Contemporary Legal and Economic Issues

Editors
Ivana Barković and Mira Lulić

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Dedication

Josip Juraj Strossmayer University of Osijek celebrates in the academic year 2006/2007 remarkable 300 years of the higher education in Osijek and 32nd academic year of Osijek University. The Faculty of Law in Osijek has been the member of the university family for more than three decades in which it has been establishing a tradition in teaching the law, advancing the understanding of law and legal institutions and promoting the idea of the justice under the rule of law. In addition, the Faculty of Law in Osijek endeavors - through all its scientific and teaching activities - to create a learning environment where each member of academic staff can develop their full potential as individuals and members of the world community and where students are prepared for the productive leadership, professional success and personal fulfillment.

We have dedicated this book "Contemporary Legal and Economic Issues" to this festive occasion since the purpose of the book and its character speak the best of what higher education truly is and can be in the international academic community shaped by dramatic transformations in the essentially borderless world today. It is the work of 33 authors coming from various institutions of higher education in Europe and beyond. The authors are students and professors who have individually or as a joint effort contributed an article that deals with legal or economic issues often proving in their texts that law and economics are two scientific fields that are in many cases highly inter-related. The book promotes scientific writing as a primary tool of academics and scholars to disseminate thoughts, ideas, research results and boldly present them to the professional and lay public for discussion, praises and critiques. Thus it promotes cooperation between students and professors, i.e. mentorship, which is rewarding for both students and their professors by uniting them in a joint effort to produce a work where each invests effort, knowledge and enthusiasm to the best of their potential and benefits from the synergy effect. Furthermore, it promotes international cooperation between individuals and institutions taking part in this project pointing out that the distances in geography no longer represent an obstacle in establishing and developing the international cooperation and making the world of science truly global. However, it is a proof that topics covering nearly all issues, in this case related to the law and economics, have left the strict realm of purely domestic jurisdiction.

We are proud to be the members of the academic community which has been nurturing the higher education for three centuries and we look forward to all challenges ahead of us hoping to continue pursuing excellence in everything we do, serving the needs of our stakeholders and influencing actions inside our faculty and outside to effect the changes for the better.

Editor's Word

It is our pleasure to introduce to you a collection of papers in the fields of law and economics united in the book under the title "Contemporary Legal and Economic Issues". This kind of publication itself is a conventional form of publishing academic/scientific writings but the idea behind the book, along with the authors presented, is what gives it an unconventional character.

In the course of our work at the Faculty of Law in Osijek (Croatia), we have been engaged in developing students' communication skills, specifically development of written and oral ones, through so called seminar courses (i.e. research paper courses) in which students learn to master the academic and scientific writing as well as to present their work to fellow colleagues and peers. Often have we been witnessing that many of them show not only great motivation and desire to improve their research and writing skills, but they also exhibit maturity and dedication to produce a written work that meets standards of academic and scientific writing while dealing with various topics in the field they have chosen for their future professional life. This is particularly true for graduate students who show great success in combining theory and practice, which makes their written work interesting not only for the academic community but for practitioners as well.

By discussing often with our colleagues from international academic community the importance of scientific/academic writing not only for scientists and their career advancement but as an integral component of having a true academic education for any future career chosen, we have come up with an idea to make a book of papers written by undergraduate and graduate students individually or as a joint work of student(s) and professor(s). The idea has been enthusiastically welcomed by our international colleagues who we invited to join us in the effort of making and publishing this book.

The purpose of the book has been to promote student's research and writing, to increase the cooperation among students and their faculty staff and to illustrate the differences, as well as similarities in styles and forms among academic/scientific works coming from various European institutions of higher education and beyond. In addition, selected and published papers can serve as teaching and learning materials in particular courses since they all reflect current topics dealt in the fields of law and economics, as well as a quite instructive text for wider audience who find legal and economic issues challenging. In addition, working

on this book has proven to be a productive initiative to establish contacts and collaboration among academic scholars from countries/institutions that showed interest for this form of cooperation.

Samuel Johnson, the most quoted English writer after Shakespeare, once said "What is written without effort is in general read without pleasure". A lot of effort by lot of people – authors, editors, reviewers - has been invested in this book. Thus, we hope that it will bring not only equal amount of pleasure but also benefits to its intended audience.

Ivana Barković and Mira Lulić

In Osijek, 27th November 2007

The Societas Europaea

Agnieszka Knade-Plaskacz
Ph.D. Candidate
Faculty of Law and Administration
Nicolaus Copernicus University in Toruń
Toruń, Poland
E-mail: aknade@wp.pl

Abstract

The European Company Statute, which was adopted by EU Member States on 8 October 2001 and entered into force on 8 October 2004, created a legal framework for a new kind of corporate entity, the European Company or "Societas Europaea" ("SE"). The establishment of the European Company offers for national public limited-liability companies, active across the Internal Market, new options for cross border cooperation. It means in practice, that companies established in more than one Member State will be able to merge and operate throughout the European Union on the basis of a single set of rules and a unified management and reporting system. The establishment of the SE is a step forward to European company law harmonization program.

Key words: *European Company Law, Internal Market*

1. INTRODUCTION

A European Company ("Societas Europaea" or abbreviated "SE") is a public limited-liability company which is governed by Community law. The main conditions for the functioning of the SE are determined in the Regulation on the Statute for a European Company (SE)[1] and the Directive supplementing the Statute for a European Company with regard to the involvement of employees[2].

A new type of a cross-border company with unimpeded legislation made it possible for companies, operating internationally but incorporated in different Member States, to establish a common holding company or subsidiary company,

[1] The Council Regulation no. 2157/2001/EC of 8 October 2001 on the Statute for a European Company (SE); OJ no. L 294, 10 *November* 2001, p.1.

[2] Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European company with regard to the involvement of employees, OJ no. L 294, 10 November 2001, p. 22.

which earlier was obstructed by the existence of as many legal systems as Members in the Union[3].

2. HISTORICAL BACKGROUND

The history of the European Company can be divided into three distinct phases: the first that roughly coincided with the consolidation of the European Economic Community (1959-70), the second that was contemporaneous with the implementation of the internal market program (1988-91), and final phase that corresponds to the period of institutional consolidation in the EU (2001-2004).

The concept of European company "was born" in 1959 in France, at a meeting of French notaries[4]. A significant step was taken five years later. On 15 March 1965 the French Government addressed a Note to the Common Market Ministers, proposing the creation of a "commercial company of European type"[5].

In 1966 the EEC Commission prepared a draft proposal supporting the idea to set-up legislation on a European Company in a treaty between the EC Member States. On the basis of that document, the Commission published a first proposal on the statute for a European Company in 1970[6]. In the 80's this proposal was almost forgotten. However, in 1988 the Commission renewed the debate and brought it up again by issuing a relevant memorandum[7]. In 1989 the Commission presented the second formal proposal for a statute[8]. Finally, after thirty years negotiations, the Council of the EU approved the European Company, and the legislation was adopted in October 2001.

After three decades of negotiations, the European Union decided to create the European Company by the aforementioned Regulation of 8 October 2001 establishing the Company law rules ("SE Regulation") and the Directive 2001/86/EC supplementing the Statute for a European Company with regard to the involvement of employees ("SE Directive"). Both, the Council Regulation and Directive are based on the art. 308 (ex art. 235) of the EC Treaty. The

[3] see: S. Israel, *The European Company Statute* - "SE," in E. Wymeersch (ed.), *Further Perspectives in Financial Integration in Europe*, Berlin-New York, 1994, p. 219.

[4] Compare D. Thompson, *The Creation of a European Company, International and Comparative Law Quarterly*, 1968, vol. 17, no. 1, p. 183.

[5] For further details see: O. Fioretos, *The Firm and European Integration: The Long History of the European Company Statute*, Temple University, Philadelphia 2005, p. 3.

[6] Commission proposal for an SE directed to the Council of Ministers, OJ no. C 124, 10 October 1970.

[7] Memorandum of the Commission on the statute for the European company,15 July 1988 , EC-Bulletin 1988, no. 3, p. 320

[8] Commission proposal for an SE, OJ no. C 263, 16 November 1989, revised in 1991 Regulation OJ no C 176, 8 July 1991.

Regulation entered into force on 8 October 2004. The Member States were obliged to transpose the Directive until the same date.

3. THE MAIN CHARACTERISTICS OF SE

The European company (SE) represents the first example of a European's own type of a commercial company. An SE may be set up within community in the form of a public company limited by shares. An SE can be characterized by several elements:

- it has a supranational legal form with national roots,
- it has legal personality,
- the incorporation of an SE is characterized by a mandatory cross-border element,
- the capital of an SE is divided into shares and is expressed in Euro,
- the subscribed capital cannot be less than EUR 120,000 and
- the corporate structure offers the choice between two systems (one-tier and two-tier board) [9].

The company name of a European company must include the abbreviation SE either before or after the company name. Only European companies may include the abbreviation SE in the company name. In principle, the SE is treated as a limited liability company governed by the law of the Member State in which it has its registered office an all other matters, such as tax and accounting, insolvency, competition and intellectual property are to be governed by the national laws of each of the Member States in which the SE operates.

4. FORMATION

4.1. General remarks

An SE can be created in the following ways: through the merger of at least two public limited-liability companies (art.2 par.1 SE Regulation), through the creation of a holding company by at least two public limited-liability companies or private limited-liability companies (art.2 par.2), through the creation of a subsidiary by at least two companies (art.2 par.3), through the transformation of an existing public limited-liability company (art.2 par.4), through the creation of a subsidiary SE by another SE (art.3). It is important to note, that in all these cases there must exist a transnational element, the companies concerned must be governed by the laws of at least two European Union Member States. In the

[9] M-A Arlt, C. Bervoets, K. Grechenig, S. Kalss, *The Societas Europaea in Relation to the Public, Corporation of Five Member States (France, Italy, Netherlands, Spain, Austria)*, European Business Organization Law Review 2002, no. 3, p. 733.

event of a transformation, the company should have had a subsidiary in another Member State for at least two years.

4.2. Formation by merger

An SE may be carried out in accordance with two procedures of a mergers[10]: merger by acquisition[11] and merger by the formation a new company[12]. The procedure for merger by acquisition means the operation whereby one or more companies are wound up (but without going into liquidation) and transfer all their assets and liabilities to an existing company. A merger by acquisition must have the following consequences *ipso iure*: all the assets and liabilities of each company being acquired are transferred to the acquiring company, the shareholders of the company being acquired become shareholders of the acquiring company, the company being acquired ceases to exist, and the acquiring company adopts the form of an SE[13].

The procedure for merger by the formation of a new company (in accordance to the provisions of the Third Council Directive concerning mergers of public limited liability companies) means the operation whereby several companies are wound up without going into liquidation and transfer to a company that they set up all their assets and liabilities. Optional merger by the formation of a new company may also be effected where one or more companies which are ceasing to exist is in liquidation, provided that this option is restricted to companies which have not yet begun to distribute their assets to their shareholders. In this procedure merger must have the following consequences *ipso iure*: all the assets and liabilities of the merging companies must be transferred to the SE, the shareholders of the merging companies become shareholders of the SE, the merging companies cease to exist[14]. In the case of a merger by acquisition, the acquiring company must take the form of an SE when the merger takes place. In the case of a merger by the formation of a new company, the SE must be the newly formed company[15].

Pursuant to art. 19 Article of the SE Regulation, the laws of a Member State may provide that a company governed by the law of that Member State may not take part in the formation of an SE by merger if any of that Member State's competent institutions (a court, notary or other competent authority) opposes

[10] The procedures of mergers were laid down in the Third Council Directive 78/855/EEC of 9 October 1978 based on Article 54 (3) (g) of the Treaty concerning mergers of public limited liability companies, OJ no. L 295, 20 October 1978, p. 36–43

[11] In accordance with art. 3 par.1 of the Third Directive

[12] In accordance with art. 4 par.1 of the Third Directive

[13] In accordance with art. 29 of the SE Regulation

[14] In accordance with art. 29 of the SE Regulation

[15] In accordance with art. 17 of the SE Regulation

to it before the issue of the certificate, conclusively attesting to the completion of the pre-merger acts and formalities[16]. Such opposition may be based only on grounds of public interest. There is no definition of public interest. The boards of the companies involved must draw up written report explaining the draft terms of the merger and setting out the legal and economic grounds for them, in particular the share exchange ratio. The report must also describe any special valuation difficulties which have arisen. Additionally one or more experts, acting on behalf of each of the merging companies but independent of them, appointed or approved by a judicial or administrative authority, must examine the draft terms of the merger and draw up a written report to the shareholders. The draft terms of merger must be approved by the general meeting of each of the merging companies. The draft terms of the merger must include arrangements for employee involvement pursuant to Directive 2001/86/EC[17]. According to the provisions of the Directive 68/151/EEC[18], for each of the merging companies the draft terms must be kept in file in the commercial or companies register and be available by application in writing (Art. 3 par. 2 and 3 of the First Directive). Furthermore, it is necessary that at least a reference to the document which has been deposited in the register is published in the national paper indicated for that purpose by the Member State (Art. 3 par.4 of the First Directive).

It is necessary to indicate that the merger and the simultaneous formation of an SE take effect after registration. That may not be effected until the court, notary or other authority competent in the Member State controls the legality of a merger19. Therefore, each merging company must submit to these institutions the certificate attesting to the completion of the pre-merger acts and formalities within six months of its issue together with a copy of the draft terms of the merger approved by that company. The authority must in particular make sure that the merging companies have approved draft terms of merger in the same terms and if the SE has been formed in accordance with the requirements of the law of the Member State in which it has its registered office. At the moment of registration all rights and obligations of the participating companies, existing at the date of the registration, concerning terms and conditions of employment arising from national law, practice and individual employment contracts or employment relationships must be transferred to the SE.

