 2012. As stated before, it remains a work in progress. Nevertheless, even now the European Commission (2011) estimated certain benefits/effects (Figure 4) which can be expected upon the completion of the overall internal energy market.

Figure 4 Estimated effects of opening electricity and gas markets



Source: European Commission (2011)

Achieving a fully functional and competitive European electricity and gas market can add an extra 0,6% - 0,8% to EU GDP, create additional employment and curtail inflation. Also, a properly functioning internal energy market is essential in order to send the right investment signals and to able to react to the general economic downturn. It is the reason why safe, sustainable and affordable energy contributes to Europe's competitiveness, brings benefits to electricity and gas consumers and represents a priority for EU's strategic interests and growth.

[15] See further: The internal energy market – time to switch to higher gear, http://ec.europa.eu/energy/gas_electricity/legislation/doc/20110224_non_paper_internal_nergy_market.pdf (retrieved on April 28, 2011)

4. CONCLUSION

The principal reasons for electricity sector reform are the following: increase in quality of electricity supply, lower electricity prices, introduction of new technologies and investments, efficiency increase and system sustainability. The process of creating the internal electricity market in the European Union was initiated with the belief that it will increase competition among market participants, cross-border trade and interconnection capacities as well as diminish market concentration.

Even though positive developments were registered on the internal energy market in the recent years (for example, increased energy trade and electricity generation capacity, slight increase in network interconnection capacity, wholesale market liquidity and transparency), the completion of a fully functional electricity market encountered on several barriers. These barriers are the reason why this process is still far from being completed.

Main obstacles to the EU electricity market liberalization process are the ones referring to limited existing and planned generation and transportation infrastructure, deliberate state interference motivated by a desire to support its "national champions", varying electricity price levels among member states for both residential and industrial consumers, price regulation and lack of power of regulatory authorities. There is also a problem of high market concentration and low switching rates which leaves the consumers to choose between only few electricity suppliers. In other words, the general reason lies in the absence of real competition which can be evidenced by the fact that due to improper implementation of the required legislation (which is essential in order to make market opening fully effective) the European Commission initiated, up to now, over 60 infringement procedures.

In order to finally achieve a competitive electricity market, new Directive on electricity (Directive 2009/72/EC) together with the Regulation (EC) No 713/2009 represent a possible final step on a way of improving and integrating the electricity market in the EU encompassed with the estimated effects on EU GDP, employment and inflation which are expected upon the final and full opening of electricity (and gas) markets.

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MANAGEMENT DE L'INNOVATION AU CENTRE DE LA POLITIQUE COMMUNAUTAIRE

<u>RESUME</u>

Conformément à l'étude réalisée par Boston Consulting Group „Senior Executive Innovation Survey 2006", les innovations – des moteurs de succes de n'importe quel type d'affaire – représentent le thème majeur de toute discution de top-management.

Si au niveau microéconomique, les innovations sont essentielles pour que l'entreprise survive dans un contexte concurrentiel sévère, au niveau macroéconomique, l'innovation est considérée comme facteur de croissance. Cela justifie l'implication des pouvoirs publics afin de mettre sur le tapis un véritable système de recherche et innovation au point de vue national et européen.

A Lisbonne, en 2000, l'Union Européenne a lancé le concept d'espace européen de la recherche et l'innovation (EERI) en proposant une série de mesures destinées à situer l'économie de la communauté européenne, fondée sur la connaissance dans le top de la compétitivité et du dynamisme au niveau mondial. Le sujet est repris en 2002, à Barcelone et en 2004, à Lisbonne, où, José Manuel Baroso déclare: „La recherche scientifique, le développement technologique et l'innovation sont les facteurs clé pour la croissance de la compétitivité des entreprises et des places de travail"..

Mots clé: recherche, innovation, développement, politiques européennes

JEL classification: M11

<u>1. INTRODUCTION</u>

Le troisième millénaire est tenu comme celui du développement de l'intelligence intuitive. Chaque jour on est le témoin de l'apparition de nouvelles technologies appliquées aux processus de production, desquels résultats sont les nouveaux produits qui étonnent le monde entier. Il en est naturel, car, sans une innovation continue, la vie même n'existerait pas. C'est la vie qui est un processus continu d'innovation.

Pour les entreprises, l'innovation est devenue une provocation réelle et une activité récurrente. Ce double caractère de récurrence et incertitude des activités d'innovation constitue une véritable provocation du management, qui est dans la situation de trouver des solutions a deux questions majeures:

1. Comment dérouler d'une manière simultanée des activités d'exploiter les produits existants – la source des revenus actuels – et des activités d'exploration qui conduisent au lancement de nouveaux produits – la source des revenus à l'avenir?
2. Quel type d'organisation, quels instruments de gestion, quelle façon de prendre les décisions doivent être conçus et mettre sur le tapis afin de répondre à une telle provocation?

Le problème est devenu si aigu que, à plusieurs entreprises industrielles, de services et même dans la sphère des services publics, est apparu le besoin du métier de manager d'innovation. C'est pourquoi, en 2007, le Nomenclateur des Occupations de la Roumanie enregistre l'occupation de «manager d'innovation » comme personne «spécialiste ayant fonction administrative et commerciale [...], responsable de la gestion efficiente du processus d'innovation à une firme" (groupe 2419; code 241941).

Si au niveau microéconomique, les innovations sont essentielles pour que l'entreprise survive, au niveau macroéconomique, l'innovation est perçue comme facteur de croissance, ce que justifie l'implication des pouvoirs publics afin de créer un véritable système de recherche et innovation au niveau national et européen.

L'Union Européen a conçu l'ensemble des pays membres comme une Espace européenne de la recherche et innovation (EERI) où des dispositifs communs d'appui agissent. On propose la création des centres communs de recherche, le lancement des programmes d'appui financier, la création de l'Institut Européen de Technologie, comme des prémisses pour réaliser le désir conformément auquel, l'économie européenne fondée sur les connaissances devienne la plus compétitive et la plus dynamique au niveau mondial.

2. LA RECHERCHE – L'INNOVATION, DES EXIGENCES DE LA POLITIQUE ECONOMIQUE COMMUNAUTAIRE

2.1. Objectifs

La déclaration de Lisbonne (2000) coagule la recherche européenne dans une espace bien définie, performante et compétitive. L'investissement dans les connaissances et leur exploit représentent le meilleur moyen pour que l'Europe participe à l'économie globale.

La croissance économique durable dépend de plus en plus, de la capacité des économies régionales de changer et d'innover. Autrement dit, il faut déposer plus d'efforts afin de créer un milieu qui encourage l'innovation, la recherche et le développement (C&D). C'est ainsi que, promouvoir l'innovation, signifie un élément essentiel des Programmes nationaux d'application de la stratégie de Lisbonne et une priorité fondamentale des programmes du sein de la politique de cohésion, prévus pour la période 2007 – 2013.

L'Europe doit devenir plus inventive, elle doit réagir plus vite aux conditions de marché et aux préférences diverses des consommateurs et la société et l'économie doivent devenir plus favorables à l'innovation.

Dans le document mentionné ci-dessus, l'expression «espace européen de recherche»I (ERA = European Research Area) apparaît comme essentielle et cela suppose d'intensifier et d'approfondir la collaboration au sein de l'Union Européen et au-delà de ses limites (les pays en train d'adhérer y compris). Le concept ERA a été mis en œuvre par le Programme Cadre VI (2002-2006) et repris par le Programme Cadre VII (2007-2013): "La création d'une Europe des connaissances ». De plus, à travers l'initiative «Régions pour le changement économique», on stimule l'échange des idées et l'apprentissage des expériences des autres régions, afin d'améliorer la capacité d'innovation, les connexions TIC, le capital humain ou pour donner aux clusters industrieux un impulse vers l'innovation.

2.1.1. La Résolution du Parlement Européen

Le 15 juin 2010, le Parlement Européen a adopté la Résolution concernant le revoir de la politique communautaire en matière d'innovation dans un monde changeable. Le document exprime la volonté d'appliquer une large politique d'innovation qui comprise tous les types d'innovations, non seulement technologiques, mais aussi administratives, organisatoriques ou sociale set du domaine du travail, sans négliger les deux autres côtés du triangle de la connaissance: la recherche et l'éducation. On suggère de continuer les investissements en éducation et formation, car, un personnel qualifié constitue la garantie de la prochaine compétitivité, surtout dans les conditions dans lesquelles, l'Europe n'utilise pas d'une manière satisfaisante le personnel bien qualifié en recherche, par rapport avec les autres pouvoirs économiques du monde. Pratiquement, 46% des chercheurs européens sont actifs en économie également, face 69% en Chine, 73% en Japon et 80% aux Etats Unis.

En Roumanie on peut parler de maximum 30% du personnel en ayant des habilétés de recherche-innovation impliqué dans les activités économiques concrètes. (Robescu, 2011).

„Afin d'empêcher l'apparition de nouvelles formes d'inégalité sociale", […] il faut qu'à l'avenir, les innovations ne soient plus évaluées seulement par rapport avec les avantages écologiques et économiques supposés, mais à travers le prisme de leur valeur sociale ajoutée", ce qui démontre une fois de plus la préoccupation de la communauté européenne de réduire les décalages entre les Etats membres, à tous les niveaux.

On recommande plus loin de focaliser l'innovation sur l'individu et on encourage de continue ret d'intensifier le dialogue entre les universités et le milieu d'affaires et aussi la création des centres spéciaux d'innovation et initiative autour des universités, des instituts de recherche comme l'Institut Européen d'Innovation et Technologie (IEIT) et les parcs scientifiques et technologiques.

2.2. Ressources

Réduire le déficit existant en ce qui concerne l'innovation au niveau des régions européennes signifie l'un des principaux objectifs de la politique de cohésion. C'est pourquoi on a décidé d'investir dans les directions suivantes:

1. Recherche – développement et innovation;
2. Entrepreneuriat;
3. Absorbption de TIC;
4. Développement du capital humain.

La Résolution du Parlement Européen adoptée le 15 juin 2010 invite les Etats membres de majorer le financement pour C&D et d'arriver de dépenser 3% du PIB, ainsi comme on a établi à Barcelone, en 2002.

Dans la période 2007-2013, les instruments de la politique de cohésion fourniront aproximativement 86,4 milliards euros (presque 25% du budget total) pour C&D et innovation, pour intégrer des actions innovatrices et expérimentales y compris. De ce montant, **la recherche-le développement et l'innovation** recevront 50,5 milliards euros pour l'infrastructure liée de la recherche et du développement technologique et les centres de compétence, des investissements dans les firmes directement liées de la recherche, des activités de recherche et développement technologique au sein des centres de recherche, de l'assistance accordée spécialement aux PMEs, afin de stimuler la recherche et le développement technologique, le transfère technologique et l'amélioration de la coopération des réseaux, le développement du potentiel humain dans le domaine de la recherche et de l'innovation et assistance accordée aux PMEs afin de promouvoir les produits et les processus de production écoloqiques ; **l'entrepreneuriat** – 8,3 milliards euros pour les services avancés d'appui les entreprises et les activités indépendantes ou les entreprise trouvées au début ; **les technologies de l'information et de la communication innovatrice** – 13,2 milliards euros pour les services et les applications adressés aux citoyens (services sanitaires et administratifs en ligne, apprentissage en ligne et intégration électronique, etc.) et pour les services et les applications destinés aux PMEs (commerce électronique, éducation et formation, création des réseaux etc.); **le capital humain** recevra 14,5 milliards euros pour le développement des stratégies et des systèmes d'apprentissage continu au sein des firmes, les activités de formation et les services pour les salariés afin de stimuler une adaptation plus rapide au changement, promouvoir l' entrepreneuriat et le changement, afin de développer des services spéciaux destinés à occuper la force de travail, aux activités de formation et d'appui liées de restructuration et pour réaliser des systèmes capables d'anticiper les compétences nécessaires à l'avenir et pour concevoir et diffuser des modalités innovatrices plus productives d'organiser le travail.

Il s'agît, au moins, d'un montant triple des ressources financières destinées à l'innovation et à la recherche, par comparaison avec la période antérieure (2000-2006). Les investissements dans la recherche et innovation sont la voie unique, à long terme, de sortir de la crise et d'avancer vers une croissance durable et équitable au poin de vue social. La Commission Européenne encourage les Etats membres et les régions d'optimiser les possibilités d'investissements offertes par la politique de cohésion et par les programmes communautaires, spécialement en fournissant les conseils concernant les opportunités de financement pour la recherche et l'innovation.

3. LES PROGRES DES ETATS MEMBRES DE L'UNION EUROPEENNE DANS LE CONTEXTE DE L'UNION DE L'INNOVATION

LE 1 février 2011, la Commission Européenne a donné à la publicité le premier scoreboard concernant les progrès réalisés en 2010 par les Etats membres dans le contexte de l'Union de l'Innovation. La situation montre que l'Union Européen n'a pas réussi de récupérer le décalage qui la sépare des Etats-Unis et Japon dans le domaine de la recherche et de l'innovation.

Le Scoreboard présenté par la Commission Européenne – Les performances de l'Union de l'Innovation dans le domaine de la recherche et de l'innovation a été demandé par la Direction Générale Entreprises et Industrie de la Commission Européenne, en étant élaboré par le Centre de Recherche et Formation Economique et Sociale concernant l'Innovation et la Technologie de Maastricht (UNU-MERIT), en collaboration avec le Centre Commun de Recherche de la Commission Européenne (JRC).

Le scoreboard pour 2010 réunit 25 indicateurs du domaine de la recherche et de l'innovation et il analyse les réalisations des Etats membres de l'Union Européenne, mais aussi des autres Etats non membres, comme Croatie, Serbie, Turquie, Islande, Norvège, Suisse, etc.

Les indicateurs sont classifiés en trois catégories principales : moyens (ressources humaines, financement et appui, systèmes de recherche attractifs), activités des entreprise (les efforts déposés par les firmes pour innover : investissements, entrepreneuriat, collaboration avec le secteur public) et résultats (le nombre des firmes qui ont introduit des innovations et les effets économiques de l'innovation concernant la diminution du chômage, de l'export et des ventes).

On en relève que, malgré à la crise économique, dans la majorité des Etats membres, les tendances sont prometteuses, mais les progrès ne sont pas suffisamment rapides. L'étude montre que l'union Européenne maintient son avance envers Inde et Russie, Brésil enregistre des progrès constants, tandis que Chine récupère rapidement.
En ce qui concerne les Etats membres, ceux-ci s'encadrent en quatre catégories (voir l'Annexe no.1):

1. Leaders en innovation: Suède, Danemark, Finlande et Allemagne;
2. Innovateurs majeurs: Belgique, Autriche, Irlande, Luxembourg, France, Chypre, Grande Bretagne, Pays Bas, Slovénie et Estonie;
3. Innovateurs modérés: Croatie, République Tchèque, Grèce, Hongrie, Italie, Malte, Pologne, Portugal, Slovaquie et Espagne ;
4. Innovateurs modestes: Lettonie, Bulgarie, Lituanie şi Roumanie.

En ce qui concerne la Roumanie, en 2010 face à 2009, on a enregistré des progrès, la moyenne annuelle pour la majorité des indicateurs a augmenté les résultats pour les dépenses publiques en recherche et développement se sont améliorés. Malgré à tous ces efforts, la Roumanie a enregistré une performance modeste, sous la moyenne de l'UE.

4. CONCLUSION

Dans le contexte de l'économie globale et de la concurrence acerbe, l'innovation est la première priorité de n'importe quelle politique de tout niveau. Elle se trouve à la base de maintenir la performance des entreprises, de survivre et de trouver les moyens, les méthodes et les techniques afin de répondre aux prochains besoins de la société.

La politique européenne dans le domaine de l'innovation doit prendre en compte, de la même façon, tous les trois aspects de la société fondée sur la connaissance : éducation, recherche et innovation. Aussi elle doit comprendre tous les types d'innovations applicables au domaine technologique, mais à bien d'autres : organisation, administration, société, de nouveaux modèles d'affaires et services innovateurs y compris.

La Commission Européenne et les Etats membres sont impulsionnés de consolider leurs politiques dans une direction convergente de telle manière que, l'élimination des différences existantes soit seule une question de temps.

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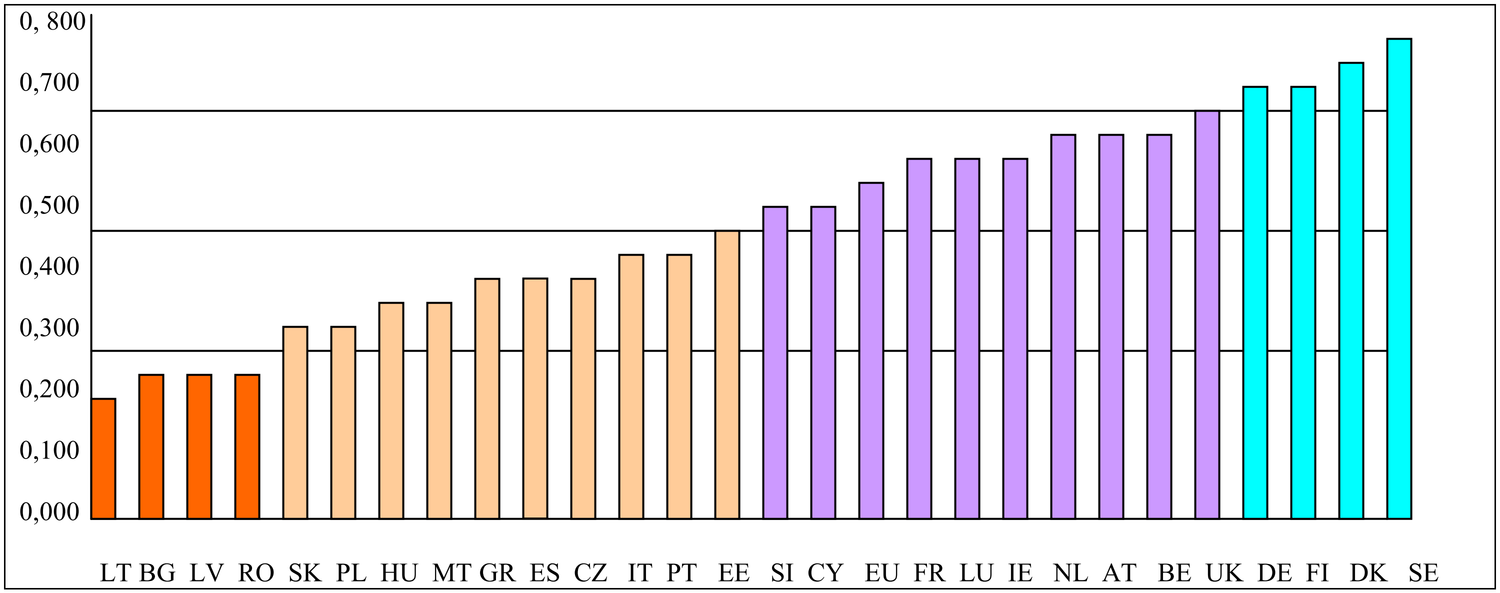
Annexe 1

Figure 1: Performance en innovation des Etats membres



Source: Innovation Union Scoreboard 2010

Annexe 2

Abréviation des pays

Abréviation	**Pays**	**Abréviation**	**Pays**
AT	Autriche	IE	Irlande
BE	Belgique	IT	Italie
BG	Bulgarie	LT	Lituanie
CY	Chypre	LU	Luxembourg
CZ	République Tchèque	LV	Lettonie
DE	Allemagne	MT	Malte
DK	Danemark	NL	Pays Bas
EE	Estonie	PL	Pologne
ES	Espagne	PT	Portugal
EU	EU 27	RO	Roumanie
FI	Finlande	SE	Suède
FR	France	SI	Slovénie
GR	Grèce	SK	Slovaquie
HU	Hongrie	UK	Grande Bretagne

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ACCESSION TO THE EU AND MANAGEMENT OF CHANGES

ABSTRACT

This paper is intending to follow the perspective of the need for new and challenges in the area of European law. The very immediate challenge is the legal aspect of enforcement of law. Although this modern aspect of law has been initiated and by now consolidated as large field of legal research in Economic analysis of law this paper suggests that enforcement of law issues have their dominant empirical field in European law and legal practice.

The first ideas about how the changes are about to be accomplished origin much before EC was established but from her intellectual and political father Jean Monnet…..”define the objectives, organize discussion, encourage convergence and finally give democratic institutions the task of administering the common interest” (1945).

The institutionalization of European policies at present reveal that this ideas have been brought in the practice and transplanted to newly accessing and association countries.- The examples are the institutions as separate bodies with powers to decide and overseeing or implementing policies. The most developed are related to competition policy, consumer protection policy, environment protection policy but also newly established agency network in public utilities and other policy areas.

Key words: European law, management, EU institutions

JEL classification: K0

1. EUROPEAN INNOVATION OR ANTICIPATION OF MANAGEMENT OF CHANGES

In the walk of EC law and institutional development the functional aspect of evolution from free zone to internal market has been strictly projected. Each further evolutionary step toward next stage of integration has been carefully described. More than that each next step in the walk to highest levels of European union has been carefully planed and made conditioned upon fulfillment of previous stages of customs union – common market – economic union – single European market – internal market – European union, The phasing out is one of the highest standards of organizational changes as seen from present perspective. In the European law it has been first time applied in

EEC Treaty (1957).[1] The technical and categorical mode of by and large derogates the traditional peace making and welfare enhancing legal vehicles of UN and GATT. The supranational character of European legislation has not been depending on renewal of the consensus of member states but this does not resolve the automatic moving along the transitional period.

One of example for this statement is Art. 33 of EEC Treaty selected at ransome although many other regulations and articles have the same content and message.

“ (8) If the Commission finds that the application of the provisions of this Article, and in particular of the provisions concerning percentages, makes it impossible to ensure the abolition of quotas provided for in the second paragraph of Article 32 is carried out progressively, the Council may, on proposal from the Commission, acting unanimously during the firs stage and by a qualified majority thereafter, amend the procedure laid down in this Article and may, in particular, increase the percentages fixed .”

At this early stage of legal enforcement the European methodology has been very advanced.

The novelty in attitudes toward law are in interest and research of law **after enactment**. The traditional attitudes were focused on drafting phase before enactment. As the proposal of legislation has been approved in the parliament interpretation and explanation about the rules was considered to contribute to enforcement sufficiently enough. The ultimate and legitimate enforcement bodies were courts and administrative bodies.

Such innovations are not outdated since on national judicial policy and legislation they still prevail.

Summing up it could be pointed out that features of European actual standardized enforcement politics and modes are:

1. Institutionalization of enforcement by creating competent well funded and independent bodies on national and European level which guides the implementation process;
2. Well prepared implementation of EU legislation papers and drafts which enable and facilitate the transmission of directives into national law and economy:[2]

[1] Art. 13 EEC Treaty : „ Customs duties on imports in force between Member States shall be progressively abolished by them during transitional period in accordance with Articles 14 and 15.“
Art. 14 (2) EEC Treaty: „ The timetable for the reductions shall be determined as follows: (a) during the first stage, the first reduction shall be made one year after the date when this Ttreaty enters into force; the second reduction, eighteen months later; the third reduction at the end of the fourth year after the date when this Treaty enters into force,, (b)……

[2] The good example of this is the recent Consultative document and Draft for Implementation of Directive 2005/56/EC on Cross Border Mergers of Limited Liability Companiey of March 2007 which contains very wide range of statistical dana and projections of possible increased expences for klients of newly established cvross border merger.

3. Monitoring of results of enforcement by reports and publications of esearch papers (Green paper, White paper, Guidelines, Notice etc.). [3]

In spite of very new and well structured enforcement policy and monitoring the European legislator have not gone outside the legal institutionalism.

2. REGULATORY AGENCIES RESPONSE

The regulatory model of enforcement has been newly only after 90ties inquired and implemented in EU. The regulatory task of agencies has been grounded on the enforcement issue. Regulatory agencies are promoted as technical advanced social model superior do large democratic institutions which have not enough expertise and judicial institutions which are slow and resistant to changes and novelties.

With their technical and social legitimacy and attributions of independence they were promising accountability, efficiency, transparency and performance in the large good governance context. By all means the new areas and politics in which state has entered required new device of regulation. Consequently, agencies both at European and national level are appropriate mode to accomplish new state tasks. That has been common and predominant belief so far. There are recent doubts about their genuine independence, neutrality of technical staff and ultimate efficiency. There are indications that turning away and being at distance from political institutions and people does not per se mean independent best governance. Officers in technical branch can be reliable in terms of expertise but can and often do depend on specific branch and industry which can also frustrate good governance in the interest of public good.

3. MANAGEMENT OF CHANGES – MANAGEMENT OF EU?

As described previously EU management of legislative process is under serious question if the traditional European enforcement models can comply with new demands of 80.000 pages of acquis, 27 member states a whole array of new policies and EU responsibilities. There are not ways to inquire this general problem but it certainly indicates that new existing doctrine and models could be applied and tested on the issue.

One of them is the management of changes theory which originates from business but also psychology. Recently it has been successfully developed when applied on new public policy and legislation in social relations.

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[3] Green paper – Liabilty for defective products, COM(1999)396, White paper on Modernisation of the Rules implementing Articles 85 and 86..(1999/C 132/01), Commission Notice –Guidelines on Vertical Restrain (2000/C 291/010) Commission Notice on horizontal cooperation (2001/C 3/02) end others.

As many others management branches also this one relies on traditional behaviorist American teaching which has been largely adopted also by L&E research on the issue of enforcement of law process.[4] (Cotter)

It starts with remote models and immediate acting which considers that at the core of enforcement is human perception and human behavior and without creating the impetus to internalize the rule imposed or suggested by law here fewer possibilities to talk enforcement based on sanctions, threat. Transaction costs are minimized if voluntary adherence to certain rules and whole systems of law is secured.

In this respect the enforcement of legislation and policies new as well as old one within 27 EU member states requires approach that takes in consideration different experiences and perceptions of a modern market economy. It is exactly the change management that deals with people side of change providing a framework for managing people side of adopting new behavior social rules and projected change.

Successful change legal or other requires engagement of people involved. The process of changes must be structured in order to enable transition to desired future state which includes also new policies, new legislative outcomes, new stage of the projected changes before etc.

3.1. Mapping

Another management tool is mapping. It is also called constructionist principle and steams from neuroscience. The working premises are that people do not have absolute knowledge of reality. They have only a set of beliefs developed through their experience and mental disposition.

Simplified it would mean that it is the perceptions that rule the world and not the one objectively established knowledge.

Consequently applied to the model of change process it would be necessary to attain a equilibrizum of information. In order to attain changes in EU information about changes must be accessible and properly understood by people with different belief, attitudes and histories. Methods that are developed within change management based on Map/ Territory relation can help people in their thinking and acquiring common durable perception about law but also the vision of common better future.

The options offered by new research and models of changes could be selected and tested on some areas legislation and change program. Communication in change in EU is necessary in order that within 27 actors a common perception is acquired regardless of different beliefs.

[4] Cooter R./ Selvin H.: Do Good Laws Make Good Citizens, Olin Program in Law and Economics, Berkeley, Cooter R/ Selvin H: The Theory of Market Modernization of Law, University of California. Authors are revising the beliefs that modernizing the law implies comprehensive reforms directed by state officials. The discusse alternative, called “market modernization” in which state repeals laws creating obstacles to market.

4. CHANGING THE MODELS OF CHANGE

The considerations about the new models of enforcement of European law and managing changes are necessary because of several reasons.

The EU has expanded in number of member states, restructuring and policies planed, legislation to 100.000 cca, negotiating partners for accessions and associations and others. The approach has not evolved in proportion to such dramatic evolution and expansion.

The traditionally European approach remains: functional, adaptation focused, institutional, realistic rather than rhetoric but nevertheless, predominantly normativist.

Regarding the supervising policy in EU no changes occurred but the amount and demanding objects of supervision is making it ineffective if possible at all and very costly. Specialized and limited on selected area research are very convincing in putting serious doubts about possibilities of supervising policies of EU institutions and operations.[5]

4.1. Monitoring of changes

Whilst EU is not yet explicitly in research of new views and perceptions on its methodology new monitoring and change institutions emerge.

One of them is an independent body like European Monitoring Center on Change (EMCC). It is established with different tasks regarding change. It has been set up in 2001 with a mission to cast spotlight on social and economic developments that drive change in European economy.

The high targets of such institution have support of both European Commission and European Parliament.

In the further walk of its practice it is expected that they generate new concepts of European supervising and enforcement policies.

The EU has so far not yet raised awareness about necessity of changes in change management regarding my inside and understanding the subject. But, since there is no absolute knowledge (constructionist tool!) about EU matters as well it might be just another perception and in reality new tools for European management of changes are about to be hammered out.

[5] Wymeersch E.: The future of Financiasl Regulations and Supervision in Europe, CMLR 42; 987-1010,2005, pg. 987.

5. CONCLUSION

EU strategies makers should revise the normativist approach to change and growth; research in MOC, L&E tools and research should me more taken in consideration; the approach should be focused on behavior, people side of changes, traditional beliefs and different experience that state members bring into EU; different levels of understanding and expectations must be able to participate in information i.e. acquis communitaire and be managed within the EU

Starting with academic discussions and research this new page in European managing changes and enforcing European law should be opened.

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DEVELOPMENT OF FINANCIAL REPORTING AND AUDIT AS KEY DETERMINANTS OF CORPORATE MANAGEMENT IN B&H

ABSTRACT

Establishing a quality system of corporate management in B&H is, among the others, one of the conditions for its joining the European Union. In fact, in order to become a member state of the European Union, Bosnia and Herzegovina, like other countries wishing to join the EU, must fulfill certain conditions, among which is also the implementation of all parts of the «acquis communautaire»[1]

Keeping in mind that the system of corporate management of one country consists of formal and informal rules accepted in practice and the implementation mechanisms regulating the relations between those who manage the companies on one side and those who have invested their assets into those companies on the other side, as well as the importance of this system for the economic development as a whole, it is quite certain that Bosnia and Herzegovina must undertake numerous activities toward creating conditions for the establishment of a solid system of corporate management.

The work will include a certain number of the laws regulating this area in B&H, which are relevant for understanding the role of financial reporting and audit in the system of corporate management, even though some solutions in some laws are not quite clear and are sometimes contradictory.

But the most important thing in the establishing of a quality system of corporate management in B&H is raising awareness of all relevant participants in this process about the importance of corporate management in our country. [2]

In shortest, the importance of establishing a quality system of corporate management mirrors in the following:

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[1] OECD Principles of Corporate Governance - Edition Principes de gouvernement d'enterprise de l'OCDE - Édition 2004
[2] Vukoja B,Katić B. – Script – Financial Reporting and Audit, Vitez University, 2011.

1. *Good corporate management provides the companies for easier access to external sources of financing, which on the other side brings to growth in economy;*
2. *Good corporate management reduces the costs of capital and in that way the overall value of the company is increased. This attracts investors and makes the investments into this kind of companies more attractive, which, in turn, leads to employment increase and economic growth generally;*
3. *Good corporate management contributes to creating better business results through better allocation of resources and better management, and in that way to the general growth and development of the company as well as the economy in general;*
4. *Good corporate management supports direct foreign investments and the investment portfolio and it mobilizes domestic saving which brings to growth and development of the economy.*

As a result of all this, a further development of the legislative framework will quite surely be needed in the area of corporate management as to align our country among the developed European countries.

Key words: corporate management, financial reporting, audit, internal audit, external audit

JEL classification: G3

1. INTRODUCTION

An inevitable role in the process of corporate management has accounting and auditing profession, the responsibility of which is especially accentuated in the OECD Principles and according to which the accounting profession must be responsible to share holders, not to management, and the administrations must effectively supervise the function of financial reporting through assuring an adequate control system. One of the requirements lying before the accounting profession, and the management too, is the publishing of financial reports.

According to that the companies must transparently publish the achieved financial results in the form of financial reports. The published financial reports present a significant informational potential on the grounds of which all interest groups participating in the process of corporate management need to make business decisions through which they will materialize the goals and interests. The interest groups participating in the process of corporate management should have sufficient and reliable information on a regular and timely basis.

Besides, corporate management is defined as a supervisory activity of the company administration and audit boards in order to insure the integrity of the financial reporting process. One of the most important functions of corporate management is quality assurance of the process of financial reporting. The recent disastrous cases of big and seemingly successful companies have intensified the necessity of introducing internal control mechanisms into the process of corporate management as to reduce the risk of materially important (fraudulent) financial reporting.

As a consequence of such events the interest groups had sent appeals to regulators to toughen the internal supervisory mechanisms of financial reporting, which had resulted in the drafting of various guidelines as to prevent unwanted events in the future and to regain the investors' confidence in the market capital.

Traditionally, the external auditor played an important role in the supervision of control of the financial reporting, and therefore he/she is an important factor in the process of corporate management. However, due to inherent limitations of the audit it is not possible to thoroughly eliminate the possibility of auditor's error. In the same way, it is the responsibility of the client to prevent and detect frauds, errors and other irregularities in the financial reports.

Therefore the regulators had given guidelines and imposed the necessity of implementing additional safety mechanisms as to improve the quality of financial reporting.

Primarily, that relates to improving accountability and performance of supervisory boards and – which is of special importance for financial reporting – audit boards.

The financial reporting has particular importance for the development of corporate management, where – in the process of drafting and publishing financial reports – information is created for owners and shareholders as well as for external users. The area of financial reporting is regulated by accounting standards the goal of which is harmonizing the process of financial reporting, all in function of receiving quality, transparent and comparable information.

Standardization in the area of accounting is the issue of the world's accounting community; its goal is to harmonize the accounting and especially the financial reports. It is possible to say that the globalization in accounting is carried out through standardization, targeting bigger and bigger international harmonization. Here, the special position has the International Standards of Financial Reporting through which the intention is to reduce, i.e. eliminate alternative solutions from the International Accounting Standards.

2. DEVELOPMENT OF CORPORATE MANAGEMENT

In the economic theory the corporate management is defined in different ways. Different approaches to defining corporate management appear mainly because of the different structure of ownership in some countries, i.e. due to whether corporate management is looked at from the prospect of shareholders or stakeholders.

A few definitions of corporate management, most often found in literature, follow here:

«Corporate management is a process of supervision and control, the goal of which is to ensure that the company management acts in the interest of shareholders» J.E. Parkinson

Corporate management presents an overall system of law, procedures and controls which is established internally and externally over the company management, the goal of which is to protect interests of all stakeholders. «Center for European Political Studies»

«Corporate management presents a set of links between the company management, its boards, shareholders and other stakeholders. «OECD Principles of Corporate Management»

Keeping in mind the neutrality in terms of relations, the shareholders/other stakeholders as the most often used definition of corporate management a definition was created according to which:

«Corporate management presents a system through which companies are managed and controlled» Cadbury Report[3]

That is a process which defines the goals of the company, follows and controls their implementation. Corporate management also deals with linkage and responsibilities of the boards in companies, their management, shareholders and other relevant stakeholders within the legislative and regulatory framework.

Ownership structure basically determines the selection of the model of corporate management as well as the management of the potential conflict between ownership and control. In fact, in Great Britain and the USA, due to orientation of these countries toward the stock exchanges, there is a wide dispersion of ownership on the capital market. Contrary to that, in the countries of continental law, such as Germany, France and many developing and transitional countries, the concentrated ownership structure dominates and the financial systems of these countries are chiefly orientated toward the banks.

In the countries with a wide dispersion of ownership it is possible to have a potential conflict between owner of the company (as the principal) and board of directors who (as agents) have control over the company and who may allow that their personal interests influence the decisions they bring. In the countries of concentrated structure of ownership over the capital the majority shareholders significantly influence the work of the board of directors. In this case the conflict becomes among the control majority shareholders who can benefit at the expense of minority shareholders.