[16] According to art. 25 par.2 of the SE Regulation

[17] Cited *supra* not 2

[18] First Council Directive 68/151/EEC of 9 March 1968 on co-ordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of Treaty, with a view to making such safeguards equivalent throughout the Community OJ no. L 65, 14 March 1968, p. 8-12

[19] According to art. 30 of the SE Regulation the absence of scrutiny of the legality of the merger may be included among the grounds for the winding-up of the SE.

4.3. Formation of a holding SE

Formation of a holding company means, that public and private limited-liability companies formed under the law of a Member State, with registered offices and head offices within the Community, may promote the formation of a holding SE[20]. Formation of an SE as a holding company is regulated in articles 32-34 of SE Regulation[21]. According to these provisions two requirements of art. 2 par. 2 of SE Regulation must be complied with: at least two of the interested companies must be governed by the law of a different Member State or for at least two years must have a subsidiary company governed by the law of another Member State or a branch situated in another Member State. Nevertheless, the Regulation give authority to a Member State to enact a provision that a company which has its head office outside the Community may participate in the formation of an SE if it is formed under the law of a Member State, has its registered office in that Member State and has a real and continuous link with a Member State's economy (art. 2 par. 5). The provisions which deal with the formation of a holding SE state that a company promoting this operation shall continue to exist. The process of formation of a holding SE is similar to merger and commences with a drawing up of the draft terms (art. 32 par. 2).

The management or administrative organs of the companies promoting the formation of SE must draw up the draft terms for the formation. The draft terms must include a report explaining and justifying the legal and economic aspects of the formation and indicating the implications for the shareholders and for the employees of the adoption of the form of a holding SE. The draft terms must also fix the minimum proportion of the shares in each of the companies promoting the operation which the shareholders must contribute to the formation of the holding SE. That proportion must be equal to shares conferring more than 50 % of the permanent voting rights. For each of the companies promoting the operation, the draft terms for the formation of the holding SE must be published at least one month before the general meeting which is called to decide on it. The draft terms must be examined by independent experts. Experts report points out difficulties of valuation and states whether the proposed share-exchange ratio is fair and reasonable. After that time the general meeting of each company promoting the operation must approve the draft terms of the formation of the holding SE. The holding SE could be formed only if, the shareholders of the companies promoting the operation have assigned the minimum proportion of

[20] For details, see: K. Oplustil, *Selected Problems Concerning Formation of a Holding SE*, 4 German Law Journal 2003, no. 2, p. 107.

[21] The holding structure on the European level are presented by J.L Colombani, M. Favero, *Societas Europaea. La société européenne*, Paris 2002, p. 86.

shares in each company in accordance with the draft terms of the formation and if all the other conditions are fulfilled.

4.4. Formation of a subsidiary SE

The formation of a subsidiary SE is governed by national law. Article 2 par.3 predicts two conditions that have to be met. Firstly, the parent companies must be governed by different legal systems of the Member States. Secondly, they must already have had a subsidiary in a different member state for at least two years. The second condition is very strict in particular for companies that are expanding to other countries. This would cause a two-year delay in order to create a subsidiary SE.

4.5. Formation by transformation

An SE can be created by transformation of an existing public limited-liability company, formed under the law of a Member State, which has its registered office and head office within the Community. A conversion cannot take place earlier than two years after the registration of the European company, and not until the two first sets of annual accounts have been approved. A conversion into an SE doesn't lead to the winding up of the company or the creation of a new legal person.

The procedure of conversion is similar to merger and holding. The management or administrative organ of the company in question must draw up the draft terms of the conversion and a report explaining and justifying the legal and economic aspects of the conversion and indicating the implications for the shareholders and for the employees of the adoption of the form of an SE (art. 37 par.4). The general meeting of the company in question must approve the draft terms of the conversion and the statute of the SE. Again, the draft terms of the conversion are to be publicised. After registration all rights and obligations of the company are converted on terms and conditions of employment arising from national law. Individual employment contracts or employment relationships existing at the date of the registration must be transferred to the SE.

5. MANAGEMENT STRUCTURE

5.1. General remarks

The management structure is regulated by Article 38 SE of Regulation. According to it an SE must comprise of a general meeting of shareholders and a decision-making organ or organs. The greater flexibility in a company's management structure makes it possible to choose between the dualistic (two-tier) system with a Board of Management and Supervisory Board, and the monistic

(one-tier) system with a single Administrative Board. The shareholders of an SE are able to decide which of the organisation systems they prefer. However, the choice of one of these organizational structures made in the SE's statute, for example at the time of the formation of the SE, is not final and binding. The company's general meeting may opt for the other structure at any time.

The members of company organs shall be appointed for a period laid down in the statute which cannot exceed six years. The members of an SE's management, supervisory and administrative organs are to be liable, in accordance with the provisions applicable to public limited-liability companies in the Member State in which the SE's registered office is situated, for loss or damage sustained by the SE following any breach on their part of the legal, statutory or other obligations inherent in their duties (art. 51).

5.2. Two-tier system

The supervisory organ controls the work of the management organ. This organ is not entitled to manage the SE. The members of the supervisory organ must be appointed by the general meeting. However, to simplify the procedure of creation of an SE the members of the first supervisory organ can be appointed by the statute.

The management organ is responsible for managing the SE. The members of the management organ are appointed and removed by the supervisory organ. The number of members of the management organ or the rules for determining it must be laid down in the SE's statute. However, Member States are able to fix a minimum and a maximum number. No person may at the same time be a member of both the management organ and the supervisory organ of the same SE. Every three months the management organ must present the supervisory organ with the report on the progress and foreseeable development of the SE's business. The supervisory organ may require the management organ to provide information of any kind which it needs to exercise supervision.

5.3. One-tier system

The one-tier system means that apart form the shareholders' meeting there is only one decision-making organ - the administrative organ. The main tasks of that organ are connected with the management and administration of the company. The members of the administrative organ are appointed by the general meeting. Similarly to the supervisory organ in two-tier system the members of the first supervisory organ can be appointed by the statute.

The administrative organ holds meetings at least once every three months at intervals laid down by the statute to discuss the progress and foreseeable development of the SE's business. The administrative organ elects a chairman from

its members. If half of the members are appointed by employees, only a member appointed by the general meeting of shareholders may be elected a chairman.

5.4. General meeting of shareholders

The general meeting should decide on matters for which it is given sole responsibility by SE Regulation (e.g. approval and amendment of an SE's statutes, approval of the draft terms of the merger, approval of the draft terms of the formation of the holding SE, approval of the draft terms of the conversion together with the statutes of the SE) or the legislation of the Member State in which the SE's registered office is situated.

An SE must hold a general meeting at least once each calendar year, within six months of the end of its financial year. General meetings may be convened at any time by the management organ, the administrative organ, the supervisory organ or any other organ or competent authority. One or more shareholders that together hold at least 10 % of an SE's subscribed capital may request the SE to convene a general meeting and draw up the agenda therefore. General meeting's decisions are taken by a majority of the votes unless the Regulation or national law request a larger majority (art. 57).

6. OTHER REGULATIONS

6.1. Winding-up, liquidation, insolvency and cessation of payments

Winding up, liquidation, insolvency and cessation of payments of the European company are regulated by the national law. According to article 63 of SE Regulation [a]n SE should be governed by the legal provisions which apply to a public limited-liability company formed in accordance with the law of the Member State in which its registered office is situated, including provisions relating to decision-making by the general meeting.

6.2. The conversion of an SE into a public limited-liability company

An SE may be transformed into a public limited-liability company governed by the law of the Member State in which its registered office is situated. Decision on transformation may not be taken before the approval of the first two sets of annual accounts. The conversion do not implicate winding up of the company or creation of a new legal person.

The management or administrative organ of the SE must draw up the draft terms of the conversion and a report explaining and justifying the legal and economic aspects of the conversion and indicating the implications of the adoption of the public limited-liability company for the shareholders and for the

employees. The general meeting of the SE must approve the draft terms of the conversion together with the statute of the public limited-liability company.

6.3. Accounts

As far as tax purposes are concerned an SE should be treated as any other multinational company according to the national fiscal legislation applicable at company level or branch level. For that reason preparation of annual and, where appropriate, consolidated accounts including the accompanying annual report and the auditing and publication of those accounts are subject of national law.

7. EMPLOYEE INVOLVEMENT

Article 12 par. 2 of SE Regulation predicts that an SE may not be registered unless an agreement on arrangements for employee involvement has been concluded. The principal employee involvement provisions are to be found in the Directive supplementing the Statute for a European company with regard to the involvement of employees[22].

The employee participation does not require participation in day-to-day decisions, which are a matter for the management, but participation in the supervision and strategic development of the company. Employees have their own representatives who must be provided with such financial and material resources and other facilities which enable them to perform their duties properly[23]. The general meeting of the shareholders may not approve the formation of an SE unless one of the models of participation defined in the Directive has been chosen.

Several models of employees' participation are possible: a model in which the employees form part of the supervisory board or of the administrative board, a model in which the employees are represented by a separate body, an agreement between the management or the administrative boards of the founder companies and the employees or their representatives in those companies, the level of information and consultation being the same as in the case of the second model[24].

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[22] See *supra* note 2

[23] Compare: C. Teichmann, *The European Company – A Challenge to Academics, Legislatures and Practitioners*, German Law Journal 2004, no 4, p. 309

[24] The negotiating procedure between company organs and representatives of the companies' employees in the preparation of a plan of an SE formation is presented by V. Edwards, *The European Company - Essential Tool or Eviscerated Dream?*, CMLRev 2003, no 40, p. 458

8. THE COUNCIL REGULATION ON THE SE AND ITS IMPACT ON POLISH COMPANY LAW

Polish legislation on the European Company entered into force on 18 August 2006 (Act on the European Economic Interests Grouping and European Company of 4 March 2005[25]). It concerns: the registration procedure, the governing bodies of the SE, the transfer of the statutory seat of the SE, employee involvement in the SE and protection of employees' rights.

9. CONCLUSIONS

The creation of the European Company corresponds to the new demands of an integrated European market. It is connected with free competition between enterprises operating on the Common Market and opens a much broader outlet for their products and activities. The provisions of SE Regulation permit the creation and management of companies with a European dimension, free from the obstacles arising from the disparity and the limited territorial application of national company law.

However, the SE Regulation has been criticized. One of the critics is that the Regulation does not cover certain areas of law, such as: taxation, competition, intellectual property and insolvency. McCahery and Vermeulen point out that the proposed statute excludes a large number of areas relevant to business operating in two states, all of which continue to be governed by national legislation[26]. Springael indicates that the European Company is not a uniform company type, as originally intended, but instead a national European Company[27]. Hampton argues that without an EU-wide regime for tax, freedom of movement between countries and a single corporate form, it offers little that cannot be achieved already[28]. On the other hand, it should be noticed that the SE can create a certain competition among EU Member States by inducing them to amend their legislation in order to better accommodate to the specific needs of a pan-European legal entity.

To conclude, the establishment of the SE is a step forward to the European integration because entities from different European countries are able to cooperate more easily with each other.

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[25] Journal of Law of 2005, no 62, item 551, further changes in Journal of Law of 2005, no 183, item 1538; and in Journal of law of 2006 r., no 149, item 1077)

[26] J.A. McCahery, E.P.M., Vermeulen, *The Changing Landscape of EU Company Law*, TILEC Discussion Paper, 2003, no. 24, p. 17.

[27] B. Springael, *Taxation Issues and the Single European Company: a Preliminary Look at Societas Europaea*, EuroWatch 2002, no. 14, p. 15-18.

[28] C. Hampton, *European Company Law Reforms Make Uneven Progress*, EuroWatch 2002, no. 14, p. 10-14.

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Embargo in the United Nations System and Human Rights

Davorin Lapaš, Ph.D.
Assistant Professor
Faculty of Law
University of Zagreb, Croatia
E-mail: dlapas@pravo.hr

Ivan Tot
Faculty of Law
University of Zagreb, Croatia
E-mail: ivantot01@gmail.com

Abctract

This paper deals with the relation between embargo as a coercive economic measure provided in Article 41 of the Charter of the United Nations, and human rights as peremptory norms of international law. The authors try to answer the question how to find a balance between demands for more efficient embargoes and demands for more humane embargoes. Firstly, the theoretical concept of the embargo is discussed, and then we analyze various types of embargoes in the light of the United Nations Security Council practice. Afterwards, an analysis of the relevant provisions of the Charter of the United Nations is given, and the embargo implementation machinery is presented, with a concise review of the legal nature of the embargo. Finally, fundamental human rights protected by peremptory norms of international law are explained, along with the limitations they present to the implementation of embargo in the United Nations system.

Key-words: *embargo, economic measures, United Nations, human rights*

1. INTRODUCTION

It is almost impossible not to encounter with the term «embargo» in our everyday life. One of the reasons for that is significant proliferation of the enforcement of embargo as a measure provided in Article 41 of the Charter of the United Nations in last seventeen years. In the media the term «sanction» is frequently used inaccurate as a synonym to embargo. These two terms have to be clearly distinguished because embargo in the United Nations system, as we will see later in this paper, has a completely different legal nature and it is not correct to refer to it as to sanction.

«Human rights» are another almost unavoidable term. Owing to the development of the international law today there is a global awareness on the human rights and they are guaranteed to every individual more than ever in history. Today, fundamental human rights in international law are protected by *ius cogens*, peremptory norms of international law.

This paper tries to explain the relation between embargo as a coercive measure provided in Article 41 of the Charter of the United Nations and fundamental human rights as protected by *ius cogens* norms of international law. This relation is observed through the relevant provisions of the Charter of the United Nations and of the Universal Declaration of Human Rights, as well as through the ample practice of the UN Security Council in the enforcement of embargo. It would be seen that in the practice the relation between embargo and human rights depends on the two opposed demands: demand for the more efficient embargo and demand for the more humane embargo.

2. THE CONCEPT AND THE TYPES OF EMBARGO

Article 41 of the Charter of the United Nations,[1] amongst the measures not involving the use of armed force, *inter alia*, provides «complete or partial interruption of economic relations». According to Article 39, the United Nations Security Council decides what measures shall be taken if the Security Council determines the existence of a threat to the peace, breach of the peace or act of aggression. In international law doctrine measures of interruption of economic relations are usually divided into commercial and financial measures.[2] Amongst the commercial measures embargo is the most significant and the most common measure.