There is no universal approach to corporate management. Many countries of continental Europe apply the approach of stakeholders according to which the companies are perceived as «social institutions» and which have a responsibility not only toward the shareholders but toward the employees and the society as a whole.

[3] OECD Principles of Corporate Governance Edition 2004

Contrary to that the Anglo-Saxon approach puts an emphasis on the creating of value for shareholders. In connection to that one of the main tasks of corporate management is to find a way of satisfying the interests of shareholders, managers and other stakeholders.

Corporate management is much more important to big companies whose shares are traded at stock exchanges who have a significant distinction between ownership and management, unlike the small companies, especially those whose shares are not traded at stock exchanges. The companies whose shares are traded at stock exchanges receive the capital through capital markets and the investors who possess a significant portfolio of shares and other investments in those companies should know if their money is safe. If there is any doubt on the intentions of those who manage the company that will certainly have influence on the value of the company shares and cause difficulties in obtaining supplementary sources of financing.

In connection with that, if corporate management in some country is generally bad, that country will quite certainly have problems attracting foreign investments and vice versa.

Beside the companies whose shares are listed at stock exchanges the corporate management can be applied also in smaller companies whose shares are not listed at stock exchanges and in other legal entities such as state owned companies, state institutions and agencies, institutes and associations, humanitarian organizations, etc. These legal entities also face a central dilemma of corporate management: in which way to delegate the rights and responsibilities to different groups and how to ensure that the common goals are achieved. For example, while the companies are managed in the interest of the owner the state organizations are managed in the interest of the state and the whole society. In a similar fashion, humanitarian organizations are managed in the interest of the beneficiaries of humanitarian aid and also in the interest of those who have provided the assets.

Of what importance corporate management is shows the statement of the former President of the World Bank Mr. James Wolfensohn, who says: «Managing companies is more important for the world's economic development than managing countries. »

3. IMPORTANCE OF FINANCIAL REPORTING AND AUDIT IN THE PROCES OF CORPORATE MANAGEMENT

In a turbulent, volatile and uncertain environment it is hard to manage a company. It is especially apparent in conditions when a number of interest groups are interested in the business of a company, starting from owner, creditor, supplier, employee, and customer. At times, their interests are, at first sight, opposing and conflicting. But, regardless of individual goals, interest groups in most cases want the company to successfully develop, make profit and enlarge its value. Regardless of the goals or interest groups, information is needed in the decision making process. Without quality information certain interest groups would not be able to bring quality business decisions[4]. In that sense, in the scientific and competent literature, the term of corporate management is elaborated more and more.

Corporate management is also defined as a system within which the rights and responsibilities of actors are supervised. Furthermore, corporate management can be defined as a system of supervisory mechanisms to which all suppliers of crucial resources need to ensure the return of their investments in the corporation, without jeopardizing its long term subsistence. In that sense the goal of corporate management is to add value to all interest groups. According to that, corporate management includes broader implications and is crucial for economic and social welfare of the company. On one side, corporate management ensures stimulation and performance measures through which a business success is achieved, and on the other side, it provides a more responsible approach to sharing the welfare of different interest groups. From there stem the benefits provided by the top-quality corporate management to all interest groups in the company. The top-quality corporate management is the precondition enabling the companies to easier obtain the capital from the market and to have lower financing expenses. Except for that, corporate management means improvement of operational and financial performances of the company, which – in the final instance – renders a positive influence on the market price of the shares. To better understand the term of corporate management it is necessary to understand the context and outer mechanisms of corporate management, as well as the internal mechanisms of corporate management.

The accounting profession certainly has an inevitable role in the process of corporate management. The importance of accounting profession is emphasized in the OECD principles, according to which the accounting profession must be responsible to shareholders, not to management, and the administrations must effectively supervise the function of financial reporting by ensuring an adequate control system. One of the requirements laid down before the accounting profession, the management too, is the publishing of financial reports.

According to the Code of Corporate Management the company is obliged to draft its financial reports in accordance with the International Standards of Financial Reporting, taking into account the modern International tendencies in financial reporting as well as the requirements of the market.

The annual, semiannual and quarterly reports are the most important and most complete database on the company; therefore they should not be limited only to containing the data in accordance to legal requirements and standards of financial reporting, but certainly need to include a comprehensive analysis and the management's stance on the business in the past period as well as the explanation by the management with regard to potentially more important variances in comparison to planned results and achieved strategic goals.

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[4] International Standards of Financial Reporting, RRIF 2007

According to that, the companies are due to transparently publish the achieved financial results in form of financial reports.[5]

The published financial reports present a significant information potential on the grounds of which all interest groups participating in the process of corporate management need to make business decisions through which they will achieve the wanted goals and interests. In order to be able to bring quality business decisions on the grounds of information it is necessary that the financial reports be true and that they present a real picture of the company's business. Untrue, deviated picture on the company's business may bring to making wrong business decisions which can result in big losses with incorrigible consequences.

3.1. The role of independent external audit of financial reports as an instrument of protecting interest of capital owners

Though the company's management bears responsibility for financial reports, the independent external auditors also play an important role in the process of financial reporting, because through their opinion they raise the credibility of financial reports.

In fact, keeping in mind that the users of financial reports usually make their business decisions on the grounds of information presented in the published financial reports, they expect that the independent auditors provide a reasonable explanation that those reports are objective end true. The users, also, expect the auditors to investigate and detect significant mistakes, whether intentional or unintentional, and to prevent the potential publishing of untrue or falsified reports. In connection with that, and in the context of numerous cases of publishing falsified financial reports in the last few years, often we can hear questions such as: «How come the independent audit did not detect these frauds?» or «Is that not part of their responsibility?»

But, in order to understand the problems of modern audit and the issues laid down before it, it is necessary to go back and briefly consider the genesis and development of the auditing profession in general.

Audit, in one or the other form, has been existing as long as the corporate companies. There has always been a need that those who had entrusted their property with someone else have a way of checking their work. A generally accepted stance is that the modern financial audit, i.e. the audit we have today had begun to develop in mid 19th century. With the emergence of corporate companies, with ownership and control were separated, a need has arisen for financial audit and a more detailed publishing in the financial reports.

In its beginning the audit had focused on finding errors in business records and on preventing all the more frequent frauds which had been connected to the phenomenon of professional managers and «the absent» owners. However, as the companies had begun to grow in the 19th century and become more complex the detection of accounting fraud became more and more an unrealistic goal, even though it had

[5] Law on Accounting and audit F B&H (Official Gazette FB&H 83/09)

continued to be generally perceived as one of the main goals of the audit of financial reports, at least by the public.

Between the 30-ties and the 80-ties in 20th century the focus of the audit partially shifted, so that the modern audit today is described as an independent research and expression of thought on the financial records of the company by a qualified auditor.

The result of the financial audit process is the opinion whether financial audits give a «fair picture in all important aspects» (American audit) or a «true and fair picture» (European audit) of the financial position, financial success and the company's financial situation. According to that, contrary to the general stance of the public, fraud detection is not a primary goal of the audit. This conflict of goals of the audit is defined as a «gap in expectations». In fact, it is a gap between expectations of the public (detection and fraud) and what the auditors claim to be their task (giving opinion on financial reports)[6].

However, according to the International standards and announcements of the audit, ethic and assurances, even though there is no doubt that the audit report strengthens confidence in financial reports in a way that it offers a high level of assurance, still, it does not provide an absolute level of assurance. In connection with that it is believed that the main responsibility for the prevention and detection of fraud still bears the company's management.

In order to be able to understand the role of independent external audit in the system of corporate management it is necessary to consider the functions of independent external audit, the very process of audit as well as the basic questions regarding assurance of high quality of financial report audit.

3.1.1. Functions of independent external financial reports audit

The independent external audit undoubtedly has a central role, not only in ensuring a correct application of International Standards of Financial Reporting, but also in a broader context of corporate management.

In connection with that, the basic functions of independent external audit can be defined as:

3.1.1.1. Function of ascertaining the exactness and reliability of financial reports

Audit reports present instruments with the help of which the shareholders and other beneficiaries of financial reports receive information on whether and to what level the revised financial reports give an objective and fair picture of the financial position and successfulness of the company, and whether they are done in accordance with appropriate accounting standards. Therefore, external audit largely contributes to reliability of financial reporting, keeping in mind that financial reports for shareholders

[6] Žager L. Accounting Standards, Financial Reports and Audit, Engineers' Bureau biro d.d. Zagreb,1996.

and other stakeholders present a basic source of information on the economic position of the reported company.

External independent audit in fact provides, in the first place to shareholders but also to other users of financial reports, an assurance that the information presented by the management in the financial reports is objective and true. This fact is very important keeping in mind that the financial reports are used as a basis for making business decisions by a wide circle of users.

In fact, the information from financial reports and financial indexes calculated on their basis are used not only for making decisions on whether to invest into a certain company or not, but also for making other business decisions by the creditors, employees, suppliers, state, etc.

In connection with that the function of independent external audit, which mirrors in confirming the exactness and reliability of financial reports, presents a function of broader public interest.

3.1.1.2. Function of providing support to non-executive directors or supervising board

Except for giving an auditor's opinion, which is meant for shareholders and other stakeholders, the external auditors are also obliged to inform, through their findings, the bodies of the company which are in charge of supervision and management control.

Independent external auditors assist non-executive directors (or supervisory board) and the board for review of their work in a way that they communicate with them about the issues connected to the control of the financial reporting process and the publishing of financial information, as well as about other issues of importance for supervision and control of the company.

3.1.1.3. Function of ensuring correct application of accounting standards by the management

Independent external auditors make influence on the improvement of quality of financial reporting in two ways. The first one is that the request for audit of financial reports is incited by the management for the purpose of drafting quality financial reports. The other way is the fact that the audit report has a great influence on the public.

In connection with that, the fear from negative opinion or an opinion with reserve is incited by the management in order to make corrections in false entries to financial reports as detected by the auditors, prior to their giving their opinion on those financial reports. That is the reason that in practice negative auditor's opinions or opinions with reserve are rarely found.

3.1.2. Process of performing an independent external audit

In order to understand the interconnection between external audit and a broader aspect of corporate management it is important, at least generally, to be familiar with the process of audit, its goals, focus and conceptual framework.

In connection with that, further in the text we shall give a brief overview of the audit process on the grounds of the International framework for offering assurance and the existing International Assurance and Audit Standards (IAAS), including only the most important elements of independent external audit from the aspect of corporate management and without entering a detailed analysis of financial report audit.

In fact, the International Assurance and Audit Standards (IAAS), published by the International Audit and Assurance of Standards Board (IAASB), are used as a basis for audit in most of the world's countries.[7]

3.1.2.1. Goals of audit

«The goal of external audit of financial reports is to enable the auditors to express their opinion on whether the financial reports, by all materially important questions, are drafted in accordance with the identified framework for financial reporting», for instance, International Standards of Financial Reporting.

An auditor needs to plan and implement the audit assuming the position of professional skepticism, at which it is necessary to take into consideration the fact that there may be circumstances causing that the information presented in the financial report are materially false. Professional skepticism, in fact, means that the auditor is doing a critical assessment reexamining his stances with regard to validity of the gathered audit evidence, at which special attention needs to paid to contradictory evidence, i.e. evidence that bring the reliability of the document or the statements to the management into question.

Furthermore, and audit which is performed in accordance with generally accepted audit standards needs to offer a reasonable assurance that the financial reports, in entirety, do not contain materially important errors. A reasonable assurance is a concept related to gathering audit evidence needed for making conclusions that the financial reports, taken in entirety, do not contain materially important errors.

But, inherent limitations are characteristic of audit; they affect the auditor's ability to detect materially important errors. These limitations are the result of certain factors such as the use of the auditor's sample and other testing procedures, inherent limitations of the accounting system of internal control, etc.

[7] Standards of Audit and Similar Services of the Federation of B&H, Institute for Accounting and Audit, Sarajevo 1998

These limitations are result of certain factors, such as using auditor's sample and other testing procedures, inherent limitations of accounting system, internal control system, etc.

3.1.2.2. Audit evidence

An auditor needs to gather satisfactory evidence which will make possible for reasonable conclusions on basis of which he/she will form own opinion. Audit evidence is gathered through appropriate combination of tests, controls and procedures of substantial research. Under certain circumstances, audit evidence can be gathered only on the basis of substantial research procedures.

Control tests mean tests carried out for the purpose of obtaining audit evidence on the adequacy of structure and efficiency of the functioning of accounting and internal control systems.

3.1.2.3. Internal control as part of external audit

During the financial report audit the auditors are mostly concentrated on those policies and procedures within the accounting system and the internal control system which are important for statements in the financial reports.

As part of the control risk estimate, the auditors do the estimate of control environment at the level of the whole company. The quality of the factors making up the control environment, such as the corporate structure, control awareness, integrity of the leader, organizational structure and delegation of authorities have a significant influence on the possibility of auditor's relying on internal controls. For that reason a negative control environment will make a negative influence on auditor's estimate of control risk.

Furthermore, understanding relevant aspects of the accounting system and the internal control system, coupled with the estimate of inherent and control risks and other considerations, makes possible for the auditor to:

1. Identify kinds of potentially materially significant errors which may occur in financial reports;
2. Consider factors effecting the risk of materially significant errors;
3. Conceive appropriate audit procedures.

3.1.2.4. Accounting frauds

Corporate scandals and shattered confidence in financial reporting in general, in the last few years, caused numerous dilemmas and logical questions among the public. One of the most frequently asked questions was the issue of auditor's accountability and whether the auditors could have and should have prevented these occurrences. In connection with that an avalanche of discussions was put in motion on the professional as well as the legislative level worldwide. However, the stance of the auditing profession on the issue of auditor's accountability for potential frauds and wrong statements, i.e. false statements in financial reports, stayed almost unchanged.

The term «fraud» implies an intentional act by one or more persons accountable for management, supervision and control, employees or third persons using fraud for the purpose of making incorrect and unlawful advantage. There are two kinds or intentional and untrue statements in financial reports, relevant for the auditors: untrue statements which become due to financial reporting for criminal purposes and untrue statements which become due to embezzlement. [8]Financial reporting for criminal purposes includes intentionally false statements or failure to publish an amount, the purpose of which is to deceive a user of financial report.

Primary responsibility for the prevention of fraud and errors, however, remains to dwell on the persons in charge of management, supervision and control in the company.
Together with those in charge of supervision and control, the management needs to establish appropriate controls as to prevent fraud and errors in the company.

On the other side, the goal of the financial report audit is to enable an auditor to express opinion on whether the financial reports, in their materially important aspects, are drafted in accordance with the established framework for financial reporting. In fact, an audit which is in accordance with International Audit Standards needs to provide a reasonable assurance that the financial reports, in entirety, do not contain materially important untrue statements caused by fraud or error.

In connection with that, it is important to emphasize that the auditor can be absolutely sure that the materially important untrue statements in the financial reports will be detected. In fact, due to inherent limitations of the audit there is an inevitable risk that some of the untrue statements in the financial reports are not detected even if the audit is correctly planned and carried out.

For that reason an auditor may only have a reasonable assurance that the materially important untrue statements in financial reports will be detected. In the same manner, the risk of the auditor not detecting a materially important statement in the financial report which became as a result of fraud by the management is greater than the risk of not detecting frauds potentially committed by the employees.
The reason for that lies in the fact that the managers are often in position which implies honesty and which makes possible for them to avoid formally established control procedures.

3.1.3. Report on audit of financial reports

The form and contents of audit report are not left to freedom and different interpretations and opinions of auditors. The auditor's report must contain the following elements: a) title, b) recipient, c) initial or introductory excerpt (titling of financial reports which are subject to audit, statement on accountability of the company's management and auditor's accountability), d) excerpt – scope (reference to appropriate

[8] Vukoja B. ; Audit of Financial Reports and Risk Management in the Company; Financial Rules and Practice; Fircon d.o.o.No 02/2007;

FB&H standards or practices and description of work published by the auditor, e) excerpt – opinion on financial reports, f) date of report, g) address of auditor and h) auditor's signature[9]

Standard positive opinion is given when auditor concludes that the financial reports are giving a true and fair review in accordance with the financial reporting framework.

Auditor's positive report can be modified: 1) by accentuating the facts which do not have influence on auditor's opinion (e.g. if the company has altered a manner of calculating depreciation it has a great influence on comparability of financial reports) and 2) due to the facts influencing the auditor's opinion. In the report the auditor puts down his/her opinion along with inserting an excerpt, accentuating the facts in the notes, describing his/her deflection in detail.

Auditor will not give a positive opinion if these reasons exist: a) existence of limitations in the scope of duty; b) deflection from generally accepted accounting standards; c) existence of disagreement with management regarding accounting policies, methods of application or adequate publishing in the reports;

For that reason other possible **kinds of auditor's opinion** occur:

1. **Conditional opinion** is given when the errors or false presentation of facts is considered significant, but the deflection from accounting standards, limited scope of duty or disagreement with management is not significant to the extent that it is necessary to publish a report that the financial reports are not realistic or objective;
2. **Sustained opinion** is given when the auditor does not have a sufficient amount of appropriate evidence for giving opinion on financial reports;
3. **Negative opinion** is given when there is a significant disagreement with financial reports saying that the reports are not realistic or objective and that they deflect form generally accepted accounting principles.

Limitation as auditor's scope appears when, due to circumstances, the auditor was not able to gather a sufficient amount of evidence about certain positions of their financial report (auditor did not attend the inventory, files were not updated)

Deviation from generally accepted accounting principles is of such character that the auditor gives a conditional or negative opinion.

Disagreement with management is mainly connected to the above reasons; if the disagreements are important for realistic and objective presentation of financial reports the auditor needs to give a conditional or negative opinion.

[9] Žager L. International Audit Standards, translation from English, Croatian Association of Auditors, Zagreb 1999

3.1.4. Quality assurance of the financial reports audit

Though the numerous discussions, which were led on the national and the broader International level, showed that the task of the audit is not and cannot be providing absolute assurance that the financial reports contain materially significant errors, the common goal is that the quality of the audit can be significantly improved. In connection with that, there are a few ways for improving the process of financial reports audit, which increases the security of shareholders and other users of financial reports.[10]

Establishment of an adequate regulatory framework for auditing profession quite certainly contributes to its improvement. Establishing standards on independence and objectivity of auditor, bringing high quality auditing standards, efficient and transparent control of auditor's quality of work and public supervision over the auditing profession are only some of the ways for regulating auditing profession, which quite certainly significantly improve its quality.

3.1.4.1. Professional standards on independence and objectivity of auditor

Determination toward obeying the norms of professional ethic is crucial for credibility of external auditors, as well as for accounting profession as a whole. From the aspect of publicity, the independence of auditor presents the basic precondition for a reliable and authentic audit of financial reports. If the auditors are not essentially and formally independent, the financial reports will not be reliable, which is why the investors and creditors will not have confidence in the presented financial information. Furthermore, in order for the auditor's opinion to be reliable, it has to be based on objective and unbiased assessments.

In connection with that, the principles-based approach, in accordance with recommendations from the IFAC Code of Ethics for professional accountants, defines fundamental principles of independence and establishes a significant security of independence and objectivity of auditor, which the auditors must always keep in mind.

3.1.4.2. High quality auditing standards

The bringing and the application of high quality auditing standards is also a way to improve the quality of audit. It is possible to say that the International Auditing Standards, published by IFAC International Standards for Audit and Assurance Board, today present global standards used for audit of financial reports. In connection with that, numerous countries – including the EU countries - have built into their legislations the obligatory application of International Auditing Standards.[11]

[10] Law on Accounting and Auditing F B&H (Official Gazette FB&H 83/09);

3.1.4.3. Effectiveness and transparency of quality control systems of auditing and disciplinary regime

The bringing and the application of high-quality ethical standards and auditing standards need to be followed by establishing an appropriate system of auditing and disciplinary regime quality control system. While the system of auditing quality control mainly has the preventive effect, which significantly reduces the risk of auditing failure, efficient disciplinary regime is needed for examining potential breaches of professional requirements and for the application of clear sanctions in cases this kind of breaches is proven.

Basically, there are two different methodologies of quality control: monitoring and peer review. Monitoring implies that the employees in the professional or a regulatory body manage the system and do the quality control of the auditing work. Peer review, on the other side, implies that the quality control is done by active members of the professional body, i.e. the very auditors. Both methodologies are acceptable and are considered equal. However, no matter the methodology, it is necessary to pay attention to the quality and objectivity of those who are doing the control.

3.1.4.4. Public supervision over the auditing profession

For the purpose of ensuring the credibility of auditing profession in public, along with professional regulatory rules it is also necessary to ensure a satisfactory level of public supervision. In connection with that, it is necessary to establish and implement minimum standards of adequate public supervision over the auditing profession on the state level. Establishing public supervision over the auditing profession increases confidence in the presented financial information and strengthens capital market.

Adequate representing of public interest should be defined in a comprehensive way, so that the body that would perform the function of public supervision over the auditing profession, beside the state representative, in its team also has the representatives of other interested parties, such as commission for papers of value, stock exchanges, regulatory bodies from the area of banking, professional accounting bodies, universities, etc.

3.1.5. Defining the sicze of small and medium-sized companies from the aspect of obligatio of financial report audit

The size of companies in FB&H is regulated by the Law on Accounting (Official Gazette FB&H 83/09). Currently the Law on Accounting Audit FB&H is in use; this law has been in power since 01.01.2010. According to this law all companies are categorized as:

1. Small companies
2. Medium companies and
3. Big companies

According to the criteria of: assets, total income and the average number of employees, which is best seen in Table 1 of the criteria and their values in the next table:

CRITERION: LEGAL ENTITY:	**AMOUNT OF INCOME (IN KM)**	**AVERAGE VALUE OF PROPERTY (IN KM)**	**AVERAGE NUMBER OF EMPLOYEES**
1. SMALL legal entities	**< 2.000.000**	**< 1.000.000**	**<50**
2. MEDIUM legal entities	**2.000.000 - 8.000.000**	**1.000.000 - 4.000.000**	**50 do 250**
3. BIG legal entities	**> 8.000.000**	**> 4.000.000**	**>250**

In order to classify the legal entities as small or medium companies it is enough that they fulfill two (out of the three) criterions from this table.

Legal entities that have one of the values exceeding the value stated as the criterion for big legal entities are also classified as medium sized legal entities.

Big legal entities are those exceeding the upper values from at least two out of the three (stated in the table) conditions for classifying as big legal entities.

Annual financial reports for the budget, budget users and extra budget funds are prescribed by the *Book of Rules on Financial reporting and Annual Settlement of Accounts in Federation B&H (Official Gazette FB&H No. 17/05, 66/08 and 73/08).*
This book of rules also prescribes the forms for annual reporting, established applicants, users, intervals and deadlines for submitting prescribed reports.

These tributaries apply the *Book of Rules on Budget Accounting in the Federation B&H* with analytical accounting plan for budget and budgetary users (Official Gazette F B&H No. 15/07) as well as the *Decree on Accounting of the Budget in the Federation B&H (Official Gazette FB&H No. 10/07).*

According to the mentioned Law on Accounting Audit FB&H all medium and big companies are tributaries of the financial reporting audit if they are limited companies. Also, the tributaries are all banks, microcredit organizations, saving and credit cooperatives, insurance companies, leasing companies, companies for managing the investment funds, broker and dealing companies and other financial organizations listed as big legal entities no matter the presented values as per stated criteria.

4. FURTHER DEVELOPMENT OF COOPERATIVE MANAGEMENT IN B&H COMPANIES

Structure of cooperative management in B&H companies also needs to ensure objectivity and independence of external auditors, and thus contribute to improving the quality external audit in the interest of shareholders and other stakeholders in the company. At the same time, audit boards have an important role.

Efficient corporate management demands active cooperation between supervisory board, management, external and internal auditors and audit boards. Audit boards in B&H today have an important role in the system of corporate management. They assist external independent auditors to stay independent of the management and contribute to ensuring high quality financial reporting and audit, as well as the effective functioning of internal control and internal audit.

In connection with that, special emphases in the future work has to be put on the role of audit board in the supervision of the auditing function – external as well as the internal. External supervision of the auditing function, by the audit board, primarily mirrors in the selection of external auditor whose appointment needs to be confirmed by shareholders at the annual assembly in terms of ensuring independence of the auditor. On the other side, the audit board also performs internal supervision of the auditing function through checking the process of financial reporting and controlling procedures of internal audit as well as the system of risk management in the company. However, the basic role of the audit board is providing a certain level of security for shareholders and investors that the company's reviewed financial reports and other financial information is not false and that it will not bring to delusion. Basically, the audit board helps ensure a high level of financial reporting quality.

However, it is necessary to point out that beside the fact that the audit board supervises the process of financial reporting it does not bear the final responsibility for the quality of financial reports. Furthermore, keeping in mind the importance of the supervising role over the financial reporting, which the audit board carries out in the name of supervising board, the members of the audit board must be persons of high moral values, possessing adequate knowledge and experience, most of whom must be independent.

However, beside the evident importance of audit board, for improving the auditing process and ensuring the independence of external auditors, as well as the system of corporate management as a whole, it is always important to keep in mind that the audit boards present a kind of „preparatory" boards, which in fact, only help boards of directors, i.e. their supervisory boards.

In connection with that it is necessary to take care not to create a „gap in expectations", i.e. not to have expectations by the audit board go beyond the boundaries of the task and the role of this extremely important function.

Hopefully, the started reforms in the B&H financial sector, especially in the sector of financial reporting, will continue to follow the EU directives and the corporate management in B&H will continue to develop in accordance with OECD principles, all for the purpose that B&H, within foreseeable time, becomes an EU member country with developed economy and financial system.

5. CONCLUSION

Corporate management has become one of the most frequently used phrases in global business dictionary today. It presents one of the key elements of economic development and strengthening confidence of investors.

However, though there is no unique definition or a universal approach to corporate management, establishing a quality system of corporate management enables an easier approach to external sources of financing, reduces cost of capital, attracts investors, opens new jobs, stimulates direct foreign investments and investment portfolio, mobilizes domestic saving, reduces the risk of financial crises, etc., which all together leads to development of the economy as a whole.

On the other side, pour corporate management stimulates corruption and crime and opens space to various abuses and machinations, which in the final instance undermines the foundations of each social community.

Financial reporting and audit undoubtedly present one of the key aspects of corporate management.

Without quality information from financial reports quite certainly it is not possible to successfully manage the company or to bring decisions on potential investing or withdrawing investments from the company.

Keeping in mind that the financial reporting is an instrument „in the hands"of the management, and that the interests of the managers in the system of corporate management on one side and those of the owners of the capital and other stakeholders on the other side are often conflicting, there is a permanent danger from potential abuse of financial reports by the management of the company.

The reasons and ways of abuse of financial reporting, i.e. presenting falsifies financial reports are numerous. However, no matter why or in which way the managers present false information, it always leads to serious, sometimes catastrophic consequences not only for companies and its shareholders but for the society as a whole.
In the same way, it is clear that the abuses will be bigger if there is no quality control system in the company over the financial reporting process, and if owners of capital and other stakeholders do not possess the mechanisms for the protection of their interests. In connection with that, the only security to owners of the capital and investors that the financial reports correctly and in a fair manner present the financial situation and successfulness of the company is the audit. It must assure the owners of the capital and other stakeholders that the financial reports are objective and true.

That can only be achieved if the external auditors are independent and if they are not under influence of the management, i.e. by establishing an audit board which, also, needs to work in the function of protecting the interests of the owners of the capital.

Establishing a quality system of corporate management in B&H is, among the others, a condition for the country's joining the European Union.

In connection with that the consideration of the issue of corporate management in the world *acquis communautaire* undoubtedly shows that the quality of corporate management is one of the key factors for development. All transitional countries had faced this, which certainly refers to the conclusion that we, the people of Bosnia and Herzegovina, will sooner or later face this very complex issue as well.

Harmonization of entity laws on accounting and audit with the Law on Accounting and Audit at the level of B&H and the harmonization of this law with the EU regulations and directions leads to conclusion that B&H is faster moving toward the EU in this area than in many other areas.

In the implementation of this it is necessary to get acquainted with, and then accept the *acquis communautaire* as the most suitable tool for improving the system of corporate management, which would be in the function of developing our country.

For the adaptation of our legislative and regulatory framework, when speaking of improving corporate management, and in connection with that the financial reporting as well, it is necessary to refer to the necessity of systematically handling these issues, keeping in mind the adopted directives of the European Community as well as the International Standards of Financial Reporting, International Auditing Standards and all other, generally accepted, principles from this area.

Only on this basis can we create a business environment which would be sufficiently attractive for bigger investments as the basic factor of development in the coming period, especially as the future EU member country.

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CURRENCY BOARD IN BOSNIA AND HERZEGOVINA - MACROECONOMIC STABILITY FACTOR, OR OBSTRUCTION OF ECONOMIC DEVELOPMENT IN THE PROCESS OF INTEGRATION IN EU AND EMU

ABSTRACT

Monetary policy makes the integral part of macroeconomic policy by which a country implements its economic policies. Traditionally, the monetary policy consists of issuing and controling the quantity of money in circulation, participating in open market operations, and setting the interest and discount rates. The role of the monetary system and the monetary policy in general is somewhat different in Bosni and Herzegovina as supposed in other open market economies. Bosnia and Herzegovina applies the fixed exchange rate of the national currency based on the principles of the Currency Board which is established on the Euro pegged national currency – convertible mark (KM). In spite of the advantages, the Currency Board has also showed certain disatdvantages which were particularly indicative at the time of the global financial crisis. The current research discusses the role of the Central Bank of Bosnia and Herzegovina, its monetary policy, and advantages and disadvantages of the Currency Board.

For this reason, the history of currency board, which is the most extreme form of connecting foreign-exchange course, is presented first, together with its basic characteristics. After that, classical central banks are compared with Currency Boards in order to present the basic advantages, as well as disadvantages of that arrangement. In the last section of the work, experiences of some countries are presented, especially those in the field of suppressing the inflationary trends and reaching monetary stability with the arrangement discussed, with special reflection upon Bosnia and Herzegovina. It is emphasized in that context that, even though significant results have been achieved in the past fourteen years in Bosnia and Herzegovina in the sphere of monetary policy, there are some potential dangers facing the viability of Currency Boards in the coming period. The authors propose solutions for elimination or reduction of those dangers.

In this paper, special attention has been focused on the sustainability of the currency board, and the impact of the Currency Board model for economic growth and development. The fact is that the Currency Board has a positive effect on macroeconomic stability, but at the same time this model of monetary policy has a negative impact on economic development of the country and its economy. Therefore, *the authors want to contribute and emphasize the importance of this theme in this paper.*

Key words: Currency board, monetary policy, central bank, macroeconomic stability, economic development, Europe union.

JEL classification: F3, O1

1. CENTRAL BANK AND MONETARY POLICY OF BOSNIA AND HERZEGOVINA

In majority of countries, a central bank creates and implements the monetary policy. The Central Bank of Bosnia and Herzegovina (CBB&H) is established on the same principal. However, there is one important difference between the CBB&H and a *traditional central bank* operating in an open market economy. The CBB&H operates on the *Principle of Active Participation of the Currency Board.* This is a common principle that has proven to be very efficient in structuring the monetary policies of the economies in transition and the post-war countries.

Monetary policy of Bosnia and Herzegovina is based on the following principles:

1. Coverage of monetary liabilities of the Central Bank with the net foreign currency reserves in the amount of 100%;
2. Unlimited convertibility of KM into EURO at the foreign currency exchange rate of 1KM=0.51 EURO;
3. Money supply includes: net foreign capital assets, loans, gross foreign currency reserves and sales and purchase of KM, and
4. No participation in *open market operations.*

Another important characteristic of the CBB&H is a high level of institutional and financial independence. This implies that the Management Board of CBB&H defines, adopts, and controls the monetary policy of the entire country, B&H.

The law of Bosnia and Herzegovina (B&H) stipulates the basic principles of monetary policy and the policy of foreign currency exchange rate and the role of the CBB&H. This implies that the emission and withdrawal of the currency in circulation is performed by simple exchange of foreign currency and the local currency, and on the basis of the fixed and defined rate and CBB&H.

Monetary policy with such a concept ensures the real independence of CBB&H. This concept definitely disables the politicians and other interested parties to influence the actions of CBB&H without previously amending the legislation. This is one of the advantages of the Currency Board system in B&. If this was not the case, there would be three currencies in B&H and each ethnic group (there are three ethnic groups in B&H – Bosnians, Croats, and Serbs) would print their own quantities as they please.

Another important characteristic of the CBB&H is its ability to realize significant income through its activities is of great importance. The Law on CBB&H stipulates that the profit should be distributed according to 60%-40% principle where the 60% is reserved for the budget of the state institutions and 40% for the increase of the capital of CBB&H. This unique approach furthermore strengthened the independent position of CBB&H.[1]

The financial independence of the CBB&H has proved to be very efficient principle. Just within the first two years of this legislation implementation, the CBB&H transferred 38 million KM to the state authorities. Similarly the CBB&H has an authority to appointment the management bodies and the officials of the Central Bank. Namely, the Presidency of B&H appoints the members of the Management Board, and they, among their members, elect the governor for the term of six years (in accordance with the requirements of European Union). The members of the Management Board may be replaced only provided that they fail to observe the principles of monetary policy as prescribed by the Law or if they do not behave in compliance with the law.

Another interesting characteristics of the CBB&H is its credibiltiy or the way it is perceived. Since its establishment, the CBB&H has been seen as a highly credible body and it has achieved remarkable results. Namely, when in August 1997 CBB&H was founded and when the convertible mark (KM) was introduced as the local currency, three more currencies were in use in B&H. These three curencies were German Mark (DEM), Croatian Kuna, and Yugoslav Dinar. This was just one of the (numerous) negative sideeffects of the war that was experienced in Bosnia and Herzegovina. The country's economy was devided into two entities, while the entire economic system was destroyed. There was no economic connections between two entities. Within a relatively short period of time – between the August 1997 and until the end of 1999 – CBB&H managed to reintegrate the monetary system. The three other currencies that were used along with KM (DEM, Croatian Kuna, Yugoslav Dinar) were eliminated from circulation and the local currency, KM, became the only legal means of payment. Another great success in buiding up the confidence was achieved in the field of price stability. Namely, the price index shows that the inflation dripped from 13.3% in 1998 to 3.7% in 2005, and within the period 2002-2004 the average price increase was about 0.5%. In this way CBB&H managed to completely preserve the inner stability of the local currency.[2]

The external stability was provided by successful maintenance of the fixed exchange rate and regular servicing of the external debts of B&H which is done by CBB&H as the fiscal and monetary agent. Throughout the years, the CBB&H has become the trustworthy institution and is considered to be out of the reach of political influence. Namely, with its activity CBB&H, not even once, strayed away from its goals and thus made sure that the expectations of the public are completely met.

[1] Central Bank of BiH, (2010), " Annual report 2010", *Central Bank of Bosnia and Herzegovina*, Sarajevo, 2010.
[2] Central Bank of BiH, (2006), "Annual report 2006", *Central Bank of Bosnia and Herzegovina*, Sarajevo, 2006.

2. ADVANTAGES AND DISADVANTAGES OF THE CURRENCY BOARD AND ITS ROLE IN THE MONETARY POLICY OF BOSNIA AND HERZEGOVINA

Since establishing of the Currency Board until present time, there has been a debate about the adequacy of having the Board. One of the basic reasons for introducing the Currency Board in the countries considered to be the "economies in transition" is, certainly, the great sensitivity of the Central Banks to political pressures. The political pressure usually focuses on the budget deficit financing and the actions of the Central Bank, which, in return, frequently caused high rate of inflation and instability of the overall economic system.