2.1. The concept of embargo

Regarding the term «embargo», various definitions which are different in substance can be found in doctrine of international law. Several authors define embargo as a measure of forced detention of ships and other vessels of target state in the ports of sender state.[3] Such standpoint is obsolete and more accurate

[1] Charter of the United Nations is available for reading on: http://www.un.org/aboutun/charter/index.html (29-03-2007).

[2] Doxey, M. P., International Sanctions in Contemporary Perspective, Basingstoke, Macmillan Press, 1987, p. 11; Hufbauer, G. C. / Schott, J. J. / Elliott, K. A., Economic Sanctions Reconsidered, Washington, Institute for International Economics, 1990, p. 36.

[3] Andrassy, J., Međunarodno pravo, Zagreb, Školska knjiga, 1990, p. 557.
Ibler provides similar definition of embargo. However, additionally he defines embargo as a refusal to export to the target state and as a measure that can be applied by UN Security Council when acting under Chapter VII of the Charter of the UN. Ibler, V., Rječnik međunarodnog javnog prava, Zagreb, Informator, 1987, pp. 81 – 82.

definitions are given in the recent doctrine. For instance, Neff properly defines embargo purely as a refusal to export to the target state.[4] Certain authors incorrectly make difference between the «embargo on exports» and the «embargo on imports».[5] What is called «embargo on imports» by these authors in fact is boycott, a refusal to import from the target state. In this sense boycott is a "backside" of embargo.[6] Neff unnecessarily expands the definition of boycott in a way which includes embargo; according to him, boycott is refusal to permit economic dealings of any kind with the target state.[7] Neff uses this approach probably because sometimes in practice these two commercial measures are implemented simultaneously and they refer to same kinds of goods. Although it can be argued that embargo and boycott are two halves of the same measure, yet they are two separate measures which can be applied and frequently are being applied autonomously, independent of one on another.[8]

2.2. The types of embargo

2.2.1. Embargo according to sender

Sender of embargo is a subject of international law, an «organ» of the normative system which is entitled under the norms of that system to implement embargo in behalf of the system.[9] Usually, but not necessarily, sender of embargo is the addressee of the norm of international law which was violated by the target of embargo.

According to the sender of embargo, unilateral and multilateral embargo can be differed. Unilateral embargo is an embargo whose sender is a particular country or other particular subject of international law. Multilateral embargo is an embargo whose sender is more than one state (or another subject of international law). In this dualistic classification, embargo whose sender is the United Nations organization could be considered as multilateral, taking into account that it is implemented by different countries which are members of the UN, however, it is more accurate to consider the embargo whose sender is the UN as unilateral

[4] Neff, S. C., «Boycott and the Law of Nations: Economic Warfare and Modern International Law in Historical Perspective», British Yearbook of International Law, Vol. 59, 1988, p. 115.

[5] E.g.: Doxey, op. cit. (note 2), p. 11; Hufbauer / Schott / Elliott, op. cit. (note 2), p. 36.

[6] Lapaš, D., Sankcija u međunarodnom pravu, Zagreb, Pravni fakultet u Zagrebu, 2004, p. 291.

[7] Neff, op. cit. (note 4), p. 115.

[8] As an example of boycott as stand-alone measure, it can be reffered to boycott of rough diamonds that originate from Sierra Leone imposed pursuant to Security Council resolution S/1306 (2000). The diamonds in question are so called conflict diamonds, i.e. the diamonds that originate from areas controlled by forces or factions opposed to legitimate and internationally recognized governments, and are used to fund military action in opposition to those governments, or in contravention of the decisions of the Security Council. For more on conflict diamonds visit: Conflict Diamonds, http://www.un.org/peace/africa/Diamond.html (20-3-2007).

[9] Cf: Lapaš, op. cit. (note 6), p. 12.

measure, regarding that the UN is a distinct subject of international law, separate from their members states. Considering that this paper deals with the embargo solely in the UN system, differentiation of embargoes regarding the sender is not of great importance.

2.2.2. Embargo according to substance

According to substance, three types of embargo could be differed: embargo on commodities and services, embargo on raw materials and embargo on technology.[10]

Amongst various kinds of embargo on commodities, the most significant is the embargo on arms, ammunition and military equipment. This is the most common measure employed by the Security Council.[11] The embargo in question is usually general arms embargo, which implies a refusal to export all sorts of arms, ammunition and military equipment,[12] and frequently covers military vehicles and their spare parts. However, sometimes arms embargo will include specific kinds of arms, listed in the Security Council resolution or in its annex.[13] Interesting example of embargo on commodities from the recent Security Council practice is embargo on luxury goods.[14] Goods considered to be luxury goods are e.g.: alcoholic beverages, tobacco and tobacco products, truffles, caviar, transport vehicles, jewelry, precious and semi precious stones, precious metals, sports equipment, etc.

The most common embargo amongst embargoes on raw materials is embargo on oil and oil derivatives.[15] Sometimes embargo prohibits the export of equipment needed in oil industry.[16]

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[10] Cf. Lapaš, op.cit. (note 6), p. 290.

[11] Embargo on arms, ammunition and military equipment was employed against, e.g.: Southern Rhodesia (S/232, 1966), South Africa (S/418, 1977), Socialist Federal Republic of Yugoslavia (S/713, 1991), Somalia (S/733, 1992), Libya (S/748, 1992), Liberia (S/788, 1992), Haiti (S/841, 1993), Rwanda (S/1011, 1995), Federal Republic of Yugoslavia (S/1160, 1998), etc.

[12] In most of the Security Council resolutions mentioned in previous note, a general arms embargo was phrased as: «measures to prevent the direct or indirect supply, sale or transfer, ..., of arms or any related *matériel*, ...».

[13] The example of specific arms embargo is the arms embargo employed against Democratic People's Republic of Korea pursuant to the Security Council resolution S/1718 (2006) which prohibits export of battle tanks, armoured combat vehicles, large calibre artillery systems, combat aircraft, attack helicopters, warships, missiles or missile systems and related materiel, including spare parts, to the Democrativ Peoples Republic of Korea (DPRK).

[14] See: Security Council resolution S/1718 (2006) regarding DPRK.

[15] For example, oil embargo was employed against: Cambodia (S/792, 1992), Haiti (S/841, 1993), Angola (S/864, 1993), Sierra Leone (S/1132, 1997), etc.

[16] See: Annex of the Security Council resolution S/883 (1993) regarding Libya.

Embargo on technology includes the prohibition of transfer of technology to the target state.[17] Following measures should be also considered as types of embargo on technology: prohibition of transfer of technical training, advice, services or assistance related to weapons of mass destruction-related programs,[18] and prohibition of transfer of technical advice, assistance, or training related to the military activities.[19]

2.2.3. Embargo according to range

According to range of embargo, two types of embargo are differed: comprehensive embargo and embargo targeted on specific commodities or products.[20] Comprehensive embargo refers to all sorts of commodities and products.[21] Article 41 of the Charter of the UN refers to comprehensive embargo as to «complete interruption of economic relations». However, the comprehensive embargo is rarely employed,[22] and from its implementation some goods are regularly exempted: supplies intended strictly for medical purposes and, in humanitarian circumstances, foodstuffs.

2.2.4. Embargo according to target

The target of embargo is the subject of international law against whom embargo is employed. Target of embargo is the addressee of the international legal norm, that is of its disposition as a request by the legal system. Because of the infringement of that request, embargo is employed as a reaction to that wrongful act. Sometimes embargo produces collective punishment as a consequence, since the UN Security Council identifies the target of embargo with the subject who committed a wrongful act, even though there is not always a sign of equality between those two.[23] The described disparity between the wrongdoer and the target of the reaction to the wrongful act, especially in the case of collective

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[17] Recent example of embargo on technology is given in the Security Council resolution S/1737 (2006). The embargo in question is embargo on technology which could contribute to Iran's enrichment-related, reprocessing or heavy water-related activities, or to the development of nuclear weapon delivery systems.

[18] See: Security Council resolution S/1718 (2006).

[19] See: Security Council resolution S/1333 (2000).

[20] Lapaš, op.cit. (note 6), p. 290.

[21] In Security Council resolutions comprehensive embargo is expressed as: «measures to prevent the sale or supply, ..., of any commodities or products, whether or not originating in their territories,...».

[22] Comprehensive embargo was employed in four cases: Southern Rhodesia (S/253, 1968), Iraq (S/661, 1990), Federal Republic of Yugoslavia (S/757, 1992) and Haiti (S/917, 1994).

[23] Typical examples of this are the cases where the Security Council had qualified a civil war in certain country as a threat to peace. E.g.: employment of the arms embargo against Socialist Federal Republic of Yugoslavia (S/713, 1991), Somalia (S/733, 1992), Liberia (S/788, 1992). In these cases, Security Council had not determined the perpetrator of the wrongful act, but it employed the embargo «neutrally», on the situation in total, to all parties in the conflict.

punishment, is the characteristic of the primitive legal systems.[24] Frequently in the doctrine, when the legal nature of international law is examined, conclusions might be found that international law, compared to contemporary stage of development of municipal legal systems, is the law which is on a certain primitive stage of its development.[25]

According to the target, two types of embargo could be differed: the embargo whose target is certain state and embargo whose target is a non-state entity. Usually embargo is employed against the state. Cases where embargo was employed against a non-state entity are rare in the Security Council practice.[26]

2.2.5. Embargo according to duration

Employment of the embargo can be limited in time and unlimited. Usually, Security Council in its resolutions does not define the period of time for which the embargo would be applied. However, in the Security Council's recent practice there were few cases of embargoes limited in time.[27] When embargo is employed for a limited period of time, in the Security Council resolutions there is always a provision which states that at the end of that period, the Security Council will decide whether the target state has complied with the requests made by the Council, and, accordingly, whether to extent the embargo for a further period.

3. EMBARGO IN THE UNITED NATIONS SYSTEM

3.1. The competence of the United Nations Security Council on the enforcement of embargo

According to the provision of Article 24 of the Charter of the United Nations, primary responsibility for the maintenance of international peace and security is conferred on the UN Security Council.[28] This widely adjusted function of the Council is limited in the same article with phrases «to ensure prompt and effective action» and «the Security Council acts on their behalf» which indicate

[24] Lapaš, op. cit. (note 6), p. 13.

[25] Andrassy, J. / Bakotić, B. / Vukas, B., Međunarodno pravo, Vol. 1, Zagreb, Školska knjiga, 1998, p. 12.

[26] E.g.: oil embargo employed against the Khmer Rouge in Cambodia (S/792, 1992); oil and arms embargo employed against the National Union for the Total Independence of Angola (UNITA) in Angola (S/864, 1993); comprehensive embargo employed against the Bosnian Serbs in Bosnia and Herzegovina (S/942, 1994); arms embargo employed against the Afghan faction known as the Taliban in Afghanistan (S/1333, 2000).

[27] E.g.: arms embargo employed against: Eritrea and Ethiopia for a period of 12 months (S/1298, 2000); Democrat Republic of Congo for a period of 12 months (S/1493, 2003); Côte d'Ivoire for a period of 13 months (S/1572, 2004).

[28] Article 24, para. 1 states as follows: «In order to ensure prompt and effective action by the United Nations its Members confer on the Security Council primary responsibility for the maintenance of international peace and security, and agree that in carrying out its duties under this responsibility the Security Council acts on their behalf».

that the functioning and the competence of the Council is limited on those matters in which exists a necessity to prevent the escalation of the conflict or to resolve the already generated conflict by acting under the Chapters VI and VII of the Charter, to which chapters, *inter alia*, the Article 24 explicitly refers.[29]

Chapter VII of the Charter of the United Nations is titled «Action with respect to threats to the peace, breaches of the peace, and acts of aggression». Those three matters, listed in the title of this Chapter, are the preconditions, under the Article 39, for the action of the Security Council carried out in order to maintain or restore international peace and security. For that purpose, the Council may, after determining the existence of one of the afore-mentioned matters, make recommendations to the UN member states or decide what measures shall be taken in accordance with Articles 41 and 42 of the Charter. Article 42 refers to measures involving the use of armed force, which can be employed if the Council considered that measures provided for in Article 41 would be inadequate or had proved to be inadequate.

Measures provided for in Article 41 are measures not involving the use of armed force. Article 41 empowers the Security Council to decide what measures not involving the use of armed force are to be employed to give effect to its decisions, and to call upon the members of the United Nations to apply such measures. These measures may include «complete or partial interruption of economic relations and of rail, sea, air, postal, telegraphic, radio, and other means of communication, and the severance of diplomatic relations». These measures are not *numerus clausus*, they are just provided for in Article 41 *exempli gratia*. The widely adjusted expression «complete or partial interruption of economic relations» provides for all sorts of economic measures, including embargo, so the provision of Article 41, amongst other afore-mentioned articles of the Charter, represents the cornerstone for the employment of the embargo by the Security Council.

The decisions of the Council on employment of the embargo are legally binding for the UN member states who are obliged to accept and carry out these decisions. The obligatory character of decisions of the UN Security Council is provided in Article 25 of the Charter.[30] In this context it is worth to mention the provision of Article 103: «In the event of a conflict between the obligations of the Members of the United Nations under the present Charter and their obligations under any other international agreement, their obligations under the present Charter shall prevail».

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[29] Andrassy, op. cit. (note 3), p. 413.

[30] Article 25 of the Charter of the UN: «The Members of the United Nations agree to accept and carry out the decisions of the Security Council in accordance with the present Charter».