The greatest disadvantage of this model is completely conscious waving of the series of instruments of monetary policy by the monetary authorities. The experience of some of the *economies in transition,* that have applied this model, shows the several advantages and disadvantages of the Currency Board model. The advantages of the Currency Board model are:

1. Guaranteeing convertibility of the local currency;
2. Guaranteeing price and monetary stability;
3. Introducing macroeconomic stability;
4. Improving foreign trade;
5. Stimulating the direct and portfolio foreign investments;
6. Stimulating the development of sound banking system and presence of foreign banks in domestic economy.

This model is particularly advantageous solution for two groups of economies:

1. Small and open economies with the emphasized orientation on international trade (large participation of the sector of ¨tradable goods¨);
2. The economies that did not have highly emphasized macroeconomic instability.

The success of the Currency Board model depends on other elements of economic policy as well. These elements include:

1. The level of the starting reserves,
2. Firmness of fiscal policy and flexibility of its instruments,
3. Flexibility of the labor market,
4. Interest rates trend.

However, in spite of frequently mentioned advantages, this model is not the ¨remedy¨ - for all economic problems. Its disadvantages are:

1. *Limitations, even prohibition of granting the loans as the last resort, which may lead to*
2. *Instability of the banking system;*
3. *Disabling the active monetary policy;*

4. *Limited protection from the impacts of speculations.*

The criticisms addressed to the system of the Currency Board are mainly related to the key principle of its functioning and that is automatism. By tying the hands of the monetary authorities, as regards to their discretion to monetary policy, the system indeed serves as the stabilizer of the foreign currency exchange rate and prices. Adjusting the economy of Bosnia and Herzegovina to absorb the external economic shocks is carried out by adjusting its activities and adjusting the money supply, level of domestic prices, salaries and employment. Therefore the currency board is frequently criticized as the mode of monetary policy not being able to stimulate the development of B&H economy.

Historically, the comparative statistical methods and formal econometric analyses have shown that the Currency Board is able to provide better results compared to other regimes of the fixed foreign currency exchange rate. For instance, it turned out that the existence of the currency board reduces annual inflation by 3.5% as a result of the ¨trust effect¨— which basically occurs due to faster increase in money demand.

Another criticism of the Currency Board model focuses on its reserve requirements. The critics argue that keeping the reserves is inefficient and that disables usage of the available resources that would otherwise be at the disposal of the system of discretionary monetary policy (partial reserves). Namely, the critics of the Currency Board notice that there are reserves of the local currency which never get convert into the reserve currency. This is particularly important given the fact that when applying the model of the Currency Board, especially in the case of the economies in transition, the decisions are practically made between the channels that stabilize the economy and the ones that transfer the authority of monetary policy.

The Currency Board in Bosnia and Herzegovina requires that anyone who wants to have local currency – the Convertible Mark (KM) – must buy it with another foreign currency. In the case of buying KM by the reserve currency – in this case by EURO - the purchases are made on the basis of the *fixed foreign currency exchange rate*. However, if the local currency is purchased with some other convertible currency, then the transaction is based on the *market exchange rate.* From the perspective of CBB&H balance that means that its monetary liabilities may never be greater that the foreign currency active assets. The liabilities of CBB&H consist of the cash KM emitted into circulation and the credit balance of the residents, deposits of the commercial banks, deposits of other local sectors, except central government. Foreign currency active assets consist of foreign convertible currency cash in the safe deposits of CBB&H and assets at foreign banks either as deposits or investments in stocks as well as net foreign reserves.

3. MONETARY POLICY OF BOSNIA AND HERZEGOVINA UNDER THE CIRCUMSTANCES OF FINANCIAL CRISIS

Due to the conservatism of the Currency Board system, CBB&H has tied hands during the current global economic and financial crisis. Its only monetary policy instrument has been the required reserves rate. Therefore, the fiscal policy become the priority given the fact that its full efficiency is seen in stabilization of the state budget (reduction of the deficit) and in management of the national debt. As previously stated, one of the main advantages of the Currency Board is the stability of prices (*anti-inflation effect*) which certainly is the advantageous solution under the current global crisis. Due to the fixed currency exchange rate, local banks, mainly in foreign ownership, are thus protected against currency risks which can arise under the circumstances of the global financial crisis. This is yet another advantage of the Currency Board system of Bosnia and Herzegovina. For all the above stated characteristics, the banking sector is well protected from the influence of the crisis.

The other side of the picture, the dark one, shows all disadvantages of applying the fixed foreign exchange rate and, along with it, the disadvantages of the Currency Board in Bosnia and Herzegovina. This refers to the real sector of economy where, above all, there is negative foreign trade balance of the current account of the state (i.e. very high foreign trade deficit). This problem did not arise with the crisis and it is a common problem facing the economies in transition. Unfortunately, Bosnia and Herzegovina failed to make and thus implement the macroeconomic stabilizing strategy at the state level. The fundamental postulates and principles of that strategy should have been related to the local economy and establishing competitiveness with the economies of the neighboring countries, Europe, and the World. With strengthening of the local industry, especially production in the local companies where new values are created, Bosnia and Herzegovina, with its macroeconomic strategy of development, should have emphasize its comparative advantages. This would be a solid foundation for its future economic development.

The monetary system of Bosnia and Herzegovina made the great contribution to the country's economic stability despite the global financial crisis. In this case, Bosnia and Herzegovina applied the principles of the German (and later on European Union) monetary system. Knowing the fact that the essence of the EU economic policy is stability of prices (anti-inflation), it is clear how much importance is given to the currency. The essential difference between the economic objectives of EU and USA is that EU emphasizes stability of prices while the USA emphasizes the economic development. The evidence for this is a recent reaction of the USA government related to the fight against the financial crisis, which consisted of adding the additional quantity of dollars (around 750 billion) into the monetary system in order to strengthen the economy. This would not be the positions and policy of EU. Unrealistic foreign exchange rate, which is the result of the over-valued of the local currency, additionally stimulates import and discourages the export.

4. THE MONETARY POLICY OF BOSNIA AND HERZEGOVINA IN THE STABILIZATION FUNCTION OF THE ECONOMY AND THE INTEGRATION PROCESS TOWARDS THE EUROPEAN UNION

The commercial banks of Bosnia and Herzegovina used the current financial crisis as an excuse for unjustified increase of the active interest rates. The only thing that CBB&H could do in this case, as one of the measures of monetary policy, was to reduce the rate of obligatory reserves of the commercial banks in order to provide the banks with additional disposable assets. In combination with the rate of capital adequacy and with the reduction of rates, CBB&H tried to lessen the consequences of the financial crisis.

Unfortunately, there is no universal model of how to lead the policy during the global financial crisis. Each country, according to the level of the economic development, political and social environment, and general strivings, selects the most adequate model of its own. Practical application has proved that what is good for one country may not automatically be applicable in others. Nevertheless, the fundamental postulates of the selected models in the countries are very similar.

The basic characteristics of the model of the Currency Board in some economies in transition such as Bulgaria, Estonia, and Lithuania, show similarities with Bosnia and Herzegovina. These three countries are the ones that have already become the members of EU. At the moment, the three countries are modifying their monetary system according to the requirements of the European Monetary Union (EMU).[3]
The model of Currency Board is generally acceptable and it is applicable in different political and economic environments. It is true that this model has not given the same results in each country, but, still, the main characteristics of the model, in the first place stabilizing effect, can be recognized in the examples of some of the best known Currency Boards in practice. In the short-run, the system of Currency Board has a stabilizing effect, while in the long-run, it only represents transition to the full European-like monetary system of a country.

In the case of Bosnia and Herzegovina, the system of Currency Board is acceptable. However, it is necessary to reform it in two directions: devaluation of the currency and more efficient use of the foreign currency reserves of CBB&H. The former direction refers to the necessity of correction of the exchange rate KM-EURO as, under the circumstances of the present financial crisis the exchange rate completely dis-stimulates the local economy which is oriented towards export and even more it stimulates import. With the correction of the exchange rate the local businessmen would come to the equal position compared to the importers who are, with the presence of their own lobby, additionally stimulated by the too strong exchange rate. With the more efficient use of the foreign currency reserves of CBB&H, which serve as the coverage for the convertible mark, B&H would come to the situation to emit its own stocks (in the first place the short-term and long-term bonds) which would further imply positive effects to several directions:

1. With the emission of the stocks (bonds) the state would be able to settle the debts for former foreing currency savings and pay for the war reparation and invest into the capital projects;
2. The capital market would be revived by additional materials as the state trasury stocks would become the part of the trade;

[3] Đonlagić, Dž. (2006), *Evropska Monetarna Unija i Bosna i Hercegovina*, University of Sarajevo, School of Economics Sarajevo, page 134.

3. Among other things, it would be the foundation for the reforms of the retirement plan and creation of the pension fundss that would mostly invest into the state stocks;
4. All above stated would create competitiveness to the banking sector which, due to market mechanism and not the state pressure, would be forced to reduce interest rates through the money offers but not from the banking sector but from the developed financial market.

5. CONCLUDING REMARKS

The goal of any economy in transition is to achieve macroeconomic stability and to have a stable local currency. With enormous war destructions, post-war traumas, ethnic divisions, and mutual distrust within the country, the existing monetary policy and the existance of the CBB&H are proving to be beneficial. However, in order to establish mutual trust and develop overall stability of B&H society, it would be very risky to give a mandate to the CBB&H to lead the discretionary monetary policy.

Under the unfortunate conditions of economic and social destruction, as well as great needs for financing, rebuilding, and reconstruction of the country, the disretionary monetary policy would expose CBB&H to insurmountable difficulties in defining such a monetary policy as well as its implementation.

Great pressures for financing such increased needs by means of (uncovered) emission of money would certainly result in the high inflation and overall macroeconomic instability. This would make the conditions for prospective investors even more difficult for investments into economic and social recovery of B&H.

Considering everything we mentioned so far, the model of Currency Board was the most appropriate solution for B&H. Bosnia and Herzegovina has several tasks to achieve:

1. Integration of the economic area in one monetary sphere;
2. Building the single economic system;
3. Achieving the macroeconomic stability by means of stable currency;
4. Avoiding all possible conflicts of political, ethnic, entity, or partisan nature;
5. Avoiding possible influence of the executive authoroties on the monetary ones;
6. Consideration of the regional and and economic growth and development factors.

In order to recognize the characteristics of the Currency Board in practice (i.e. in leading the monetary policy of CBB&H), it is necessary to analyse all the aspects of business activities of CBB&H and the instruments at its disposal. Under the normal conditions, the system of the Currency Board mostly serves as the instrument of anti-inflation and stabilization. On the other hand, due to the overvalued local currency, especially under the circumstances of the financial crisis, it additionally deteriorates the position of the local companies, mainly the exporters.

The non-use of the reserves of CBB&H additionally facilitates the monopolistic behaviour of the banking sector which, under the circumstances of not having any competition, arbitrarily dictated the amounts of active and passive interest rates to legal and physical entities.

The generally known fact is that the best and most famous B&H brand in the world, i.e. the refugees, were the ones whose remittances enabled creation of the strong backing of the local currency. The CBB&H very easily provided the necessary funds to cover the local currency. Recently there has been an increasing trend of remittances from abroad, so that, sooner or later the foreign currency reserves of CBB&H will be questioned and they will simply „melt— because of payments of the foreign debts and especially because of financing the import that takes the money out of the country.

The authorities of Bosnia and Herzegovina are facing a very complex task of acceleration of all necessary economic, monetary, and fiscal reforms. There is a need of bringing a uniformed macroeconomic strategy of B&H at the state level and giving the clear guidelines of action to economic agents. This particularly refers to the monetary policy based on Currency Board which, under the ¨stable circumstances¨, proved to be vulnerable, especially in the times of crisis. This clearly implies that there is no universal model of monetary policy that would prove to be efficient and applicable to majority of the countries. The undeniable right of each country is to select and implement the adequate monetary policy. Frequently, this is a very complex issue, especially for small, open market economies where the selection of the monetary policy model must take into consideration the existing economic, political, and social circumstances. The creators of monetary policy are obligated to adjust the monetary activities to the level financial system development. It is certainly the case that in combination with the stimulative fiscal policy, the adequate and carefully selected monetary policy is a significant factor in achieving the macroeconomic stability of any country.

The only natural strategy for exiting the Currency Board arrangement, which would cause the lowest opportunity cost to the economy of Bosnia and Herzegovina, was held on Currency Board until joining the Euro zone. It is therefore necessary to preserve the Currency Board arrangement of all potential risks. In this paper we have tried to consider some aspects of long-term sustainability of the Currency Board arrangements in Bosnia and Herzegovina. Research in the future to find new problems, which could become an obstruction implementation of the Currency Board arrangement. Of course, there are still issues that could be addressed in the future, in the context of their impact on the sustainability of the Currency Board in Bosnia and Herzegovina.

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THE ROLE OF CONTROLLING IN STRATEGIC ALLIANCES OF GLOBAL BUSINESS INDUSTRIES

ABSTRACT

In the world of corporative world business, strategic alliances are made according to the idea „the bigger the company, the bigger part of the market it gets". Strategic alliances are developing fast on all organisational levels, national, international and even intercontinental. We find them in all industries but their character and organisation are not the same in all industries. There are significant differences among them as well as the effects that appear in each single industry.

From the aspect of corporative management the main strategy is the diversification strategy. Diversification strategy ensures its stability in maintaining competitive advantage on the market of strategic alliances of an industry. Only stable and successful companies can be members of strategic alliances. If a company has bad results it is excluded from the alliance. In this way the strategic alliance is protecting itself from the biggest business risk- decrease in its market value.

In different industries of global business we find different types of strategic alliances. Vertical, horizontal or diagonal alliances as well as the differences in their connection are still very much unexplored. Their main characteristics have to be explored due to their market domination in industries, sales, nautical tourism, airline industry and other industries. The goal of these researches is to increase the success of management of strategic alliances and their members which makes controlling an unavoidable support of management. There is no successful management without controlling. Therefore, it is necessary to answer a couple of current questions regarding strategic alliances in global world business.

What are the reasons for creating strategic alliances? What are their main characteristics? What are the specific characteristics of strategic alliance management? Why is controlling so important and what is its contribution to successful management? What are the problems within strategic alliances of different industries and how are they being solved? Those are all questions that arouse and that we are going to talk about in this paper. Even if we don´t answer all of them we will encourage further research of this current and still unexplored topic.

Therefore, the subject of this paper is strategic alliances in global world business industries with special emphasis on management and controlling.

The aim of this paper is to investigate the differences in different strategic alliances in different industries and to point to the main problems in these industries. The goal of this paper is to offer possible solutions that would bring improvement for the whole industry and not only for the alliance. No matter how similar the goals of strategic alliances are they do not improve the whole industry. Therefore, in accordance to the goal of this research the aim of this paper is to offer possible solutions that benefit to whole industry. Strategic alliances do not bring improvement per se and this is the main hypothesis of this paper. This hypothesis will be investigated through methods of empirical investigation as well as analysis and synthesis of the results which are the basis for the conclusions of this paper.

Key words: *strategic alliances, management of strategic alliances, controlling of strategic alliances, competitive advantage in the industry, value oriented management and controlling of strategic alliance.*

JEL classification: D7

1. INTRODUCTION

Strategic alliances are the most developed forms and organizational types of large multinational corporations that are found in the global market. A necessity for their development is a result of increasing demand as well as stronger competitive relations in market offers.

Strategic alliances provide its members a certain competitive advantage on market and promote their development. They also stimulate the development of small and medium enterprises. However, strategic alliances do not appear in the same way, not even with the same intensity in all industries of the global business world, so there is a need for exploring their development.

The subject of this paper is therefore strategic alliances and their management, as well as its members. Exploring the management of strategic alliances, in order to define successful management, it is necessary to associate controlling as its important part.

The aim of this study was to investigate the role of controlling in strategic alliances and identify the basic characteristics of controlling in management of alliances and its members. *The objective* is to elucidate the positivity of the strategic alliance management and its members which are value-oriented, and thereby have their own controlling.

A method of cognition, experiential methods, and research methods of analysis and synthesis of results are used during the research for this paper. Controlling is the latest "discovery" of a successful modern management and thereby specialized researches and literature are still scarce.

The basic *hypothesis* of this paper is that controlling contributes to the success of management, but this hypothesis expands to a sub-hypothesis which assumes that strategic alliances make their contribution to the development of its members, as well as enhancing their competitive advantage on market. This paper is divided into five chapters with an introduction and a conclusion while the fifth chapter has three sub-sections. The first chapter describes the work to strategic alliances and their basic characteristics, and the second chapter analyzes the management of strategic alliances and its members. The third chapter analyzes the strategy of diversification, as an inevitable and the most important corporate development strategy, used by the management of strategic alliances, as well as its members. The fourth chapter analyses the scope of development of strategic alliances which refers to the consequences suffered by industries that do not develop strategic alliances. The fifth chapter deals with the management and controlling of strategic alliances, and analyzes the importance of value orientation in controlling of a strategic alliance. There is given an example of calculation of company value EVA according to Stern / Stewart's model.

2. STRATEGIC ALLIANCES, THE CONCEPT, ROLE AND CLASSIFICATION

World business development takes place rapidly, and market competition is even more emphasized. Globalization, in terms of mastering the world market, generates bigger, enhanced and more complex forms of alliances among businesses. Corporations are no longer a novelty, and they are already deposed by these new alternate forms of large multinational companies, strategic alliances. What are strategic alliances? What is their role in global business? What are their goals?