3.2. The stages of the enforcement of embargo

First stage comprises that the Security Council shall determine the existence of any threat to the peace, breach of the peace, or act of aggression. About these circumstances the Security Council can be informed by any of the United Nations member states,[31] the General Assembly or by the Secretary General. Furthermore, the Security Council may consider these disputes or situations on its own venture.[32] The Security Council has on its disposal few instruments for determining the facts. The Council may conduct an interim inquiry, [33] or, by the wording of Article 34 of the Charter, «investigate any dispute, or any situation which might lead to international friction or give rise to a dispute». For the purpose of determining the relevant facts, the Security Council shall, according to the provision of Article 32 of the Charter, invite the state who is a party to a dispute under consideration by the Council to participate in the discussion relating to the dispute, but without voting. In such a manner, any party to a dispute which is not a member of the Security Council would be invited, and this may even be a state which is not a member of the United Nations. In accordance with Article 31 of the Charter, the Security Council may invite a UN member state which is not a party to a dispute to participate in the discussion relating to the dispute, if the Council considers that the interests of that member state are specially affected by the dispute. The member state invited in such a manner may participate in the discussion, without voting. The Council determines the relevant facts also on the base of the reports presented by the UN member states and by the Secretary General. After it had determined the relevant facts, the Council needs to qualify these facts. If the discussed situation was qualified, in accordance with the provision of Article 39 of the Charter, as a threat to the peace, a breach of the peace or an act of aggression, the Council shall decide what measures would be taken to maintain or restore international peace and security. Even before it determines the relevant facts and qualifies these facts, the Council may call upon the parties concerned to comply with such provisional measures as it deems necessary or desirable, in order to prevent an aggravation of the situation. The decision on these provisional measures has the legal meaning of a dispensable recommendation which does not implicate any condemnation yet.[34]

Next stage might be the laying down of the Security Council resolution in which it could decide to apply the embargo measure. According to Article 41 of

[31] This doesn't apply to the parties to a dispute – these states are obliged, under the Article 33 of the Chapter of the UN, to, first of all, seek a solution by one of the means of the peaceful settlement of disputes. If the parties to a dispute fail to settle it by these means, they have the right (and the duty), according to the Article 37 of the Charter, to refer the dispute to the Security Council.

[32] Degan, V. Đ., Međunarodno pravo, Rijeka, Pravni fakultet u Rijeci, 2000, p. 783.

[33] Ibid., p. 784.

[34] Ibid., p. 785.

the Charter, the Security Council may decide what measures not involving the use of armed force are to be employed to give effect to its decisions, and it may call upon the members of the UN to apply such measures. Congruously to this provision, in the practice of the Council in employing the embargo in a specific situation, usually, two separate resolutions can be distinguished: the resolution in which the Council imposes certain obligations on a designated state as a result of its certain act, and the other resolution, in which the Council, in case that the designated state failed to comply with the imposed obligations, employs the embargo against that state.[35] Typically, all of the Security Council resolutions which establish the embargo have a similar structure. Firstly, in the preamble of the resolution, the previous resolutions concerning a certain dispute or situation and the obligations imposed in them are being recalled; the concerns for the continuation of the dispute or situation and for the failure to comply with the obligations set out in the previous resolutions are being expressed; all acts of violence committed since the date of the last resolution are being condemned; the commitment of all UN member states to the sovereignty, independence and territorial integrity of the target state is being reaffirmed; the efforts of the various participants of the international community in solving the dispute or situation are being welcomed; etc. Afterwards, the determination that a certain dispute or situation constitutes a threat to the peace, a breach of the peace or an act of aggression is being set forth. This determination is followed by the list of decisions on the measures which need to be taken, with preceding exclamation that these decisions are made while acting under the Chapter VII of the Charter of the UN. The decision on employment of embargo usually has the following wording: the Security Council «decides that all States shall prevent the sale or supply to» the target state, «by their nationals or from their territories, or using their flag vessels or aircraft, of» the certain goods, «whether or not originating in their territory».[36] Considering that the decision on the employment of embargo is not a procedural decision by its nature, for it to be implied, according to

[35] E.g., in the resolution S/1696 (2006), concerning Iran's nuclear programme, the Security Council had demanded from Iran to suspend all enrichment-related and reproccesing activities, including research and development. Due to Iran's failure to comply with the Council's demands, the same year resolution S/1737 was layed down in which the Security Council employed against Iran the embargo on all items, materials, goods, equipment and technology which could contribute to Iran's enrichment-related, reprocessing or heavy water-related activities, or to the development of nuclear weapon delivery systems.

[36] E.g., in this manner the arms embargo against Eritrea and Ethiopia was enforced in the paragraph 6 of the S/1298 (2000) resolution: «Decides that all States shall prevent the sale or supply to Eritrea and Ethiopia, by their nationals or from their territories, or using their flag vessels or aircraft, of arms and related matériel of all types, including weapons and ammunition, military vehicles and equipment, paramilitary equipment and spare parts for the aforementioned, whether or not originating in their territory».

Article 27 of the Charter, affirmative votes of nine Security Council members are needed, including the concurring votes of the permanent members.

Third stage represents the implementation of the Security Council decision on the employment of embargo. The measures imposed by the Security Council normally are not self-executing but in order to secure their implementation must be transformed into legislative, executive and judicial measures at the national level of every state, according to their constitutional systems.[37] Despite the dependence of the exertion of embargo on the actions of the UN member states, the implementation of the embargo is not about a delegation of the enforcement of embargo from the Council on to the member states, but such decentralized measure remains further an United Nations measure.[38] In accordance with Article 25 of the UN Charter, the member states are obliged to implement the embargo imposed by the Security Council, and every contrary conduct should be considered as a breach of the obligations imposed on them by the Charter. There cannot be legitimate excuse for not implementing the embargo fully in the manner defined by the Council, regardless of the plausible nature of the eventual excuse, whatever the excuse could be: a norm of the internal law of the member state, an international legal duty based on the member state's position of the permanent neutrality, or the economic necessity, i.e. the difficult economic situation arisen for the member state due to the implementation of the embargo against the target state.[39]

Fourth stage of the enforcement of embargo is the monitoring of its implementation. In the resolution in which embargo is imposed, the Security Council demands from the UN member states to report the measures each of them has taken in order to implement the imposed embargo to the Council,[40] or to the UN Secretary General,[41] or to the sanctions committee established by the same or by the latter resolution.[42] Sanction committees are *ad hoc* subsidiary

[37] Gowlland-Debbas, V., Collective Responses to Illegal Acts in International Law – United Nations Action in the Question of Southern Rhodesia, Dordrecht, Martimes Nijhoff Publishers, 1990, p. 558.

[38] Cf. Lapaš, op. cit. (note 6), p. 247.

[39] Gowlland-Debbas, op. cit. (note 37), p. 491.

[40] E.g., in the resolution S/232 (1966) the Security Council calls upon the member states to report the measures each has taken to implement the imposed comprehensive embargo against Southern Rhodesia to the Council.

[41] E.g., in the resolution S/724 (1991) the Security Council requests all member states to report to the Security General within twenty days on the measures they have instituted for meeting the obligations set out in resolution S/713 (1991) to implement a general and complete embargo on all deliveries of weapons and military equipment to Yugoslavia.

[42] E.g., in the resolution S/751 (1992) the Security Council empowers the Sanctions Committee for Somalia, established pursuant to the same resolution, to seek from the member states information regarding the action taken by them concerning the effective implementation of the general and

bodies established by the Security Council on the *ad hoc* basis in order to monitor and manage coercive measures imposed by the Council,[43] in pursuance of the authorization provided by Article 29 of the Charter, according to which the Security Council may establish such subsidiary bodies as it deems necessary for the performance of its functions.[44] The members of the sanctions committees are the representatives of all of the fifteen members of Security Council, whereas in every sanction committee different persons had been appointed.[45] These persons in sanction committees make decisions by consensus, on indoor sessions, without presence of the target state representatives.[46] The actions of sanction committees are classified, and merely few selected decisions and annual reports of their activities are being made public.[47] Taking into account the nature of sanction committees as *ad hoc* bodies, their functions vary in every single case, whereas these functions are being assigned by the Security Council resolution in which a certain sanction committee has been established. Amongst the most significant functions of sanction committees, a task to consider and decide expeditiously requests for the approval of exports to the target state of products for essential humanitarian needs and to consider and decide other exemptions, should be highlighted.[48] This function of sanction committees is completely discrepant with their primary function of monitoring the implementation of embargo in order to make the enforcement of embargo more efficient. Due to these opposed functions of sanction committees and due to their insufficient institutionalization, non-transparency and arbitrariness of the decision-making process, some authors refer to the functioning of sanction committees in this manner as to «Jekyll and Hyde situation».[49] When there is no more need for their activities, sanction committees are being terminated pursuant to Security Council decisions provided in a particular resolution,[50] or in the statement of the President of the Security Council.[51]

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complete embargo on all deliveries of weapons and military equipment to Somalia imposed by the S/733 (1992) resolution.

43 Concerning the monitoring and managing embargoes, sanctions committees were, e.g., established: for Southern Rhodesia (S/253, 1968); for South Africa (S/421, 1977); for Iraq (S/661, 1990); for SFRY (S/724, 1991); for Somalia (S/751, 1992); for Haiti (S/841, 1993); for Rwanda (S/918, 1994); for FRY (S/1160, 1998); for Côte d'Ivoire (S/1572, 2004); for DPRK (S/1718., 2006); etc.

44 Cf. Lapaš, op. cit. (note 6), p. 240.

45 Ibid., p. 241.

46 Ibid., p. 242.

47 These decisions and annual reports are being made public on the official UN website as well, and are available on the following URL: http://www.un.org/sc/committees/ (14-03-2007)

48 See, e.g.: S/841 (1993), S/1132 (1997), S/1298 (2000), S/1521 (2003), S/1572 (2004), etc.

49 Lapaš, op. cit. (note 6), p. 243.

50 See, e.g. : S/919 (1994, for South Africa), S/944 (1994, for Haiti), S/1483 (2003, for Iraq), etc.

51 E.g., Sanction Committee for Eritrea and Ethiopia was terminated by the statement of the President of the Security Council S/PRST/2001/14 in the year 2001. Currently, there are twelve active

As a rule, the termination of the enforcement of embargo occurs as a result of the explicit provision contained in the Security Council resolution. In this provision the date of the termination of the enforcement of embargo might be designated as the date on which the resolution was adopted,[52] as any other calendar determined date or as a date on which a certain event is believed to occur.[53] Embargo that was limited in time is being terminated as a result of the expiration of the period of time on which it was employed, or as a result of the non-renewal after this limited period of time expired. On the termination of the enforcement of embargo in such a manner, the Security Council may lay down a separate resolution, but it also needs not to do so.[54]

3.3. The legal nature of embargo in the United Nations system

Frequently, in the everyday life, and in the legal doctrine as well, the term «embargo», in the meaning of the coercive measure provided in Article 41 of the Charter of the UN, is used almost as a synonym to the UN sanctions. However, the question remains whether embargo really deserve to be considered as a legal sanction or is it something completely different? In the legal doctrine, sanction, in the narrow sense, is defined as «a punitive, *per se* illicit reaction of a normative system to the breach of its primary norm, enshrined in the violation of the normally guaranteed right of the target of that sanction.[55] The measure of embargo could be considered as a sanction in the narrow sense, if it corresponds to the four demands installed in the above mentioned definition. It has to be:

1. a reaction of a normative system,
2. a punitive reaction,
3. a reaction to a wrongful act, perceived as breach of the primary norm of the normative system,
4. a *per se* illicit reaction, enshrined in the violation of the normally guaranteed right of the target of embargo.

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sanction committees, established pursuant to resolutions S/751 (1992), S/918 (1994), S/1132 (1997), S/1267 (1999), S/1518 (2003), S/1521 (2003), S/1533 (2004), S/1572 (2004), S/1591 (2005), S/1636 (2005), S/1718 (2006) and S/1737 (2006).

52 E.g., in the resolution S/1074 (1996) the Security Council decided to terminate the comprehensive embargo against FRY with immediate effect.

53 E.g., in the resolution S/944 (1994) the Security Council decided to terminate the oil and arms embargo set out in the resolutions S/841 and S/873 (1993), as well as the comprehensive embargo set out in the resolution S/917 (1994) at 00:01 a.m. EST on the day after the return to Haiti of the deposed President Aristide.

54 E.g., arms embargo against Eritrea and Ethiopia expired on 16 May 2001 after the period of twelve months for which it was employed, about what the President of the Security Council solely gave a statement S/PRST/2001/14, on behalf of the Council, in which he only noted that arms embargo had expired.

55 Lapaš, op. cit. (note 6), pp. 47 - 48.

There is not doubt that embargo in the UN system is a reaction of a normative system, for the UN legal system is, as well as international law in general, by all means a normative system.

The purpose of embargo is clearly defined in Article 39 of the UN Charter, according to which the purpose of embargo is «to maintain or restore international peace and security» - therefore, the purpose of embargo is not punishment, but cessation of the international wrongful act. Due to such a purpose, the legal nature of embargo is more congenial to the legal nature of the so-called «police measures». «Police measures» («*mesures de police*»), as measures with the purpose of cessation of the wrongful act as its primary purpose, are being applied «in the midst of the commitment of that act, therefore they do not have the nature of an *ex post delicto* measure, which is the characteristic of a sanction derived from its punitive element.[56] However, in the practice of the Security Council, cases where embargo indeed has a punitive purpose can also be found.[57]

An internationally wrongful act could be defined as a breach of the primary norm of the normative system. For a measure to be a sanction, it needs to be, among other elements, a reaction to such a wrongful act. Certain measure might occur not only as a reaction to a wrongful act, but also as a reaction to a permissible act that is, not contrary to the primary norm, but just unpleasant to interests of the sender state; if such a measure is *per se* legal, it would have a legal nature of a retorsion,[58] otherwise it would be a quasi-reprisal and actually, in the lack of the unlawfulness of its cause, a mere wrongful act.[59] In the UN system, even in the case of a permissible but unpleasant act, regarding to the lack of a primary norm of the international law which would prohibit such an act, the act in question would always be wrongful, because the condemnation of such an act and the demand for its cessation expressed in the Security Council resolution would have a significance of the primary norm, so the prolongation of such an act would

[56] Cf.: Ibid., p. 35.

[57] A good example is embargo on luxury goods enforced against DPR Korea in accordance with the Security Council resolution S/1718 in the year 2006. In October 2006, DPRK has conducted a test of a nuclear weapon, contrary to the obligation to suspend all activities related to the development of nuclear weapons, established in the Security Council S/1695 (2006). In the resolution S/1718, the Council expressed profound concern that the test conducted by the DPRK had generated increased tension in the region and beyond, determined therefore that there was a clear threat to international peace and security, and employed, among other measures, the embargo on luxury goods against DPRK. Considering that such embargo was employed ex post delicto and that, as per its purpose, it corresponded to punishment, the conclusion is made that the embargo on luxury goods employed against DPRK, regarding to its punitive element, was indeed a sanction, and not just merely a «police measure».

[58] For more details see e.g.: Lapaš, op. cit. (note 6), pp. 180 – 184.

[59] Ibid., pp. 186 - 187. For a detailed explanation of the term «quasi-reprisal», see: ibid., pp. 184 - 188.

represent a breach of this primary norm. Imputation of responsibility on the perpetrator of such a breach in the following resolution would make possible the employment of the measures provided by the secondary norm – i.e. provided by Article 41 of the UN Charter. Therefore, the employment of embargo in such a case would be a reaction to the breach of international obligation. Regarding that embargo in the UN system would always be a reaction to a wrongful act, this element of the definition of sanction is fulfilled.

For a measure to be a sanction, it needs to be a *per se* illicit reaction, which means that it has to be a violation of the normally guaranteed right of its target. From the standpoint of the general international law, there is not a single norm of the international law which would impose on a state or other international legal person the obligation to maintain economic relations with another state or with another international legal person.[60] Nor does such a norm exist within the United Nations system as in the legal subsystem of international law in general. Due to the absence of such an international legal norm, corresponding international legal right to maintain economic relations with a certain state, or specifically a right to import certain goods, does not exist as well. In respect of the non existence of such rights, embargo as the prohibition of export of certain goods to the target state, could not violate such rights of the target state. Therefore, due to the absence of its intrinsic wrongfulness, embargo in the United Nations system could never be a sanction in the narrow sense. Apart from the cases where there exists a certain trade agreement or another obligation to maintain economic relations with another state, embargo would always be a *per se* legal reaction to a wrongful act, therefore according to its legal nature it would always be a quasi-retorsion.[61]

In conclusion, embargo, as a measure provided in Article 41 of the UN Charter is a quasi-retorsion, i.e. *per se* legal reaction of the normative system to a wrongful act, whose purpose is seldom punitive, but often is contained in the cessation of that act. Therefore, the wording of the Charter is justified, since the term «coercive measure», used in the Charter, seems to be more appropriate to describe the real legal nature of embargo.

4. THE HUMAN RIGHTS AS THE PEREMPTORY NORMS OF THE INTERNATIONAL LAW

The expression of «*ius cogens*» in international law as well as in any legal system is used to determine such legal norms that could not be derogated by the agreement between the subjects of that legal system. Those peremptory norms

[60] Ibid., p. 302.

[61] For more on the term «quasi-retorsion», see: ibid., pp. 184 - 187.

could arise from the customary law and from the international treaties.[62] The existence of peremptory norms in international law is confirmed in Article 53 of the Vienna Convention on the Law of Treaties:

«A treaty is void if, at the time of its conclusion, it conflicts with a peremptory norm of general international law. For the purposes of the present Convention, a peremptory norm of general international law is a norm accepted and recognized by the international community of States as a whole as a norm from which no derogation is permitted and which can be modified only by a subsequent norm of general international law having the same character».[63]

Although their existence is not disputable, an official list of all of peremptory norms in international law does not exist, hence the question which norms of international law are part of «*ius cogens*» may only be answered in accordance with the authority of the legal doctrine and the judicial decisions.[64]

Nowadays there is a general consensus in the legal doctrine that norms providing some of fundamental human rights could be considered as «*ius cogens*»,[65] and that they primarily refers to the principles provided in the Universal Declaration of Human Rights, which was adopted in the UN General Assembly in 1948.[66] Considering that the principles of the Universal Declaration of Human Rights, particularly through the customary law, formed the legal obligation not only for every state's internal legal system but also for international law.[67] Therefore the bodies of the United Nations are obliged to act in compliance with these principles as well.

Among the rights guaranteed by the Universal Declaration, several rights should be particularly emphasized, in view of the possibility of their violation by the Security Council embargoes: the right to life, liberty and security of person (Article 3); the right not to be subjected to torture or to cruel, inhuman or degrading treatment or punishment (Article 5); the right to work, to free choice of employment, to just and favorable conditions of work (Article 23); the right to a standard of living adequate for the health and well-being, including food, clothing, housing and medical care (Article 25).

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62 Andrassy / Bakotić / Vukas, op. cit. (note 25), p. 7.

63 Vienna Convention on the Law of Treaties (1969), United Nations Treaty Series, Vol. 1155, 1980.

64 Andrassy / Bakotić / Vukas, op. cit. (note 25), p. 7.

65 Zemanek, K., «The Unilateral Enforcement of International Obligations», Zeitschrift für ausländisches öffentliches Recht und Völkerrecht, Vol. 47, No. 1, 1987, p. 39.

66 Universal Declaration of Human Rights was adopted in the General Assembly resolution A/217(III), on December 10, 1948.

67 Köchler, H., «Ethical Aspects of Sanctions in International Law – The Practice of the Sanctions Policy and Human Rights», IPO Research Papers, Vienna, International Progress Organization, 1994, Ch. II, para. 1, available on: http://www.hanskoechler.com/sanctp.htm (13-03-2007)

In the legal doctrine it is emphasized that a certain hierarchical order exists within human rights, and within this order, the right to life, from which the right to an adequate standard of living, the right to medical care and similar rights are derived, assumes primary importance.[68] The right to life and other fundamental human rights derived from the right to life are the precondition of validity of other rights, including the civil and political rights, therefore they may not be sacrificed for the sake of the latter.[69]

The principles of the Universal Declaration were transformed into the obligatory duties in the International Covenant on Economic, Social and Cultural Rights and in the International Covenant on Civil and Political Rights,[70] and today the core of these rights has been considered as protected by peremptory international legal norms. However, it is worth mentioning that the relation between peremptory norms of a legal system, protecting some of the fundamental rights of its subjects, and sanctions, targeted directly to violate these rights, should not be understood as being disparate. On the contrary, such a relationship emanates from the *per se* illegal character of the sanction content in any legal system, and consequently is not a specific feature of the sanction in the international legal system.

Having in mind the firm legal structure of sanction in municipal legal systems, particularly its clear foundation in secondary norms, the question of the relation between sanctions and peremptory norms in these legal systems has usually been neglected. However, municipal legal systems, particularly by their criminal sanctions, usually violate exactly some of the values regularly protected by peremptory norms of these legal systems: property, freedom, and even the life of their subjects. Of course, it would be futile to elaborate the *per se* illegal character of these measures in relation to those peremptory norms. Actually, these sanctions confirm those social values by violating them with respect to the subject that had violated the primary legal norm protecting the same values.

However, there is a difference here. The violation of fundamental human rights, sometimes followed by catastrophic humanitarian consequences as a result of the UN embargo implementation, is not a part of the content of that measure. Therefore, such consequences have no legal basis in any secondary international legal norm, including article 41 of the UN Charter. On the contrary, they appear only as collateral side-effects of the application of the UN economic sanctions, having their origin in the legal poverty of the UN sanction system.

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68 Ibid., Ch. II, para. 6

69 Ibid.

70 These covenants were adopted and opened for signature, ratification and accession by General Assembly resolution A/2200(XXI) in 1966, and entered into force in 1976.

5. THE RELATION BETWEEN EMBARGO AND HUMAN RIGHTS

5.1. The relation between embargo and human rights according to the Charter of the United Nations and to the Security Council resolutions

Embargo, as a measure provided in the Chapter VII, Article 41 of the Charter of the United Nations, may be employed, according to the provision of Article 39 of the Charter, in order to maintain or restore international peace and security, after the Security Council determined the existence of any threat to the peace, breach of the peace, or act of aggression. The Charter of the UN does not contain provisions which would explicitly consider the violations of human rights as a cause for the action under the Chapter VII of the Charter. However, in the Security Council resolutions, grave and systematic violations of the human rights are frequently being determined as a threat to the peace, and, based on such determinations; embargo (and/or other measures) is being employed against the target state which is considered to be responsible for such violations.[71]

Hence, the embargo in the Security Council practice indeed is being enforced as a reaction to the violations of human rights, on the other hand, it could be understood as a means of such violations as well. The provision of Article 41 of the Charter which without any restrictive clause provides the possibility of employment of coercive embargo as one of the measures of the «complete interruption of economic relations», Köchler compared to the tradition of medieval military sieges, i.e. the starvation of the civilian population in the interest of the respective power.[72] Such lack of the explicit limits to the enforcement of the coercive measures provided in the Charter in respect to human rights, Köchler considers to be the main flaw of the Charter regarding the human rights, and concludes that in the normative logic of the Charter the peace as a goal apparently prevails over the respect for human rights.[73] In the paragraph 3 of Article 1 of the Charter, as one of the purposes of the United Nations, the achievement of international co-operation «in promoting and encouraging respect for human rights and for fundamental freedoms for all without distinction as to race, sex, language, or religion» has been proclaimed. Since the Security Council is obliged, according to the paragraph 2 of Article 24 of the Charter in discharging its duties, to act in accordance with the purposes and principles of the United Nations, the Council is obliged to respect human rights, even when acting under the Chapter VII of the Charter. Hence the restoration of the peace does not assume priority over human rights, since it should be, according to the Charter,

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71 E.g., the *apartheid* policy in South Africa was determined as a threat to the peace in the Security Council resolution S/418 (1977), so the arms embargo, among the other measures, was employed against South Africa.

72 Köchler, op. cit. (note 67), Ch. II, para. 1.

73 Ibid., Ch. I, para. 4.

in the function of respect for human rights. The enforcement of embargo by the Council which would violate the basic human rights would be contrary to the purposes of the United Nations proclaimed in the Charter. Additionally, such enforcement would be contrary to the protection of fundamental human rights protected by *ius cogens* norms of general international law.[74] Therefore, in the relation to human rights, embargo is doubly limited: by the Charter of the UN and by the *ius cogens* norms of general international law.[75]

5.2. The relation between embargo and human rights – the example of the comprehensive embargo against Iraq

From the UN Security Council practice the example of comprehensive embargo against Iraq has been specially emphasized because the enforcement of that embargo had as a consequence numerous violations of human rights of Iraqi civil population and had caused the humanitarian disaster of monstrous proportions.

The comprehensive embargo against Iraq, among other measures, was imposed by the Security Council resolution S/661 in 1990, in response to the Iraqi occupation of Kuwait. However, even after the withdrawal of Iraq from Kuwait, because of the non compliance of Iraqi government with the obligations imposed by the following resolutions, the enforcement of embargo was constantly extended for more than a decade. Merely after the occupation of Iraq by the United States and its allies in March 2003, the Security Council adopted the resolution S/1483 in May 2003 and terminated the comprehensive embargo and all other measures employed against Iraq, with the exception of embargo on arms and military equipment.[76]

Albeit the resolution S/661 provided the humanitarian exceptions to the comprehensive embargo which referred to the supplies intended strictly for medical purposes and foodstuffs, the slowness and the intricacy of the administrative process conducted for their approval by the Sanction Committee for Iraq had resulted with the inadequacy of food and medical supplies for the Iraqi population. Inadequate supplies of food and medical necessities are considered to be the main reason why the Iraqi infant mortality had risen from the pre-Gulf War rate of 3,7% to 12% by 1998, and it is estimated that the deaths of 500 000 children in Iraq can be directly assigned to the enforcement of the comprehensive embargo against Iraq.[77] Because of fears they might be used in the purposes of

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74 Ibid., Ch. II, para. 7.

75 For more details here see also: ibid., Ch. II(1), para. 3.

76 Lapaš, op. cit. (note 6), p. 215.

77 Mueller, J. / Mueller, K., «Sanctions of Mass Destruction», Foreign Affairs, Vol. 78, No. 3, May/June 1999, p. 49.

war, medical diagnostic techniques that use radioactive particles, once common in Iraq, were banned under the comprehensive embargo, and even plastic bags needed for blood transfusions were restricted.[78] It is estimated that, owing to the lack of medical supplies, by 1997, 30% of hospital beds were out of use, 75% of all hospital equipment did not work and 25% of Iraq's 1305 health centers were closed.[79] The Sanction Committee did not approve the export of chlorine, an important water disinfectant, into Iraq, because it might be diverted into making chlorine gas, a chemical weapon, which lead to the shortage of potable water throughout Iraq.[80] Because of the fear of the possibility of production of weapons of mass destruction, the export of fertilizers and insecticides to Iraq was not allowed, and as a result disease-carrying pests that might have been controlled have proliferated.[81]

These facts indicate that the enforcement of the comprehensive embargo and other comprehensive economic measures against Iraq had violated the entire scale of fundamental rights of the civil population of Iraq: from the right to a standard of living adequate for the health and well-being, including food, clothing, housing and medical care, to the right to life.

An attempt had been made to alleviate the humanitarian disaster caused by the comprehensive economic measures with the «Oil for Food» program introduced in the Security Council resolutions S/706 and S/712 in 1991, and in the resolution S/986 in 1995, which allowed Iraq a limited sale of oil in order to acquire food and other humanitarian necessities for own population, therewith the income of such sale was being deposited on a special account under the control of the United Nations, from which the humanitarian help to the population of Iraq was partly financed, while the rest of assets were reserved for the coverage of the costs of the enforcement of economic measures against Iraq.[82] In such a manner a paradox situation occurred: Iraq itself had to bear the costs of the economic measures imposed against it, while the humanitarian exemptions were transformed into humanitarian help which, instead of being provided by the United Nations, Iraq itself actually had to buy.[83]

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78 Ibid., p. 50.