Strategic alliances could simply be defined as organizational forms in which two or more companies are joined together in order to commonly achieve goals agreed in advance, to share profit and to contribute their own key competences while maintaining their independence and the control over their own businesses.[1]

To be clear, a strategic alliance represents agreement or contractual relationship between two or more companies in order to form a common business goal. This goal, as we shall see below, should be considered in terms of the purpose of creation a strategic alliance. Strategic alliances are occurring in all industries of the global business world. Their size varies but the smallest strategic alliances remain at the level of the national market, but regardless, they have all the characteristics of strategic alliances.

Strategic alliances, regardless of their size, enable their members to unite resources in order to achieve a common goal, as well as achieving individual goals of partners in the

[1] Yoshino,M., Rangan, S., U.: Strategic Alliances: An Entrepreneurial Approach to Globalization, Harvard Business Press, 1995

alliance. The members of strategic alliance can be connected horizontally, vertically and diagonally, and their cooperation is subordinate to the goal of the alliance and its objectives.

The goal, as the partners' motive for entering into a strategic alliance, can be: the access to new markets, acceleration of their entry to new markets, the division of research and development costs, as well as production and marketing costs, then replenishment of product lines, learning new skills.[2] Achieving these goals are the most common reasons for joining the company into the alliance.

Strategic alliances are developed and studied as formal inter-organizational forms that are based on achieving business success, not by competition, but through co-operation between companies.

A selection of business strategy of strategic alliances, considering the two strategic market positions (1) leadership and (2) followers, derive from four basic (fundamental, essential) motives.[3]

1. When the strategy of strategic alliances is based on the total company business and the company achieved a certain competitive advantage then the typical motive for entering into a strategic alliance is *defensive*. Defensive motive includes access to a particular market (markets) and / or technology, as well as providing resources. This case is found in large computer companies like IBM, or large communication equipment companies, such as Nokia. Such large companies form strategic alliances with a relatively small firms / partners, specialized for development of software solution so in that way they are outsourcing and seeking their own specialization;
2. When the monitored segment of business continues to be the base of company's business strategy, but the company has been more follower than a market leader, then the motive for such companies entering the alliance is called "catch up";
3. When the monitored segment of business and its business strategy are marginal for company, and the company takes the leading market position, then the motive for entering is called *retaining* motive. Such an example is the strategic alliance formed by major manufacturers of beer which put the beer as a "brand" on the first place;
4. When the monitored segment of business is marginal for the overall company business and the company is the follower on the market, then the main motive for entering a strategic alliance is *reconstructing.* [4]

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[2] Varadrajan, P.R., Cunningham, M.: *Strategic alliances: A synthesis of conceptual foundations*, Journal of Academy of Marketing Science, Vol.23, No. 4., 1995., p. 282-296

[3] Lorange, P., Roos, J.: *Strategic alliances; formation, implementation and evolution*, Blackwell Business, 2000., p.7.

[4] Ibid

Figure 1 Basic motive for entering the strategic alliances

	Strategic market position: Leader	Strategic market position: Follower
Basic	*Defensive motive*	*Catch up motive*
Marginal	*Retaining motive*	*Reconstructing motive*

Strategic importance of business segments

Source: Lorange, P., Roos, J.: *Strategic alliances; formation, implementation and evolution*, Blackwell Business, 2000., page 7

The motive for forming a strategic alliance as well as the entry of some company as a member into alliance has to be clear not only for the new member but for all members constituting the alliance. The motive is a base for setting a business strategic goal of every inter-organizational form and a mission and long term goal is the base of company management and strategic alliance.

3. MANAGEMENT OF STRATEGIC ALIANCES AND ITS MEMBERS

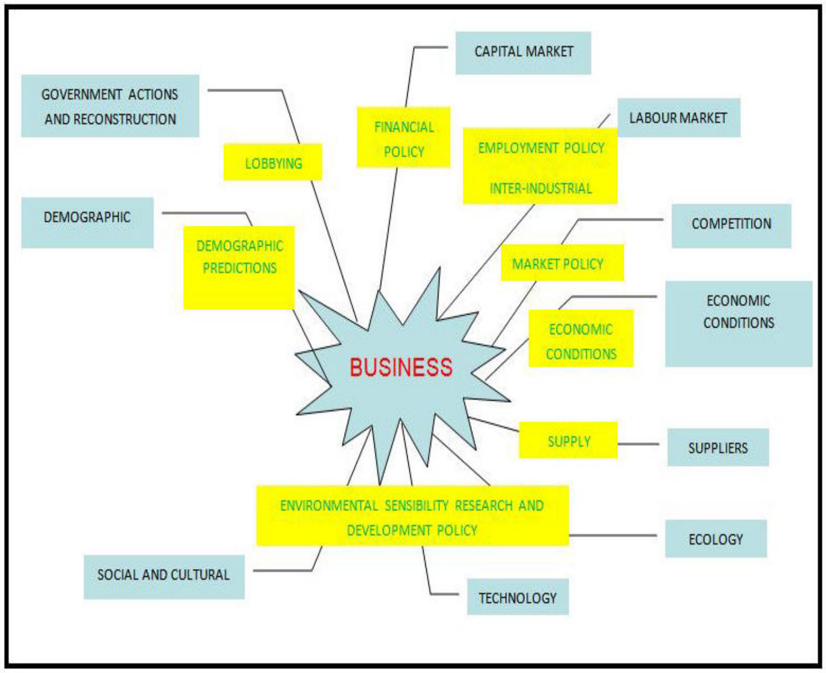
Strategic alliances are mostly developing strategic alliances management in order to realize strategic goal which is not the same as the goal of its members. So it is necessary to emphasize:

1. Basic strategic goal of strategic alliances is generally **stabilization of market share and conquering new ones;**
2. Basic strategic goal of strategic alliances members or companies is **realization of profit.**

Major market share is not a criterion for major profit nor is the major profit conditioned by major market share. So the question is: Whether members of the alliance reach the goal in the same way as when they were not in the alliance? The answer is negative.
Although the goal of every company is the profit, it is also the goal and purpose of business, but members achieve it through different development strategies before entering a strategic alliance and they do it also after the entry into the alliance. That is the essence of the alliance. Alliance is a new opportunity, but also a new strategy that has to be implemented by management.

It is clear that the company, as an independent business entity, disposes all the strategies but their use depend on internal and external environment changes. During the figuration of its business or company profile, the company faces many factors in quite complex external environment.

Figure 2 The basic factors of the complex external environment



Source: Luković, T.: „Strateški menadžment 1.“, Power Point, University of Dubrovnik, 2009./2010.

All known strategies, from corporative to generic ones, are available to the management of independent company. In addition to the basic strategic task of the company management, which is achieving profit, other more difficult tasks are placed - survival on the market and preservation of market share. Through the development of management, under the influence of the global crisis, evaluation of its performance is significantly changing and is increasingly measured by the size of the “value of the company”.

By entering strategic alliances, some of the tasks of companies’ management are becoming less expressed, because they exceed into the responsibility of the management of strategic alliances. Problems of adjustment with the external environment also exceed into the responsibility of the strategic alliance. Well-organized management of strategic alliance handles most of external factors as well as general and social environmental factors for the management of its members. In this way it achieves its primary strategic objective, maintains and increases market share. So the performance of strategic alliance management is measured by market value of strategic alliance on the global capital market and stock exchange. The question is: How does a strategic alliance maintain its value on the market or on the global stock exchange?

4. DIVERSIFICATION AS A FUNDAMENTAL STRATEGY OF STRATEGIC ALLIANCES

The purpose of the management of strategic alliances is the use of corporate strategy with a focus on developmental strategies. Developmental strategies become the dominant strategies for the management of strategic alliances, which means that the development is imperative! Development becomes a link between the goal of members of a strategic alliance, profit and the goal of strategic alliance which is to increase market share as well as to increase market value of the alliance on the market.

Figure 3 Development as a link between strategic alliance and its members

Source: Authors Ćorić, I & Luković, T.

While in our social life we are taught to live with the ill people as our equals even though we are healthy, in the business world of competition the Spartan rules and laws are applied according to which only healthy ones have the right to live. Yes, clearly these are two worlds with very different rules of life, and both are right.

In the world of successful business development becomes imperative, and it is realized by the successful management and a successful and healthy company. So the diversification strategy is becoming a central strategy for the management of strategic alliance. Diversification strategy can be divided into six sub-strategies:

1. Diversification of the product;
2. Diversification of portfolio or capital;
3. Diversification of production;
4. Diversification of risk;
5. Combined diversification;
6. Diversification of expenses.

Diversification of risk is fundamental for management of strategic alliance. It manifests itself in two directions. On the one hand the management of strategic alliance has the task to help the members in a balanced and stable development, investing all of its capacities and resources. If one of the members, despite everything, starts to lag behind in development, or cannot follow the growth and development of other members, and its lag starts to undermine the market value of the alliance, it will have to leave the alliance. It won't be any place left for it in the alliance.

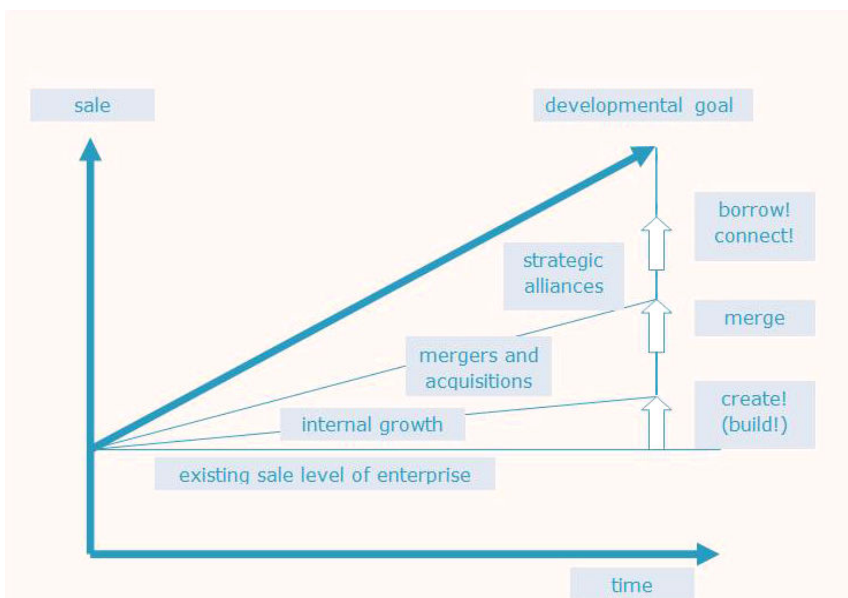
Diversification, in terms of reducing risk and maintaining the stability of the alliance and its members, has the character of conglomerate or incoherent diversification, which carries out the distribution and risk reduction. The main characteristic of conglomerate strategy of strategic alliance is strong market orientation.

5. THE SCOPE OF DEVELOPMENT AND ORGANIZATION OF STRATEGIC ALLIANCES AND DIFFERENT EFFECTS ON THE INDUSTRIES IN THE GLOBAL BUSINESS

Different industries realize different forms and types of strategic alliances with different levels of development. The imperative of development, in terms of connecting profit, as a goal of members of strategic alliances, and increasing market share, as a goal of the strategic alliance, makes this connection a business hit.

Therefore the strategic alliance is for now the highest scope of strategic management and the safest organizational form which supports development.

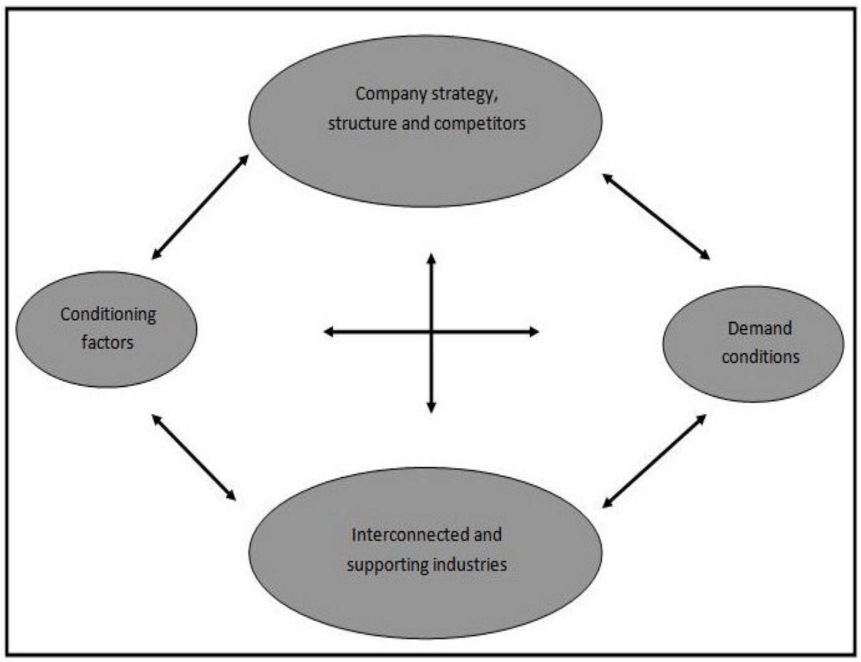
Figure 4 Methods of implementation of developmental strategies of companies



Source: Buble, M.: „Strateški menadžment", Sinergija, Zagreb, 2005., p. 118.

Strategic alliances are the confirmation of correct results of professor doctor M. Porter, who, in so called "Porter's diamond", gave the answers to two basic questions that introduced strategic management into the world of macro strategic management. Porter's Diamond answered the questions: (1) Why are some nations more competitive than others? (2) Why are some industries within the nation more competitive than others? These questions are directly related to strategic alliances and their basic philosophy that deny all the boundaries and make the market global.

Figure 5 Porter's diamond, four basic strategic factors on macro level



Source: Luković, T.: „Strateški menadžment 1“, Power Point, University of Dubrovnik, 2009./2010.

Interconnection within the strategic alliance, whether organized vertically, horizontally or diagonally, maximizes the competitive advantage of strategic alliance and its members. However, differences within the industry are essentially different. Some industries, such as trade, have developed the most sophisticated forms of inter-organizational strategic alliances, while others have not reached that level of development yet. The best example of an industry in deep crisis is the air passenger transportation. This industry with very powerful capital that in Europe has about 500 airports with around 1.2 million employees which service approximately 150,000 so-called. "air routes". The importance of the airports in the economies is in workplaces because one post at the airport hires 2.1 additional jobs outside the airport. It is predicted that by the year of 2030, 39 European airports will be overloaded while 50% of them won't be dangerous for passengers and 25% of European air traffic will be uncomfortable. All airports operate with high profit and enter into the expansion of its capacities. At the same time, many airlines, regardless of their size, operate at the edge of cover costs or generate negative results. Meanwhile insurance companies are increasing their premiums because passengers suffer greater damages on their travels, from lost luggage, flight cancellations and the travel comfort has almost vanished. This difficult situation in the airline industry could easily be solved by organization of strategic alliances which would contribute to the sustainable development of the whole industry. At the same time, the passenger is increasingly dissatisfied, and the flight routes have become everything but satisfying. Connecting the airport and airlines in strategic alliances, at least with loose connection, is still just an illusion.

Therefore, the scope of development of strategic alliances in different industries of the global business world is very different.

6. ROLE OF CONTROLLING IN VALUE ORIENTED AND SUCCESSFUL MANAGEMENT OF STRATEGIC ALLIANCES

6.1. Positioning of controlling and management of strategic alliance and its members

Under the influence of sharp market competition, the manager became a central subject and the culprit of success as well as failure of businesses, including strategic alliances. Studies have shown that the company failure is manager's fault in 99% of cases.[5] Decisions of managers bear the highest personal responsibility, and thus psychological burden. The manager became the most wanted resource and relatively consumable resource on the human resources market. Therefore, efforts are made to reduce his workload as well as the risk of his decisions to a minimum, while retaining his responsibilities. So the companies introduced internal controls and internal audits. These are all headquarters functions of management, which still have not proved sufficient. Knowledge and skills acquisition as a contribution to the reduction of management risks created a controller as well as controlling as a new headquarters function of management.

Controlling, as well as management appeared in America, but have not developed enough. Requirements that are placed before the controller and his education began to develop in German school for controlling about 20 years ago. Controlling is now inevitable headquarters function of each major and serious, market-oriented company, including strategic alliances. Without controlling the successful management has become inconceivable. But what is controlling?

We meet various definitions of controlling and will mention only significant ones:

Controlling is a process which evolves as a result of balanced mutual efforts of management (individual or team) and the controller, in order to achieve the set target of

[5] Siropolis; N.C.: „Menadžment malih poduzeća“, fourth edition, MATE, Zagreb 1995, p.18.

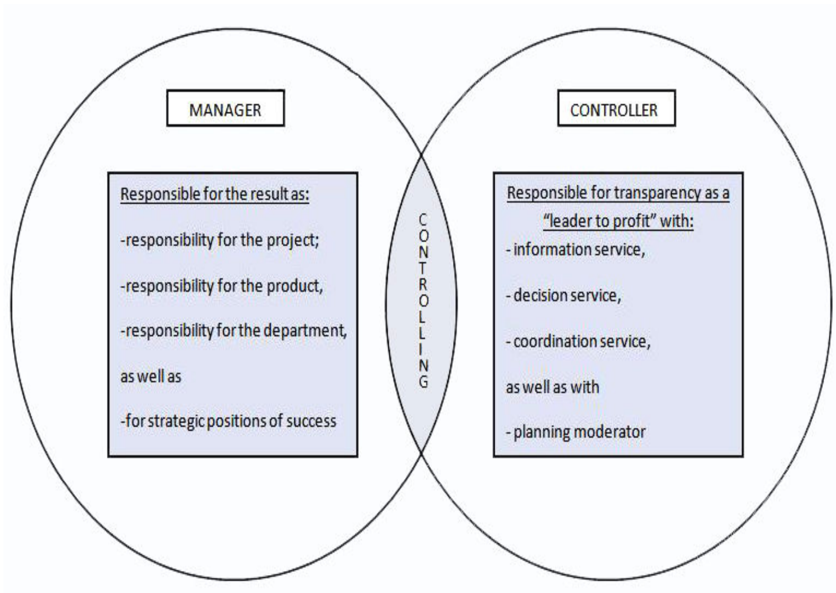
the economic subject.[6] Controlling is the navigator of all activities of the economic subject towards the realization of company's goal.[7] Controlling is the selection and application of methods (techniques, instruments, models, patterns of thought), and information for planning and control processes that occur on the basis of labor division as well as comprehensive coordination (synchronization) of these processes.[8] Controlling is the function and subsystem of management which contributes to the efficiency and effectiveness in the work of management, increasing the ability of companies to adapt to internal and external changes, increases the vitality of the company and its market eligibility.[9] Controlling is a set of multidisciplinary skills necessary for collecting the optimal amount of those required by managers and everyone who controls the company for quality decision-making, based on numerous data from company, but also outside of it.[10]

In business decision making often happens that the information in management disposal has not been sufficient to make quality business decisions. Although the information which are supplied to management by controlling, are primarily based on information obtained from the accounting, controlling is not exclusively related to accounting. It observes and explores all the functions and processes in the company and offers better solutions.