79 Bossuyt, M., «The Adverse Consequences of Economic Sanctions on the Enjoyment of Human Rights», Economic and Social Council, Commision on Human Rights, Sub-Commision on the Promotion and Protection of Human Rights, 52nd session, June 21, 2000, E/CN.4/Sub.2/2000/33, p. 16, para. 65., available on: http://daccessdds.un.org/doc/UNDOC/GEN/G00/140/92/PDF/G0014092.pdf?OpenElement (09-03-2007)

80 Mueller / Mueller, op. cit. (note 77), p. 49.

81 Ibid., p. 50.

82 Lapaš, op.cit. (note 6), p. 243.

83 Ibid.

5.3. The demands for the humanization of embargo

Certain authors, in describing the comprehensive embargo and the «sanctions» regime against Iraq in general, went as far as comparing it with the crime of genocide.[84] Article 2 of the Convention on the Prevention and Punishment of the Crime of Genocide, of 1948 defines genocide as follows: «Any of the following acts committed with intent to destroy, in whole or in part, a national, ethnical, racial or religious group, as such:

(a) Killing members of the group;

(b) Causing serious bodily harm or mental harm to members of the group;

(c) Deliberately inflicting on the group conditions of life calculated to bring about its physical destruction in whole or in part;

(d) Imposing measures intended to prevent births within the group;

(e) Forcibly transferring children of the group to another group.»[85]

Bossuyt, in his report on the adverse consequences of economic measures on human rights, prepared within the framework of the Sub-Commission on the Promotion and Protection of Human Rights, established as a working body of the UN Economic and Social Council's Commission on Human Rights, concludes: «The sanctions regime against Iraq has as its clear purpose the deliberate infliction on the Iraqi people of conditions of life (lack of adequate food, medicines, etc.) calculated to bring about its physical destruction in whole or in part. It does not matter that this deliberate physical destruction has as its ostensible objective the security of the region. Once clear evidence was available that thousands of civilians were dying and that hundreds of thousands would die in the future as the Security Council continued the sanctions, the deaths were no longer an unintended side effect - the Security Council was responsible for all known consequences of its actions».[86]

Although the comprehensive embargo does not include the use of armed force, at the end it leads to the same catastrophic consequences for civil population as the use of armed force does. The economic coercion in the proportion which exceeds the regular relations in the society, and especially the extreme economic coercion, should be considered as contrary to international law. However, the economic coercion is not a part of the substance of the economic measure, but merely a result of its enforcement.[87] Therefore, reducing of such coercion to the proportion appropriate for the international legal «sanction», should be the

[84] Bossuyt, op. cit. (note 79), p.18, para. 71.

[85] Convention on the Prevention and Punishment of the Crime of Genocide (1948), United Nations Treaty Series, Vol. 78, 1951, p. 277.

[86] Bossuyt, op. cit. (note 79), p. 18, para. 72.

[87] Lapaš, op. cit. (note 6), p. 297.

task of international regulation of the elements of its legal «infrastructure» (e.g. proportionality, purpose, duration, etc.[88]

Following the conception of St. Thomas Aquinas, Köchler emphasized four moral conditions to which the enforcement of comprehensive embargo should correspond:[89]

1. The intended final aim must be good;
2. The embargo as the means to achieve this aim must be morally acceptable;
3. The foreseen bad upshot must not itself be willed;
4. The intended good aim must be proportional to the possible bad collateral effects in the application of such a coercive measure.

The maintenance or restoration of international peace univocally is «good», but the comprehensive embargo, in a manner it was enforced against Iraq, does not correspond to the other moral conditions. Therefore, Köchler does not seen a difference in the result between the comprehensive embargo in the one hand, and the terrorism in another.[90]

The enforcement of comprehensive embargo had a catastrophic humanitarian impact in other cases as well. The comprehensive embargo employed against Haiti by the Security Council resolution S/917 (1994) had significant humanitarian consequences, e.g. the rise in child mortality.[91] Even though there is no evidence of additional humanitarian impacts of the targeted economic measures in the cases of their enforcement,[92] a targeted embargo might cause a grave violation of human rights as well as a comprehensive embargo.[93] This is in particular perceivable in cases where the arms embargo was employed equally against all parties in the conflict. The enforcement of arms embargo in such a manner is in fact counterproductive: those who do not have weapons cannot defend themselves from those who are already armed. Thus, those who have weapons, have enough of them to continue the aggression. Therefore, the arms embargo does not affect the target state too much, but on the contrary favors it and facilitates the aggression. Such a «neutral» arms embargo, as described, sometimes threatens the right to life of the members of the less armed group, and in consequence it threatens a great number of other fundamental human rights. A typical example for this is the example of the arms embargo imposed

88 For more details here see: ibid., pp. 20 – 48.
89 Köchler, op. cit. (note 67), Ch. I, para. 6.
90 Cf. ibid., Ch. I, para. 8.
91 Cortright, D. / Lopez, G. A., The Sanctions Decade – Assessing UN Strategies in the 1990s, Boulder, London, Lynne Rienner Publishers, Inc., 2000, p. 205.
92 Ibid., pp. 205 – 207.
93 Opposite: Köchler, op. cit. (note 67), Ch. II, para. 1.

against the entire territory of the former Socialist Federal Republic of Yugoslavia, in the Security Council resolution S/713 (1991), which had contributed at a large scale to the prolongation of war in Croatia, and especially in Bosnia and Herzegovina.

For the purpose of embargo humanization, in the sense of the enhanced adjustment with the human rights, Bossuyt suggests that prior to their employment, all types of coercive economic measures provided in Article 41 of the Charter, should be evaluated in accordance with the "six-prong test".[94] According to that test, the evaluation of each economic measure which is intended to be employed against a certain state has to give an affirmative answers to the following six questions:[95]

1. Are the measures imposed for valid reasons?
2. Do the measures target the proper parties?
3. Do the measures target the proper goods or objects?
4. Are the measures reasonably time-limited?
5. Are the measures effective?
6. Are the measures free from protest arising from violations of the "principles of humanity" and the dictates of the public conscience»?

Cortright and Lopez emphasize that the harmonization of the demands for more efficient economic measures and the demands for their humanization is not only possible, but necessary.[96] For this purpose, they suggest: that the humanitarian assessment reports should be conducted in the early stages of the enforcement of economic measures; that economic measures should be designed in a manner that they deny assets and resources of value to decision-making elites, and not to the entire population of the target state; that the state-specific and institution-specific procedures that grant blanket humanitarian exemptions to trusted UN humanitarian agencies in specific cases should be adopted; that the efficiency of the *ad hoc* sanction committees should be increased.[97]

Nowadays there is a generally prevailing opinion in the legal doctrine that due to proven negative consequences of the enforcement of embargo and other measures provided in Article 41 of the UN Charter on human rights, these measures should be refined. In this sense, as primary idea appeared that of the so-called «smart sanctions», because such measures which would directly affect

94 Bossuyt, op. cit. (note 79), p. 11, para. 41.
95 Ibid., pp. 11 – 12., paras. 41 – 47.
96 Cortright / Lopez, op. cit. (note 91), p. 224.
97 Ibid., pp. 247 – 248.

the political elite of the target state or just the specific, for the purpose of these measures important part of the target state's economy.[98] As «smart» sanctions particularly financial measures have been highlighted, e.g. freezing of assets or bank accounts of the responsible individuals or classes of individuals.[99]

6. CONCLUSION

As long as the «global village» in which we live will be exposed to constant threats to the international peace and security, embargo and other economic measures will remain an indispensable means of reaction to such threats, since the only alternative to these measures would be the use of armed force. However, bearing in mind that such measures, particularly the comprehensive embargo, leave behind irreparable negative consequences and by their effects are similar to the measures involving the use of armed force, their reform is essential. Adjustment of these measures to fundamental human rights is not only a legal demand, since those rights are protected by peremptory norms of international law, but is a demand of morality. Currently, as it has been already mentioned, these measures, especially taking into account their effects, have an uncertain standing in international law, and hardly have an ethical foundation.

We believe that it is possible to harmonize these, at first sight completely opposite demands: the demand for more efficient economic measures and the demand for their humanization. For the purpose of this harmonization we are suggesting three propositions.

The first proposition would be to completely abandon the use of the comprehensive embargo in the practice of the United Nations. The enforcement of such embargo, as it has been shown in the example of Iraq, has as a consequence grave violations of human rights resulting in a humanitarian disaster. What message do the coercive economic measures send out to the civil population of the target state? It seems that by the enforcement of such measures the population is held responsible for acts of its government. This being so, the civil population seems to be punished for choosing that government or for not overthrowing such a government by revolutionary means. The enforcement of such an embargo is not ethical at all, especially if it is enforced against a state with low democratic standards which do not reflect even the minimum of the democratic will of its citizens. The efficiency of coercive economic measures, in the political sense,

[98] Lapaš, op. cit. (note 6), p. 134.

[99] The statement of the UN Secretary General Kofi Anan on the press-conference, New York, April 17, 2000, Press Release SG/SM/7360, para. 6.

could be, as it will be seen in our third proposition, accomplished by other measures which do not affect the civil population so heavily.

Our second proposition is related to the enforcement of the targeted embargo. As it was demonstrated, the targeted embargo, especially the arms embargo, might violate human rights as well. Therefore, if it is considered that the employment of the arms embargo is necessary, it should be employed in a manner which affects the group that is the culprit for a certain armed conflict, and it should not be employed «neutrally», i.e. equally against all the parties of the conflict.

Finally, we would propose the complete substitution of the embargo and all other commercial measures with financial measures, such as the freezing of assets or bank accounts and similar measures. Such targeted, «smart» measures, by aiming at the political elite of the target state, do not affect the innocent civil population. On the other hand, regarding the *per se* illegal character of their content, they are sanctions in the narrow sense. Such measures are surely more efficient and they punish those individuals whose behavior needs to be harmonized with the demands of the international community. Finally, in the contemporary capitalistic world order, a hit to someone's financial interests is certainly more painful than a hit «in the stomach» or a hit «in the head».

However, we have doubts that our proposition will be realized. Since the harmonization of the demand for more efficient economic measures and the demand for their humanization, considering today's organizational framework of the United Nations, lies in the hands of the world's five leading super powers, i.e. the permanent members of the Security Council, it is not realistic to expect that for these states humanitarian interests would prevail over the efficiency of economic measures. Of a greater concern is specially the attitude presented in the last few years by the United States in their foreign policy. As a very true demonstration of the United States foreign policy, we will quote a shocking answer of Madeleine Albright, the ambassador of the United States in the UN, given in an interview in 1996 in response to the following question of the journalist, regarding the impact of the comprehensive economic measures against Iraq: «We have heard that a half million children have died. I mean, that's more children than died in Hiroshima. And, and you know, is the price worth it?» Albright responded: «I think this is a very hard choice, but the price, we think the price is worth it».[100]

As long as the political interests of the world's most powerful states is «worth the price», and the demand for more efficient economic measures prevails over the demand for their humanization, these interests will hold the priority over international law as well as over international morality.

[100] «Punishing Saddam», 60 Minutes, CBS News, broadcasted on May 12, 1996.

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Cultural Rights

Mira Lulić
Assistant Professor
Law Faculty
University J. J. Strossmayer
Osijek, Croatia
E-mail: miral@pravos.hr

Ivana Tucak
Ph.D. Candidate
Law Faculty
University J. J. Strossmayer
Osijek, Croatia
E-mail: itucak@pravos.hr

Abstract

Theoreticians of various social disciplines systematically deal with the human rights issue, its history, content, justification, nature, universality and legal status. The authors of this paper analyze the status of cultural rights within the framework of International Law. Besides outlining the most relevant international documents on human rights, they give an overview of the most important international documents containing provisions on cultural rights. There is no universally accepted definition of "culture". Therefore, this paper is focused on the issue of numerous definitions of culture and the difficulty of finding generally accepted one. At the end of the paper there is the dilemma whether the West has the right to impose its norms and standards to other parts of the world in the way the West sees them.

INTRODUCTORY CONSIDERATIONS ON THE INTERNATIONAL HUMAN RIGHTS PROTECTION

International (Public) Law is a system of legal rules which regulates the relations between the subjects of International Law – primarily between states but also between international organizations (Andrassy, Bakotić, Vukas, 1995: 1-3). It includes norms on the status, rights, obligations and responsibility of the subjects of International Law and other protagonists within international community. International Law are not always clear and specific legal rules readily applicable

to every situation in international community, but that every international situation is capable of being determined "as a matter of law" (Oppenheim, 1996: 12-13). That is because states recognise the rules of International Law as legally binding in innumerable treaties and constantly reaffirm the fact that there is a law between themselves (Oppenheim, 1996: 13). Being the basis of International Law, "common consent" of states involves their binding with International Law. Customary International law and Treaty Law are primary sources of international law. Custom is the oldest source of International Law and historically, treaties are the second source of International Law. But custom and treaties cannot be regarded as the only sources of International Law. Article 38 (1) of the Statute of the International Court of Justice authorises it to apply, in addition to treaties and custom "the general principles of law recognizes by civilised nations" and, as a subsidiary and indirect source of International Law, decisions of courts and tribunals and writings of authors ("teaching of the most highly qualified publicist of the various nations")[1].

International-legal relations have been developed everywhere where there are more states or nations connected in a way or at least some kind of related cultural communities (Andrassy, Bakotić, Vukas, 1995: 37)[2]. Although the relevant history of International Law stretches back to the mediaeval period, the history of human rights protection is not very long. Until World War I human rights had been connected, in most cases, with the abolition of slavery. Between the two wars the International Labour Organization started taking care of workers' rights. After World War I there was also the issue of the rights and protection of refugees and stateless persons (Andrassy, Bakotić, Vukas, 1995: 294-297). However, not until the horrors of World War II, genocide and, especially, the Holocaust, international community had realized urgent need for an international human rights law. During the Second World War the world faced the most heinous ethnic cleansing in the history of mankind. As the consequence thereof, international community initiated systematic work on the matter of human rights, freedoms and the protection of human dignity, and, particularly, of vulnerable groups of peoples. Even though the uniqueness of human nature and its eminence have been recognized since ancient times, modern Europe is the place where human rights were born (Villey, 2002: 13). Human rights are granted to people due to the fact that they are humans. They stem from new-age philosophic theories

[1] Official Gazette – International Treaties, No. 15/1993, p. 305 and 7/1994.

[2] For example, the ancient Greeks were aware of prerequisites for a thorough development of international relations and international law within the common "Hellenic culture ". The equality of culture and ethnic familiarity and religious bonds favoured the development of interstate relations and their legal organization. More about cultural community in ancient Greece which reflected the legal status of foreigners, members of one Greek state within another one, see in Andrassy, Bakotić, Vukas; 1995, pp. 37-38).

of "natural rights". John Locke is one of the most important philosophers that developed the theory of natural rights.

Today, there are numerous human rights. Some are inalienable (e.g. the right to live), i.e. they can be taken from a person neither temporarily nor permanently. Whereas a variety of human rights can be limited (e.g. the freedom of movement) in certain situations (e.g.. war situations), human rights are protected both on an international and on a national level. States on an international level are bound to a number of ratified international treaties. On a national level, a person should be protected by the internal legal system and laws of the state.

The systematic protection of individuals on an international level had not begun until the United Nations, the most influential international organization, was created on 26 June 1945. Consequently, the protection of rights and freedoms of individuals has found its place in a variety of provisions of the Charter of the United Nations[3], which indicates the importance of human rights in terms of this huge international organization. For instance, in Article 1.3. of the Charter of the United Nations it is determined that the purpose of the United Nations is, among others, "to achieve international co-operation (..) in promoting and encouraging respect for human rights and for fundamental freedoms for all without distinction as to race, sex, language, or religion". Article 13 of the Charter of the United Nations stipulates that the General Assembly shall initiate studies and make recommendations for the purpose of "promoting international co-operation in the economic, social, cultural, educational, and health fields, and assisting in the realization of human rights and fundamental freedoms for all without distinction as to race, sex, language, or religion". Regarding the Article 55 of the Charter of the United Nations, Organization is obliged to secure universal respect for human rights and fundamental freedoms for all. Finally, Article 62.2. determines that the Economic and Social Council may make recommendations for the purpose of "promoting respect for, and observance of, human rights and fundamental freedoms for all".

The United Nations General Assembly adopted the Universal Declaration of Human Rights (1948)[4] which urged member nations to promote a number of human, civil, economic and social rights, asserting these rights are part of the "foundation of freedom, justice and peace in the world". The Declaration represents the most important international document with respect to human rights and a basis for all other international documents from the same field. In the Universal Declaration of Human Rights it is stated in a clear and simple way that the basic human right belong equally to every person. The General Assembly recognizes that the inherent dignity and the equal and inalienable

[3] Official Gazette – International Treaties, No. 15/1993, p. 305 and 7/1994.

[4] Adopted and proclaimed by General Assembly Resolution 217 A (III) of 10 December 1948.

rights of all members of the humanity is the foundation of freedom, justice and peace in the world. Human rights should be protected by the rule of law and the friendly relations between states must be fostered. "The peoples of the United Nations" have affirmed their faith in human rights, the dignity and the worth of the human person, the equal rights of men and women and are determined to promote social progress, better standards of life and larger freedom and have promised to promote human rights and a common understanding of these rights. It is the first international statement to use the term "human rights".

Besides the Charter of the United Nations and the Universal Declaration of Human Rights (1948), the main international document on human rights protections are also the International Covenant on Civil and Political Rights (1966)[5] and the International Covenant on Economic, Social and Cultural Rights (1966)[6]. The International Covenant on Civil and Political Rights details the basic civil and political rights of individuals and nations. The Optional Protocol adds legal force to the Covenant on Civil and Political Rights by allowing the Human Rights Commission to investigate and judge complaints of human rights violations from individuals from signatory countries[7]. The Second Optional Protocol abolishes the death penalty[8]. The International Covenant on Economic, Social and Cultural Rights describes the basic economic, social, and cultural rights of individuals and nations.

Among other basic documents of International Law regarding human rights protection the following should be pointed out: Convention on the Prevention and Punishment of the Crime of Genocide (1948)[9], Convention Relating to the Status of Refugees (1951)[10], Convention on the Political Rights of Women (31 March 1953)[11], Convention against Discrimination in Education (1960)[12], International Convention on the Elimination of All Forms of Racial Discrimination (1966)[13], Convention on the Elimination of All Forms of Discrimination against Women (1979)[14], Convention against Torture and Other Cruel, Inhuman or Degrading

5 General Assembly resolution 2200A (XXI) of 16 December 1966.
6 General Assembly resolution 2200A (XXI) of 16 December 1966.
7 General Assembly resolution 2200A (XXI) of 16 December 1966.
8 General Assembly resolution 44/128 of 15 December 1989.
9 General Assembly resolution 260 A (III) of 9 December 1948.
10 Adopted on 28 July 1951 by the United Nations Conference of Plenipotentiaries on the Status of Refugees and Stateless Persons convened under General Assembly resolution 429 (V) of 14 December 1950.
11 General Assembly resolution 640(VII) of 20 December 1952.
12 Adopted by the General Conference of the United Nations Educational, Scientific and Cultural Organization on 14 December 1960.
13 General Assembly resolution 2106 (XX) of 21 December 1965.
14 General Assembly resolution 34/180 of 18 December 1979.

Treatment or Punishment (1984)[15], and Convention on the Rights of the Child (1989)[16].

States shall respect the norms of International Law protecting the freedoms and rights of individuals. Otherwise, they violate International Law. After ratifying international treaties, states are obliged to incorporate international provisions into their internal legal systems and to take account of their implementation (e.g. criminal legislation, constitution etc.). Conventional mechanisms (treaty bodies), and extra-conventional mechanisms (United Nations special reporters, representatives, experts and working groups) have been set up in order to monitor compliance with the various international human rights instruments and to investigate alleged human rights abuses[17]. The United Nations shall monitor the implementation of treaties on the behalf of the signatory states by establishing special committees or treaty bodies. States shall mostly submit periodical reports on the implementation of a particular treaty. Unfortunately, the implementation and monitoring themselves are not as efficient as they should be considering a vast majority of states. The promotion of human rights has to be an important national interest of every state. It is essential for states to ratify international treaties and to respect them.

Finally, there are some documents including the notion of "cultural rights". This legal term is stated in a great number of international documents, among which the most important are singled out. Regarding Article 27 of the Universal Declaration of Human Rights Article "(1) everyone has the right to freely participate in the cultural life of the community, to enjoy the arts and to share in scientific advancement and its benefits". Also (2) "Everyone has the right to the protection of the moral and material interests resulting from any scientific, literary or artistic production of which he is the author". Article 15 of the International Covenant on Economic, Social and Cultural Rights (1966) recognize the right of everyone to take part in cultural life; to enjoy the benefits of scientific progress and its applications; and to benefit from the "protection of the moral and material interests resulting from any scientific, literary or artistic production of which he is the author". The recent state practice suggests that cultural rights are closely linked to the right to education: Article 26 of the Universal Declaration of Human Rights; Articles 13 and 14 of the International Covenant on Economic, Social and Cultural Rights; Articles 28 and 29 of the Convention (Thamilmaran; p. 74).

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15 General Assembly resolution 39/46 of 10 December 1984.

16 General Assembly resolution 44/25 of 20 November 1989.

17 See more The United Nations and Human Rights, Official Web site of the United Nations, World Wide Web URL http://www.un.org/rights/dpi1774e.htm/.

Article 27 of the International Covenant of Civil and Political Rights (1966) regulates that in those states in which "ethnic, religious or linguistic minorities exist, persons belonging to such minorities shall not be denied the right, in community with the other members of their group, to enjoy their own culture, to profess and practise their own religion, or to use their own language". In the 1992 UN Declaration on the Rights of Persons Belonging to National or Ethnic, Religious and Linguistic Minorities, Article 4 calls upon states to take measures enabling persons belonging to minorities to develop their own culture[18]. The Convention on the Prevention and the Punishment of the Crime of Genocide (1948) declares that genocide means acts committed with "intent to destroy, in whole or in part, a national, ethnical, racial or religious group" (Article 2). Article 13 of the Convention on the Elimination of All Forms of Discrimination against Women (1979) stipulates that women have the same rights as a man in particular "The right to participate in recreational activities, sports and all aspects of cultural life". Article 31 of the Convention on the Rights of the Child recognize the right of the child "to participate fully in cultural and artistic life and shall encourage the provision of appropriate and equal opportunities for cultural, artistic, recreational and leisure activity". Article 5 (e) (VI) of the International Convention on the Elimination of All Forms of Racial Discrimination (…) Economic, social and cultural rights, in particular: (..) "The right to equal participation in cultural activities".

One of the frequent divisions of human rights is the division into legal and moral rights, depending on the fact whether the rights are set by internal and/or international legal regulations or they are moral binding (e.g. moral obligation of respecting other people). If they are protected by laws, then it all comes to legal human rights. Moral human rights are not derived from positive law.

The standpoint that human rights are negative in their essence is no longer popular. Negative rights would be those which prevent governments from undertaking certain actions in order to enable individuals to exercise one of their rights. According to this standpoint, states would not be obliged to undertake particular activities or provide certain financial means in order to enable individuals to exercise their human rights. However, although states in particular situations shall restrain from undertaking certain activities (negative rights), they shall, still, ensure exercising some other rights (positive rights). Negative rights are usually related to political rights, notably to the freedom of speech, the right to property, confession and a fair trial etc. So, in these cases, states have to *abstain* from taking actions violating those (negative) rights. Positive rights involve state activities on, for instance, (financial and other) providing education, healthcare, social welfare and a decent standard of living (requiring states to take actions to guarantee them).

[18] General Assembly resolution 47/135 of 18 December 1992.

The theory of positive and negative rights may be applied to the relations between individuals wherein, in case of negative rights, an individual has to restrain from limiting or denying other person's rights (e.g. you cannot invade other people's house or you cannot kill another person). Vice versa, when positive rights are analyzed, one has to do something in order to enable exercising other person's rights (e.g. save the person in trouble). However, this division has its flaws. Not all the rights can be clearly divided into positive and negative ones, i.e. one right can simultaneously be, depending on a language and formulation, both negative and positive. Human rights are complex mechanisms, mutually connected and intervowen, so it is very difficult to separate them clearly and sharply.

The division of human rights into three generations was proposed by Czech lawyer Karel Vasak at the end of the 1970s (Vasak, 1977). The first generation involved civil and political rights: the right to security, property, and political participation. Those rights are very likely to have developed in the 18th and 19th century. Their goal is to protect an individual in a way that they are granted with the right to live, to vote, to the freedom of speech, to a fair trial and to confession (religion). Sometime they are called "negative" human rights. The second generation of human rights (socio-economic rights) is related to equality and had not been developed until the period between the two wars. It comprises social, economic and cultural rights such as the right to be employed, right to healthcare and social security. Sometime they are called "positive" human rights. Both generations are included in the Universal Declaration of Human Rights (1948). The third generation of human rights is the most disputable one. These are the "so-called" solidarity rights, and refer to the rights making the progressive development of International Law. They, actually, represent the objectives and orientation of the future development of International Law and were developed in the last 20 years of the 20th century. They are not explicitly and officially recognized by international documents, they do not have a definite range and include all kinds of rights. Their recognition within International Law is doubtful as well as their application. These are, for example, the right to peace, right to self-determination, right to a clean/healthy environment, right to natural resources, right to participate in cultural heritage, etc. Neither this division nor the previous theory is applied in practice. This division provides assistance in comprehending the characteristics and content of some aspects of human rights but it does not disclose their essence. For example, it is necessary to have fundamental education in order to exercise the right to political participation. Some individual rights (such as *the freedom of assembly and of association, freedom of religion)* are an important part of group – minority rights.

Human rights are particularly relevant since they protect people, their life and dignity. Nowadays there are certain rights that have reached a special level of

universality and general acceptance and protect all people and individuals around the world regardless of a legal system and civilisation. Human rights include, for instance, the right to freedom of religion, the right to a fair trial, the right not to be tortured, and the right to engage in political activity. P*olitical rights* protect the freedom to participate in politics through assembling, protesting, voting, and serving in public office. There are specific *rights aiming at providing security to protected persons,* e.g. security from crimes such as murder, torture, and rape. Then, there are *liberty rights* that protect the freedoms of belief, expression, association, assembly, and movement. There are also the "so-called" *equality rights* that guarantee equality before the law. There are *social rights* which include the right to education and protection against severe poverty. Cranston held that human rights are matters of "paramount importance" and their violation "a grave affront to justice" (Cranston, 1967: 51-52). Human rights have arisen from the need to protect individuals from severe political, legal, and social abuse by the state and other non-state actors. The problem for the future of International Law is couched in the chasm between Western and non-Western notions of law and morality (Joyner and Dettling, 1999: 276). Still, it is crucial that a good government adheres to international standards and norms on human rights protection since it is the spirit of democratic states and rule of law.

WHY IS THE NOTION OF "CULTURE" SO COMPLEX?