In addition to quantitative, qualitative parameters are also included, so except of accounting data it also observes vision and strategy, organization, control system and management of human resources.

[6] Luković, T., Lebefromm, U.: „Controlling, koncepcija i slučajevi, First Book“, University of Dubrovnik, 2009, p. 5.
[7] Lebefromm, U.: „Controlling – Einfuhrung mit Beispielen aus SAP ERP R/3, Managementwissen fur Studium und Praxis“, R. Oldenbourg Munich, Vienna, Oldenbourg, 1997, p. 1.
[8] Ziegenbein, K.: „Kontroling“, RRiF Plus, Zagreb, 2008, p. 25.
[9] Osmanagić Bedenik N., „Kontroling abeceda poslovnog uspjeha“, 3rd edition, Školska knjiga Zagreb, 2007, p. 15.
[10] Očko J., Švigir A.: „Kontroling – upravljanje iz backstagea“, Knjigaprint d.o.o., Zagreb, 2009, p. 13.

Figure 6 What is controlling and how does it evolve?



Source: Luković, T. & Lebefromm, U, „Controlling, koncepcija i slučajevi, Prva knjiga", University of Dubrovniku, 2009., p. 6.

In organizational terms, controlling is, along with the internal audit, a new headquarters function and management partner.

In analyzing the two main controlling entities, manager and a controller, it is necessary to distinguish their roles in the company. General duties are apparently similar, regardless of the activity, although one should always start from basic differences between them, and those are: the manager is responsible for the success / results of the company and he makes responsible decisions, and the controller is his adviser and partner on the path to the goal (Controller Verein - German controller club), or as a professor Albrecht Deyhle said "plans and objectives vendor".[11] So the special duties of manager and controller, each in his role, require adjustment and understanding of the company business.

If we analyze the positioning of controlling of strategic alliance and its members, it is necessary to consider the differences between the goals of management of the strategic

[11] Deyhle, A.: „Controller-Praxis (Führung durch Ziele - Planung – Controlling)" 15th edition, Verlag für ControllingWissen AG Offenburg, Offenburg 2003, p. 10.

alliance and its members, and set goals according to four basic controlling characteristics.

Table 1 Basic characteristics of controlling

Focusing the company goal	Controlling functioning
-Goal formulation	- Narrow market orientation, offer and demand monitoring in order to realize operational and strategic success / goal - Target oriented organization and functioning of all activities of economic subject
-Goal conduction	- Orientation and conduction of all activities aiming to make profit
-Goal realization	- Orientation and conduction of all processes towards future in terms of successful business activity in the future

Source: Mayer, E. & Weber J.: Handbuch Controlling, C.E. Poeschel Verlag Stuttgart, Stuttgart, 1990., p. 35.

According to this it is clear that the controlling of members of a strategic alliance has a function of the realization of company's profit while controlling of a strategic alliance is in the service of positioning strategic alliance and its members on the market.

6.2. Value-oriented controlling and management

Value-oriented management and controlling have become successful form of company conduction without any alternative. The result of that is evaluation of their personal success. The global crisis created the concept of value-oriented management and controlling which place the value of the company in the foreground. All classic parameters of success are contained in preservation of the company value as well as in possible growth, but the preservation of capital value is certainly the most important in economics.

In value-oriented management and controlling, the fundamental business goal is to increase the value of the company. Static method of calculating the company value is a characteristic of the past, which means that the balance sheet, along with several others, is only one aspect of the evaluation of the company value. The development of shareholding promoted dynamic calculations of shareholder value, which are accompanied by controversial views. Value driven management must consider the fulfillment of stakeholders' interests which are very important for it and the company. The priorities or priority groups are set, because it is not possible to satisfy the interests of all groups. Therefore, some opinions indicate that placing the needs of shareholders in the foreground, means putting the needs and interests of other stakeholders in the background. The interests of stakeholders are conflicted, and when they occur in a person it creates irresolvable conflicts of interest at the level of that person. For example, employees are during the day focused on maximizing earnings while minimizing the effort. In the afternoon, as consumers, they are seeking to lower the prices of products which affect the salaries of workers. In the evening, if the shareholders, reading the daily stock market reports, are interested in higher share value of the company, it will also have an impact on salaries and prices formation. During one day, an active person goes through a series of conflicting interests and approaches in one and the same company.

6.3. EVA[12] and the company value

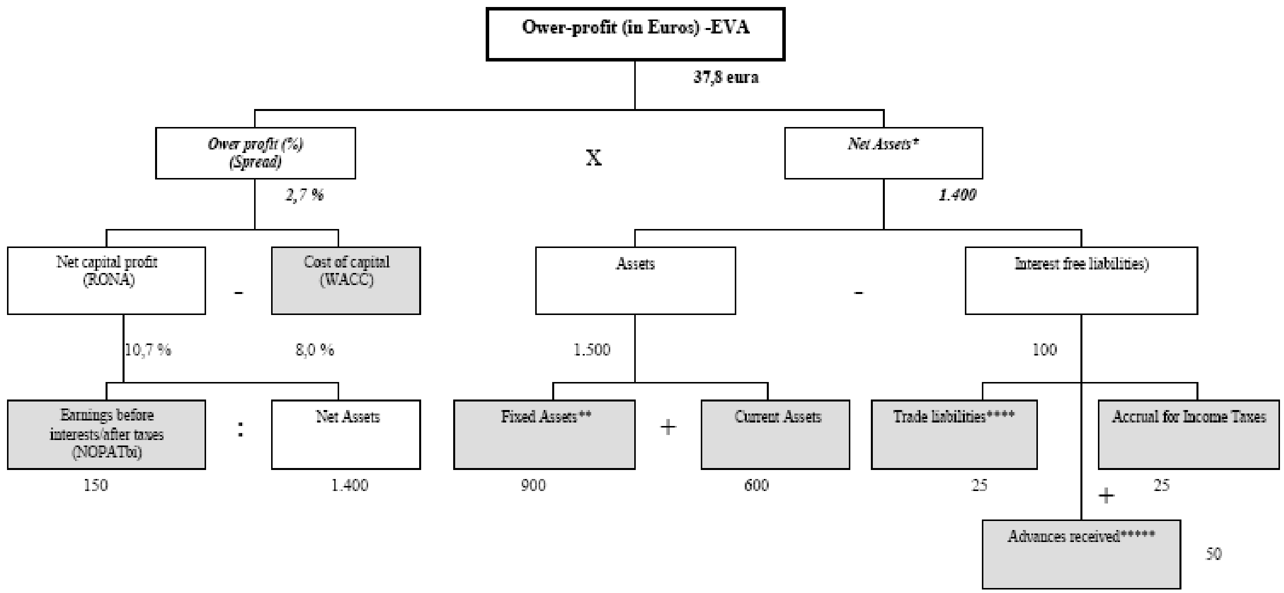
Value-oriented management has the task to ensure the value of the company, maintain it and work on increasing it. Its success is measured through the maintenance and development of the company's value.

In a global business system a true criterion of the company value is relative. It is almost daily variable so every move and management decision has to be transparent and it is evaluated by the market and expressed by the decrease or increase of the company value on the capital market. The capital market of global business is very dynamic and transparent but also very stern concerning the evaluation of management and the value of the company. This refers to stock exchange and the companies values on stock market. Strategic alliances and companies evaluate their true values in the stock exchange. However, the questions are how to calculate the value of our strategic alliance in market conditions, regardless of stock market? How to use market parameters and how our capital and how to enter a time as a component? Here is a model of EVA as a very practical example of how the value of a strategic alliance and its members can be calculated if you are not on the stock market.

EVA model by Stern / Stewart calculating the value of the company, consists of two basic parts, (1) of invested assets and (2) of decennial possible over-income (Spread).

[12] EVA model from Stern/Stewart

Figure 7 Example of functioning of EVA model by Stern / Stewart, by the example of an "X" as a member of the strategic alliance, "Y"



Legend:
* Net Asset – net invested assets
** Fixed Assets – long run/fixed assets
The market value added of the company = 37,8 euro : 0,1 = 378 euro + 1.500 euro = 1.878 euro

EVA model shows how this company's market value can be estimated at 1.878 euro, and over-income (spread) is the extent which increases its value and indicates the success of management. The market value of the member company is called Market Value Added.

The value of strategic alliance is the total value of the companies / members of the alliance.

7. CONCLUSION

Strategic alliances are the highest scopes of modern global multinational corporate business. As one form of business organization it achieves remarkable market results in the competitive market game. They are found in all industries, but with substantial differences in the scope of development. In some industries, strategic alliances are at the lowest level of development and those industries thereby suffer the greatest damage. Some industries, influenced by strategic alliances are developing very well. The fear of some economic analysts that small enterprises could be destroyed by strategic alliances has proven to be unjustified. Strategic alliances, moreover, contribute to and support the development of small and medium enterprises, as well as specialization. For members, strategic alliances represent a great deal of security and encourage the development of each member. Diversification strategy supports balanced development of its members and a member who cannot keep track with the development, must leave the alliance. The main "culprit" for success as well as for failure of each member and alliance itself is the manager or management. The burden of decision making as well as the burden of success that is carried by manager is on the highest level of difficulty. His decisions are subject to business risk and business in crisis calls for new indicators of his success. On this path of success, his backbone, in terms of "plans and objectives vendor," is the controller. Doing business in crisis and preserving capital value of the company has put managers and controllers into the focus of interests so we are talking about value-oriented management and controlling. The value of the company is also a parameter of management performance. Preserving and increasing company's market value is the task of management, and therefore of controlling. The value of the company or its assets may be increased only by the realization of profits and therefore profit is the basic goal of every companies business. The calculation of the company value viewed dynamically, for the purposes of management and the owner of the capital, can easily be calculated through EVA model by Stern / Stewart.

To conclude, we can confirm that the role of controlling in the management of strategic alliance and its members is exceptional, and the performance is adjusted to subordinate the fundamental goals. The goals of the strategic alliance and its members are not the same, but they are complementary.

Strategic alliances are our present and our future and we need to continue to seek and explore them so we consider that we have made a modest contribution to this research working on this paper.

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THE USE OF HEDGING IN CROATIAN ECONOMY: ANALYSIS OF SURVEY RESULTS

ABSTRACT

The results of the survey "The Use of Hedging in Economic Entities in Croatia" using representative sample was conducted from October to December 2009 and pointed out two important issues regarding hedging and Croatian economy:

1. *Hedging is weakly present in business practice of Croatian entities, and businessmen are not well informed on hedging techniques and its influence to business;*
2. *Despite bad awareness and practice (or precisely because of it) everybody is convinced that hedging is important and useful, and that it should be applied as soon as possible.*

There are apparently certain restraining factors, in Croatian economy and society in general, which prevent larger widespread of hedging in Croatia:

1. *Small economy;*
2. *Extremely atomized (fragmented) economy;*
3. *Lack of distinct export orientation;*
4. *Lack of global strategy of economy development (in Croatia);*
5. *Low education structure and insufficient education of management and other cadre;*
6. *High degree of resistance to changes (general disinterest).*

Clearly these factors do not reflect only economy, as their change also requires long term modification, restructuring and modernization of entire society. It brings us back to vicious circle, i.e. to question "which came first, the chicken or the egg". The question is actually whether hedging encourages development and modernization of economy and society or if modern, developed and rich economy and society use and encourage hedging as an expression of modernity and sophistication of economy.
Being in favor of the second possibility, every effort for change and progress would be meaningless and doomed to failure.
Hedging as a modern economy instrument should be regarded as financial modernity and achievement of contemporary economy; something like a computer, mobile phone, optical wire and similar, something that is not originally Croatian invention but is widely accepted in Croatian economy and society.

One of the most efficient ways of economic integration of the entire national economy into global economy would be to activate companies to trade more intensively on the world's futures markets (especially hedging).

Key words: futures trading, hedging, Croatian economy, analysis, companies, development & modernization

JEL classification: G15, G32

1. INTRODUCTION

Significance and relevance of contemporary world of futures markets is perhaps best described by the average daily volume of 900 billion dollars, which is almost equal to gross domestic product of France. Croatian share on such a huge market is none or almost imperceptible, and unless certain moves regarding education and gradual implementation of future trading techniques in our companies are done, situation will remain unchanged.

Such a trading is performed on futures markets or stock markets; generally speaking, futures business is the expression for sale and purchase of commodities, securities, foreign currency and similar in predetermined period of time where the delivery and payment are agreed upon on specific subsequent deadline. Option stands for the financial instrument which grants buyer the right but not the obligation to perform a transaction in future. Futures markets grew as a result of trying to avoid the instability of commodity rates; those are markets of exchange of the instruments derived from basic commodities or securities, and not exchange of basic commodities.
On the other hand, while being employed in one tourist agency, I noticed big problems regarding instability and huge susceptibility of tourism market, as well as volatility of exchange rates.

This problem surpasses tourism and affects many different sectors of Croatian economy such as shipbuilding, commerce, banking etc. Idea and need to question and determine whether and in which proportion Croatian businessmen, especially in the tourist sector use the futures markets possibilities, rose from the facts that the above mentioned problems expand, that the futures markets in world economy play huge role and that there are no formal obstacles for Croatian companies to "join the play". By the possibilities of futures markets, it means firstly the protection from sudden and unpredictable events and price changes on the markets, regardless to oil, steel, vessel space or currency prices.

By entering the World Trade Organization (WTO), Croatia showed it is prepared for the challenges of international market. It also actively joined the European integration processes such as Stability Pact, membership at CEFTA and it opened and strongly stepped into negotiations for EU accession process. Considering the relatively small market and open economy, the Republic of Croatia is necessarily directed to global market partners.

Hence, the priorities of Croatian economic policy are obvious and logical – continuance of building up the stable economy which is competitive on the global market, continuous reinforcement of macroeconomic stability and development of sustainable economy, increase in export and employment. The particular emphasis is on creating a favorable business environment such as in the European Union, further development and reinforcement of market economy, promotion of international competitiveness, and entrepreneurial and market freedom. Major features of Croatian economy, according to the shares of certain sectors in GDP structures are: - agriculture (7%), industry (30%), services (63%) in which tourism has crucial role.

The importance of tourism for Croatian economy is best seen by information that tourism makes 20% of its gross domestic product and that it represents the main development frame for many counties, regions and cities.

Bearing in mind all these facts and information, as well as the fact that mediation and hospitality industry are core pillars of tourism in Croatia, we are faced with two basic business problems: low profitability (tourist agencies) and high fixed costs and low capacity utilization (hotels), which necessarily problematizes the acceptable profitability of the entire business.

It is therefore logical to determine whether potentials of futures markets, firstly hedging have been used in order to avoid uncertainty and risk and to improve financial effects, thus improving the position of Croatian economy on the global market. The main reason for accentuating tourism is not only its importance for development and increase of Croatian economy but organic relation between tourism and world markets, contemporary movements and constant adaptation to unstable tourist demand. Not only tourism, but all sectors, firstly shipbuilding, commerce, construction industry, traffic and similar sectors should also use the possibilities and advantages of hedging.

Considering the proclaimed priorities of the Croatian economic policy, there is a question of how and to which extent can hedging, as one of the strategies of trading on futures markets whose primer goal is management of price risks, help and contribute to faster realization of those goals / priorities.

Other transition countries of South-Eastern Europe could benefit from the experiences, problems of (not) using futures markets, as well as from the level of knowledge on the topic and suggested measures to contribute to better usage of hedging.

2. THE USE OF HEDGING IN CROATIAN ECONOMIC ENTITIES

2.1. Basic characteristics of survey sample in the conducted survey – knowledge and usage of hedging in Croatia

The most important was to question to what extent certain entities in Croatian economy use certain instruments of futures market and to which extent has the usage of such instruments affected their business, as well as the attitude of the management of the Croatian companies towards futures trading.

Data base of Croatian Chamber of Economy (www.biznet.hr) which has all information on registered economical entities in Croatia has been used for selection of companies for survey sample. The criteria for selection were: company size (number of employees), economy sector (hospitality industry, shipbuilding, travel agencies, transport, commerce, construction industry, finances) and annual export value (financial reports from 2007) larger than 100.000 Euros. Out of 1.619 companies registered in the *Croatian Export Directory* (www.izvoz.hr), 124 (7, 69%) companies were sent the questionnaire by e-mail or mail. In October 2009, 26 completed questionnaires were returned, and in December another 17 examinees answered the questionnaire, thus making total of 43 (34,68%), i.e. more than a third, which is sufficient sample for brining relevant conclusion necessary for this dissertation.

Criterion for selecting companies for the sample was that company hires more than twenty five permanent employees. According to EU regulations, companies are considered small if they have less than 50 employees, middle-sized if number of employees range from 50 to 250 and big if there are more than 250 employees.

In analyzed sample the structure was as following:

Table 1 Sample structure regarding company size

SAMPLE STRUCTURE REGARDING COMPANY SIZE		
Company size	***Number of companies***	***%***
Small company	5	11,63%
Middle-sized company	23	53,49%
Big company	15	34,88%
Total	43	100,00%

Source: author

These companies are classified in different activities according to the National classification[79] compatible to the recommendations of the European classification of economic activities, used as well by the Croatian Bureau of statistics[80].

[79] www.narodne-novine.nn.hr/clanci/sluzbeni

[80] www.dzs.hr

Table 2 Business of analyzed companies

BUSINESS OF ANALYZED COMPANIES	number	%
Hospitality / catering industry	5	11,63%
Tourist agencies	2	4,65%
Construction industry	8	18,60%
Transport	6	13,95%
Commerce	9	20,93%
Financial mediation	5	11,63%
Shipbuilding	3	25,00%
Others	5	11,63%
Total	**43**	**100%**

Source: author

2.2. Survey results

Within the conducted survey, the examinees were sent a questionnaire comprising ten questions; response statistics and commentaries are given in the following tables.

2.2.1. Understanding futures market

Table 3 Understanding futures market

1. Understanding futures market		
Question	Answer	%
I am not acquainted with it	11	25,58%
Slightly acquainted	16	37,21%
Well acquainted	12	27,91%
Very well acquainted	4	9,30%

Source: author

Presented data enable us to conclude that Croatian businessmen are not well informed on futures trading as more than 62% of them are not acquainted or are slightly acquainted with the notion of futures trading.

2.2.2. Resource of futures trade knowledge

The further question was related to the way employees got informed to the futures trading.

Table 4 Resource of futures trade knowledge

2. Resource of knowledge		
Question	Answer	%
Through university education	6	13,95%
Through media	14	32,56%
Through seminars	3	6,98%
By personal communication	20	46,51%

Source: author

Given responses show that majority of examinees (46%) got acquainted with futures trading by personal communication, while media are on the second place (33%), and the rest of examinees (21%) got acquainted with the concept through university education and specialized seminars.

2.2.3 .Usage of futures markets

In addition, the survey analyzed the number of companies using futures markets in their daily business, the basic strategies they use and basic reasons of deficient usage of futures markets.

Table 5 The use of futures markets

3. The use of futures markets		
Question	Answer	%
YES	7	16,28%
NO	36	83,72%

Source: author

Information that only 16% of companies use some form of futures trading is defeating. This information is far from satisfying since trading on futures market is one of the most important ways of gaining competitive advantage, especially on global market.

2.2.4. The use of trading strategies

Table 6 The use of trading strategies

4. The use of trading strategies		
Question	Answer	%
Speculation	0	/
Arbitrage	0	/
Hedging	5	83,33%
Options trading	1	16,67%

Source: author

Regarding the used trading strategies, the research clearly shows that barely 14% of companies use some of the given trading strategies on futures markets: hedging (83%) and options trading. The structure of these results is not surprising as hedging and options trading mainly serve for risk protection.

The speculation strategy grants high profits and requires high risks which our businessmen avoid, while the simple arbitrage became a rarity due to informatization and globalization of world markets.

2.2.5. Type of market

Table 7 Type of market

5. Type of market		
Question	Answer	%
International	6	100,00
Domestic	0	/

Source: author

Since it is only possible to trade on international futures markets, given results are logical and expected.

2.2.6. The reasons for insufficient use of futures markets

According to the examinees, the first reason for deficient use of futures markets is insufficient education of the staff (72%), the second one is low level of knowledge and the third is the lack of company management initiatives.

Table 8 The reasons for insufficient use of futures markets

6. The reasons for insufficient use of futures markets		
Question	Answer	%
Insufficient level of knowledge	7	16,28
Insufficiently educated staff	31	72,09
Lack of managements' initiatives	5	11,63
Other	0	/

Source: author

Since the questionnaire was filled in by the management staff, they obviously put all the blame to other employees.

2.2.7. Competition and futures trading use

Even more than 81% of examinees consider that the use of futures trading will become inevitable in future and that it will be imposed by stronger competition in the market.

Table 9 Competition and futures trading use

7. Will competition force companies to a larger use of futures trading?		
Question	Answer	%
YES	35	81,40
NO	8	18,60

Source: author

2.2.8. Deadline in which futures trading will expand

Table 10 Deadline in which futures trading will expand

8. Deadline in which the use of futures trading instruments will suddenly expand		
Question	Answer	%
1 to 3 years	8	18,60
3 to 5 years	27	62,79
More than 5 years	8	18,60

Source: author

Almost two thirds of examinees consider that the expansion of trading on futures markets in Croatia will happen within 3 to 5 years. Only 18% are optimistic and think it might happen in the next 1 to 3 years, and the same number of examinees thinks that the expansion of trading on futures markets will not happen within the next 5 years.

2.2.9. Evaluation of necessary infrastructure for usage of futures trading instruments

Table 11: Evaluation of necessary infrastructure for usage of futures trading instruments

9. The degree of conformity with given statements	
Statement	
1. The usage of futures trading instruments would increase the business profitability	4,72
2. Financial market in our country is developed enough to successfully implement futures trading	4,05
3. Tourist market is successfully developed to implement futures trading	3,74
4. The most important function of futures trading is risk protection against price change	4,88
5. State should have an important role in forming futures	3,9

Source: author

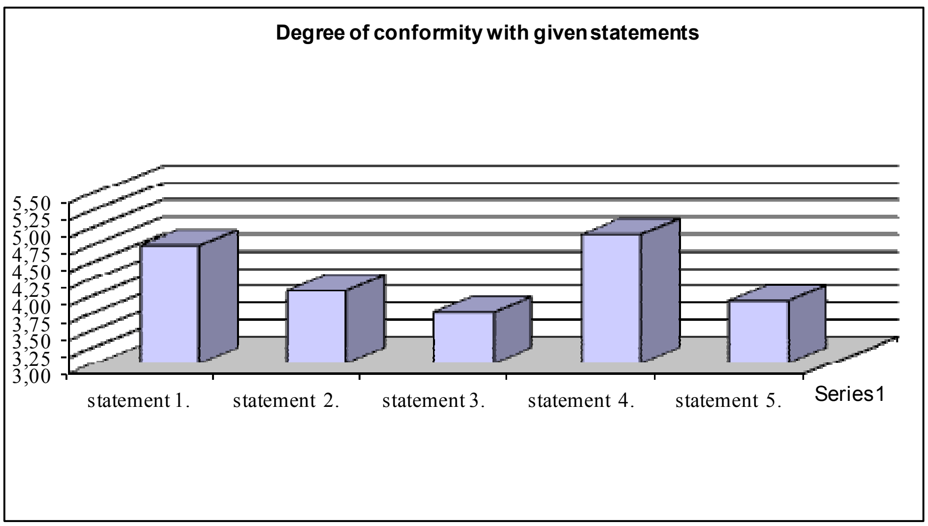
The statement that the most important function of futures markets is risk protection against price change (4,88) got the highest degree of conformity with statements in questionnaire. The highest degree is calculated as an average evaluation of given

responses. This result is not surprising as most of examinees are from tourist, transport and shipbuilding sectors which are largely open and vulnerable to change price.
The examinees are completely aware that the usage of trading instruments in futures markets would increase business profitability (4,72).

Bigger number of examined managers strongly believes (4,05) in solid development of Croatian financial market, while the statement about our tourist market being developed enough for successful usage of futures trading got weaker average grade (3,74).

The statement which says that the state should have an important role in forming the futures market in Croatia is on the last place (3,90).

Figure 1 Degree of conformity with given statements (Ref. Tab.11)



Source: author

2.2.10. Futures trading instruments and business profitability increase

Table 12 Futures trading instruments and business profitability increase

10. The usage of futures trading instruments caused increase of business profitability		
Question	Answer	%
YES	6	100,00
NO	0	/

Source: author

The positive response to a question whether the usage of futures trading instruments causes the increase of business profitability of the company supports a thesis which claims the same: Croatian entrepreneurs who use futures market have better financial result. Finally, all examinees were asked if they were interested in the final results of this survey and all answered positively. It is thus a good indicator of interest of a large part of Croatian managers for this issue.

3. MEASURES WHICH WOULD CONTRIBUTE TO BETTER AND LARGER USAGE OF HEDGING IN THE CROATIAN ECONOMY

The results of the survey *"The use of hedging in economic entities in Croatia"* point out two important issues regarding hedging and Croatian economy:

1. Hedging is weakly present in business practice of Croatian entities, and businessmen are not well informed on hedging techniques and its influence to business;
2. Despite bad awareness and practice (or precisely because of it) everybody is convinced that hedging is important and useful, and that it should be applied as soon as possible.

There are apparently certain restraining factors, in Croatian economy and society in general, which prevent larger widespread of hedging in Croatia:

1. Small economy;
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Clearly these factors do not reflect only economy, as their change also requires long term modification, restructuring and modernization of entire society. It brings us back to vicious circle, i.e. to question "which came first, the chicken or the egg". The question is actually whether hedging encourages development and modernization of economy and society or if modern, developed and rich economy and society use and encourage hedging as an expression of modernity and sophistication of economy.

Being in favor of the second possibility, every effort for change and progress would be meaningless and doomed to failure.
Hedging as a modern economy instrument should be regarded as financial modernity and achievement of contemporary economy; something like a computer, mobile phone, optical wire and similar, something that is not originally Croatian invention but is widely accepted in Croatian economy and society.
So, what can be done, which measures can be brought, which steps should be taken to encourage larger usage of hedging in the Croatian economy?
In order to avoid encouraging pretentious structural changes of Croatian society and economy, the next steps would be sufficient (and necessary) to achieve indicated objective:

1. Encourage companies to stronger functional connections within clusters in order to use the advantages of economy of scale;
2. To develop formal (schools, universities) and informal (seminars, publications, newspapers) education in contemporary finances and international trading. To introduce a program of permanent and mandatory professional trainings for company managers which would include, among others, trainings on hedging techniques advantages, and which would introduce them with world practice, Croatian experiences and theoretical accomplishments in this filed;
3. Stronger engagement of the government regarding encouraging and promoting hedging, firstly through big companies and institutions they own (National Electricity Company HEP, Croatian motorways, INA oil company (?), Croatian National Bank etc),
4. Assignments of state supports, guarantees and incentives should be more related to thoroughly transparent and modern business and business policy, which definitely includes protection against price and similar changes on world markets (hedging).

Principle and declarative measures have no effect in economy; it is necessary to implement far deeper and more comprehensive measures and reforms in order to obtain positive moves in economy. Enlargement of competitive economy and bigger export will be the results of such measures which demand far more serious and methodical engagement and require more time.

Thus, the State and its institutions are to react; they play the most important role in promoting all necessary changes and reforms, as well as in encouraging hedging as one of the risk protection business measures. It is natural that State gets such a role as it is still the biggest employer in the country and holds all economical, financial, educational and other strings; thus, it needs to show that hedging can and must be done through its companies.

Likewise, we can not forget that the State can hedge (through its agencies) on futures markets thus hedging its already enormous debt.

Recent (November, 2009) emission of dollar bonds of 1,5 billion USD value with ten year due date and with 6,75% of interest rate (based on the LIBOR plus a margin) has been done at the moment of extremely low LIBOR and low dollar value. Considering the debt deadline, what can be expected in future? The level of LIBOR and dollar will certainly increase in future which means significant rise of debt. Already 1% of dollar value increase in relation to kuna, and simultaneously the increase in LIBOR for minimal 1%, cause an increase of annual amount of interest to about 3 million dollars.
Compulsory measures can not of course force one company to use hedging. However, rich world experience in hedging, permanent and comprehensive education, informing entrepreneurs of hedging efficacy for their companies and finally, creating conditions for gradual and comprehensive introduction of hedging into Croatian economy would help achieve the results much faster and with more quality.

Another appropriate example is the fact that Croatia has no gold reserves, and all currency reserves are in dollars and euros. Currently they amount to around 8,5 billion of euros. The amount of reserves of the Croatian National Bank oscillates according to the rates of the currencies and should at least amount to three month value of the entire import and export of commodities and services. According to World Gold Council information[81], portion of gold of the reserves (June 2010) of USA is 78%, Germany 68%, France 66%, Austria 56%, and European Central Bank holds 59% of its reserves in gold. Some countries like China, Russia or Saudi Arabia have doubled their gold reserves in the past two years. WGC also states that world gold reserves are growing fast and are now around 30,5 thousands of tons. Current spot price of gold is 1.250$ per ounce and will probably reach 1.600$ till the end of the year.

Previous information show that all countries (or at least most countries) hedge their reserves from volatile foreign exchange market and that hedging became more intensive during the global financial crisis. Thus, even the neighboring countries (Slovenia and Serbia) deposited part of their reserves in gold. If Croatia had done the same, besides hedging its reserves, it would also have been a role model to other economic entities who should deal more seriously with hedging in their business.

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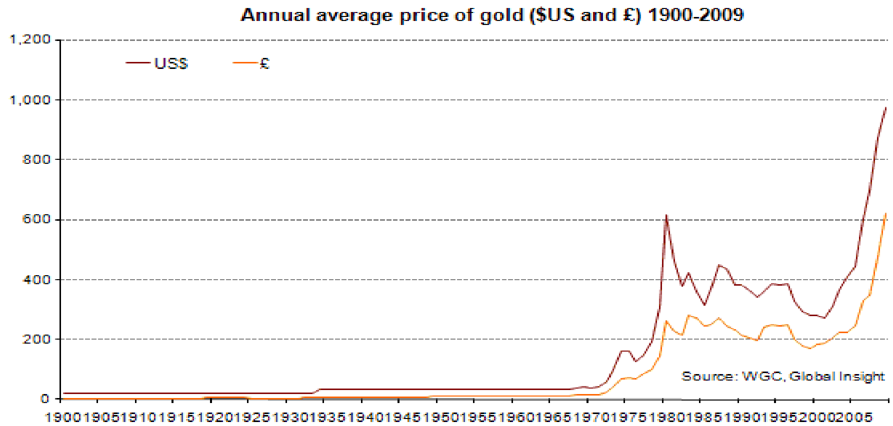
[81] www.gold.org

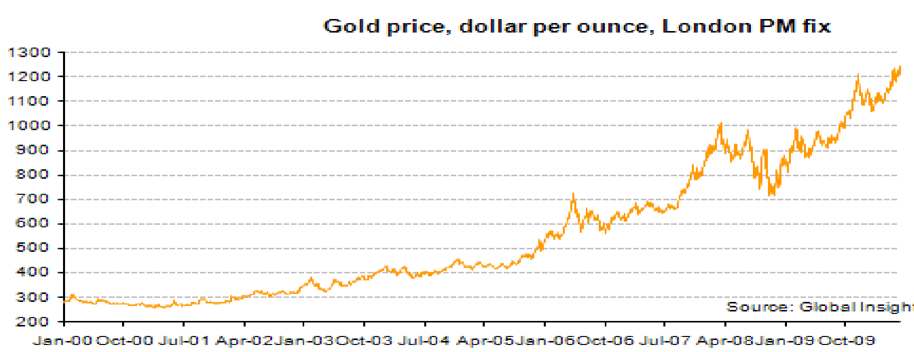
Fig.: 2 Annual average price of gold 1900 - 2009



Source:www.research.gold.org/prices/

As seen from this history chart, gold price on world markets has constantly increased (observed as a trend) since annulment of the Gold Standard in 1970, and severe price growth has been constant since 2005, which is of course directly related to the volatility increase of world markets and world economies and with intensive financial and economy crisis.

Fig. 3 Gold price movements from January 2000 to October 2009



Source: www.research.gold.org/prices/

Higher risk indeed causes the rise of gold investment as gold is traditionally safe commodity; it of course results in bigger demand and higher gold price; and later inclusion to this process makes it more expensive and less effective (Fig. 3).

4. CONCLUSION

Representative survey of economic entities show the following characteristics: more than 62% of examinees are not acquainted or are slightly acquainted with futures trading, 28% state that they are well informed on the topic, while only 9% of the examinees are true connoisseurs of the futures trading techniques.

Relative majority of examinees are autodidactic regarding the futures trading field, as they got familiar with futures trading through personal communication (47%), while 14% of examinees got certain knowledge on the topic at university. This information seems rather important as it shows that those are relatively young people who got their diplomas in the last ten years. Namely, stock exchange trading and especially futures trading have been taught on our university since recently.

Despite relatively satisfying information on futures trading knowledge, the survey showed that barely 16% of examined companies use one of the trading techniques on futures market. If this relative number is turned into an absolute, we come to the number of only seven companies.

Besides options trading, the only used trading strategy is obviously hedging which makes us conclude that companies primarily use futures market in order to protect themselves against price change risk.

Since futures trading is practically impossible in Croatia, it is completely logical and easily explained why the above mentioned companies chose international market for hedging.

72% of the examinees in the survey say that "insufficiently educated staff" is the main reason for deficient use of futures market, and only 12% think that the "insufficient managements' initiative" is the main reason. Bearing in mind that examinees are general managers or financial directors, i.e. company managers, it can be concluded that they have no self –criticism. And it is the task of managers to educate and motivate their employees.

Examinees obviously strongly believe in the power of competitive market as more than 81% of them think that market competition (global competition and global market) will force companies to use futures trading. According to their opinion (81%), the significant expansion of futures trading in our country will happen rather soon (1 to 5 years), while the rest do not doubt such a dynamics but feel that it will happen in more than 5 years.

Analyzing the degrees of accordance with five given statements in the questionnaire, it can be concluded that entrepreneurs are mostly equally convinced 84,72 – 4,88) in two statements: use of futures trading instruments would increase business profitability and the most important function of futures trading is risk protection. This totally supports already given conclusions and statements that business in contemporary conditions, especially tourism is related to incertitude and risks. Unfortunately, but true on the other hand, there is the least accordance (3,74) with the statement that tourist market is developed enough for successful use of futures trading.

The main reason of this survey was to detect the knowledge level, the possibilities and the level of futures market use (especially hedging) in the Croatian economy, and finally to suggest the measures which would contribute to better and more extensive use of futures market and hedging after the survey analysis.

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