Anthropologists define culture as the behaviour and consideration of people within certain groups that have created, learnt and shared it, and where groups of people share one culture of thinking and live in the same or a similar manner. In general, language and confession are included in culture which has always had the key place in the development of a nation. Culture may also involve beliefs, behaviours, moral, symbols, rituals, motifs, folklore, music, art, literature, dress codes, gastronomy, technology and political and economic systems. It is passed on, developed and kept from generation to generation. Furthermore, it is manifested in a way that one cultural group speaks the same language, practises the same religion, dresses similarly, eat similar food and celebrates the same holidays. Therefore, the notions of culture and society are most often inseparable. Members of a culture can easily communicate and understand each other. Culture is especially important because it develops the feeling affiliation and solidarity among its members. Culture makes the difference between people, numerous peoples and nations have developed their cultures throughout centuries. When cultures get in touch, it comes to exchange of culture, elements of one culture are infiltrated into another one since one culture rarely exists in isolation due to the interaction between nations and groups of people. These contacts and exchanges of particular cultural elements carry advantages and disadvantages. Within

one state there are often two or more cultures, which may be the reason for intolerance and even contempt, hate, plain violence and conflict as well as wish for subjugation and dominancy (Lulić, 2005: 23). Sociologists determine culture as common values and practice of a group of people in which their symbols represent the way they communicate and develop their identity. Cultures are born and go extinct, they are liable to influences of other cultures and change by the time. For instance, many members of ethnic groups, minorities and nations have abandoned once important features of theirs, such as costumes, traditional music, gastronomy, cultural events etc.

There are multicultural nations (e.g. USA, UK, Brazil, Switzerland) with a strong national identity. At the same time, one culture (e.g. Arabic culture) can exist in several states (e.g. Mid-East, northern Africa). One may speak about the "*Indian nation*" despite enormous differences among the inhabitants of India? What is, by the way, the "*American culture*": participants of Jerry Springer show, Texas farmers, Wall Street brokers or State Department officers in Washington? With the exception of Japan, the United States of America is the only well-established democracy that has not abolished the death penalty either de facto or de jure (Wyman, 1996: 544). Since the USA do not accept the abolition of the death penalty, they can be, in that sense, compared to a fair number of Islamic countries sharing that view. Seeing it as a denial of "Western civilisation norms", are the USA "in violation by continuing to apply the death penalty"?

Younger generations throughout the world tend to identify themselves more with the American culture than with their parents, ancestors, people or nation. Individuals may gradually change their own culture, some may even become "*multinational*", which, though, happens rarely and is not politically or sociologically relevant (Nielsen, 1998: 127). On the other hand, Israelis are clearly a nation despite the fact that after World War II Jewish communities were featured by completely different histories and cultures resulting from living abroad (Lulić, 2005: 36). People can be compared with Jews, although they do not share the same language, culture, tradition, historical background or the attitude towards the Jewish state (Hobsbawm, 1993: 10). Two people may share completely the same *habitus*, may look the same, dress in the same fashion, use the same products but, still, belong to two different ethnic or national groups (Brubaker, 1998: 263). Most New Zealanders or citizens of the United Kingdom are culturally so related that these two units could not be separated if they were geographically in touch. Arabs from different countries culturally differentiate more than, for example, English or Dutch (Gellner, 1998: 154). Some national groups are defined exclusively based on blood ties, ignoring the culture. Notably in German, affiliation to the German nation is determined by offspring not by culture. Consequently, an ethnic German who has spent his whole life in the

Russian Federation and does not speak German at all, has the right to the German citizenship whereas ethnic Turks who have lived in Germany since they were born and who have been assimilated in the German culture, are not granted with that right (Kymlicka, 1996: 23). A group which is now a subject of ethnological analysis might, in 50 years, lose its "*collective cultural character*", just look at the history of Mons in Myanmar or Chuang in China, East Asian immigrants in Guiana or the one of American Indians (Native Americans) in order to notice the dynamicity of those notions (Enloe, 1990: 18-19).

DEFINING CULTURE

Various definitions of culture have been present so far. However, none of them has been accepted universally, which, still, does not mean that the concept of culture is blurred. The definition of culture would be of great help when defining the scope of cultural rights. Although determination and consistent use of a name are important in general, definitions of culture are countless (Kale, 2003: 45). Moreover, Raymond Williams, one of the most important cultural theoreticians, said that «culture» belonged to the two or three most complex English words (Williams, 1983, Craufurd Smith, 2004: 8). Although many notions from the field of social sciences are featured by ambiguity and various usage, one may say that the notion of culture is the broadest of all the notions used in social sciences (Čačić-Kumpes, 1999: 9). The notion of "culture" stems from anthropology, and by the time it has found its place in other social sciences and the humanities (sociology, ethnology, social psychology and etc.)[19]. Researching scientific papers from these fields Kroeber and Kluckhohn found as many as 257 different definitions of culture (Kroeber, Kluckhohn, 1952; Kale, 2003: 44), which clearly indicates what kind of challenges scientists and experts face when trying to define the notion of culture.

The word culture is derived from the Latin word cultus meaning «growing, care, upbringing, cultivation, education, worship» (Kale, 2003: 42). The notion of culture has gone through transformation throughout the years and is used in various ways nowadays. It is applied in order to denote everything what is civilized or cultivated, or it can be seen as a group of artistic and intellectual works of a society or even as the «entire way of life» (Haralambos; Holborn, 2002: 884). Let us start with Cotterrello who focused on the relation between law and culture. He thinks that culture in juristic researches *»typically embraces traditions (a sense of share cultural inheritance of some kind) and values or beliefs (a*

[19] The concept of culture entered practical application at the end of the 18th century, as a standard for evaluating "industrial modernity" (Kearns, 2004: 389). After publishing Adelung's The History of Culture (1782), the word became a part of dictionaries and spread into other linguistic fields (Kale, 2003: 45).

sense of convergence or commonality in ways of thinking, commitments, outlooks, or attitudes in population» (Cotterrell, 2004: 6). What overlays these components are emotional elements providing the outlook of common traditions, attitudes and viewpoints (Cotterrell, 2004: 6).

According to Vrban, culture consists of the layouts and patterns which regulate the life of a community and are a part of its legacy. Comprehending culture requires the knowledge of widespread attitudes and values of most members of a community who accept and create them. Therefore, culture is, in the author's view, a social and traditional phenomenon comprising the entire society or its particular segments. It presupposes the fact that not all people are the same. On the contrary, they speak different languages and live in different areas, their ways of life and self-conscience are variable (Vrban, 2006: 210). The contemporary theory and sociology of law unanimously accept the thesis that law is also a part of culture (Vrban, 2006: 212).

At the very beginning of the era of modern codification law, Savigny emphasized that every nation had its language, so law also arises as a product of people's culture, i.e. it represents the «spirit of people» (Volksgeist). Law cannot avoid its cultural foundation, so it turns out to be more complex than a technical instrument of control. (Vrban, 2003: 543; Cotterrel; 2004:6). Cotterrel defines "legal culture" as a part of way of life, a means of interpreting social relationship, deeply rooted in all kinds of experience (Cotterrel; 2004: 6). Legal culture comprises ideas of values and beliefs that people have with respect to a legal system (Vrban, 2006: 211).

We are witnessing a rapid increase in metaculture, i.e. the discussion what culture has become in the last 50 years, which leads us to the conclusion that culture is in fact everything (Kearns, 2004: 389). Robbins sees culture as: *«Never have the moral consequences of laying claim to membership in a culture, or accepting someone else's claim to such membership, seemed so far from self-evident. As a result, many are now wondering in some bewilderment how culture could ever have been allowed to expand until there was no one it didn't appear to include, nothing it didn't appear to explain-until it had become...everything»* (quoted; Kearns, 2004: 389).

That way culture as a legal term may be inappropriate, not only because its meaning is contested but also since it can comprise almost all forms of human interaction (Craufurd Smith, 2004: 9) Some authors claim that culture may also refer to animals (Kearns, 2004: 390). The potentially open nature of the word culture requires careful questioning of the differences relevant for juristic discussions and reasons for their identification. An abstract analysis of the meaning of culture serves only to set boundaries for such an interrogation (Craufurd Smith, 2004: 9).

Regarding the relation of culture and the right to culture, the right to culture represents a lower, i.e. a more concrete category. (Kartag Odri, 1997: 112). The basic problem which occurs when determining the notion of cultural rights is the complexity and ambivalent nature of the notion of culture.

Using Kartag-Odri's and Simović-Hiber and Milinković's classification, the notion of cultural rights may be divided into the following categories of human rights:

1. The right to participation in cultural life. It is considered the basic and broadest right and represents a prerequisite for exercising other cultural rights (Simović-Hiber, Milinković; 1999: 126). The holder of this right is an individual while the state shall ensure exercising it not only with respect to governmental bodies but also with respect to non-governmental subjects or third parties (Simović-Hiber, Milinković; 1999: 128).

2. The right to scientific and technological advancement. It includes the right to information on scientific advancement and respecting the freedom necessary for scientific research and creative work. Profit from scientific advancement shall be equally available for everyone, without discrimination. In contrast to these rights there is the state that creates the conditions for scientific research and application of results as well as prevents the application of scientific research for purposes in contradiction with the goals of human rights such as jeopardizing life, health, privacy (Simović-Hiber, Milinković; 1999: 129). The state shall adopt legal and administrative measures which shall enable undisturbed exercising of these rights (Simović-Hiber, Milinković; 1999: 130).

3. The right of an individual to the protection of moral and material interests arising from their scientific, literary or artistic realizations. It deals with the protection of intellectual property. Besides cultural rights in the narrowest sense, the right to education is often considered a cultural right (Simović-Hiber, Milinković; 1999: 126).[20] It involves the right of every person to compulsory and free primary education and to the same approach to other levels of education. Cultural rights also comprise national minority rights such as the right to the protection of their group cultural identity (Simović-Hiber, Milinković; 1999: 126). Cultural identity can be defined as the « self-conscience of members of one group that historically arises and develops depending on the criterion which is set in relation to other social groups » (Stojković: 1999: 22).

[20] The right to education is included in the First Protocol of the The European Convention on Human Rights accompanied with civil and political rights. The fact that it also involves free and compulsory primary education makes it a social right. See Simović-Hiber, Milinković; 1999: 133.

NEW CHALLENGES: CULTURAL RELATIVISM

It is important to mention that despite their western origin, human rights are common legacy of mankind[21]. As it has already been pointed out, contemporary theories of human rights are based on the natural-juristic theory of human rights found in works of liberal philosophers, e.g. John Locke. Human rights are those empowerments which people have due to the fact that they are human (Donnelly, 1982: 391). They are universal and equal for all and essential for the protection of human nature and dignity (Donnelly, 1982: 394). After World War II, the principle of universal and individual human rights was included in the Universal Declaration of Human Rights and also in other documents on human rights. In this Declaration it is stated that the General Assembly proclaims this Universal Declaration of human rights "*as a common standard of achievement for all peoples and all nations*". This consensus on an international level in terms of human rights was achieved despite great cultural and economic differences. However, in 1993, immediately before the World Conference on Human Rights in Vienna, there was resistance against further expansion of human rights in the form of «cultural relativism». Since this argument had been mostly presented by East Asian officers, this debate was called the "Asian value debate" (Bell, Nathan, Peleg, 2001: 3; see more Engle, 1999-2000: 312). This attitude is explicitly expressed in the Bangkok Declaration of the Ministers and the Representatives of Asian States during the regional meeting at Bangkok from 29 March to 2 April 1993, pursuant to General Assembly Resolution 46/116 of 17 December 1991 in the context of preparations for the World Conference on Human Rights in Vienna: "while human rights are universal in nature, they must be considered in the context of a dynamic and evolving process of international norm-setting, bearing in mind the significance of national and regional particularities and various historical, cultural and religious backgrounds"[22]. The Bangkok Declaration sheds light on the discussion about the universality of human rights and cultural diversity. It does not question only the existence and necessity of International Law and human rights but also their philosophical background (Morris, 2001: 69).

[21] Other great traditions such as Confucius' teaching, Islam, pre-colonial African societies, Native Americans, which themselves differentiate among each other, do not contain the notion of law, although they have complex mechanisms for the protection of human dignity (Donnelly, 1984: 415). Hood emphasizes that the Confucius' and Islamic tradition do not acknowledge equality, freedoms and responsibilities and deny the validity and desirability of public discussions. These traditions require superior status for those in power. Nevertheless, they include civic virtues that support fair rule (Hood, 2001: 101).

[22] Bangkok Declaration on Human Rights, World Conference on Human Rights, Report of the Regional Meeting for Aisa of the World Conference on Human Rights, *29 March-2 April 1993*, A/CONF.157/PC/59.

The notion of cultural relativism was taken from anthropology and moral philosophy (Teson, 1984-1985: 871). Relativists share the opinion that there are no universally applicable standards for evaluating individual behaviour, social practice and institutional systems (Powers, Faden, 2006: 41). The thesis that there are no universally applicable standards is much stronger than the thesis that there are no universally accepted standards (Powers, Faden, 2006:41). According to Madison and Faden, this thesis shakes our faith in our own moral judgements. «The relativist position is that once we concede that there are no universally applicable standards, then we must also concede that any social practice, institution, or social structure is as just as any other» (Powers, Faden, 2006: 41). In general, cultural relativists find our knowledge and truth to be culturally conditioned and create an obstacle to cultural understanding. They find all cultures equally valuable (Higgins, 89: 95)[23].

Since there are no universally acceptable standards for judging the practice of human rights as acceptable or unacceptable, the intention to impose Western concepts of human rights to Third World countries is qualified as «moral imperialism». One of the most prominent advocates of cultural relativism, Singaporean B. Kausikan thinks «The extent and exercise of rights and freedoms is a product of historical experiences of particular peoples and therefore, vary from one culture or political community to another, and over time. Many Asian societies are more group oriented and more accepting of a wider sphere of governmental responsibility and intervention than is common in the West» (Kausikan, 1995-1996: 265).

On the other hand, universalists, advocates of universal human rights, do not deny the fact that societies are different but they can see similarities in terms of basic values in all cultures. Moreover, they share the opinion that there should the same benchmarks regarding the protection of life, the prohibition of inhuman and humiliating treatment, the protection of arbitrary rule etc. This assumption presupposes the existence of a certain core of human nature and should prevail over cultural diversity (Donnelly, 1984: 414-415)[24]. It seems that the inclusion of human rights into regulatory norms of international community represents a «moral progress» and new civilisation standard (Donnnelly, 1998: 20). There has been a significant improvement in the contemporary perception of internationally

[23] About three views on relativisim and human rights – normative hegemony, weak cultural relativism and strong cultural relativism see more Meyer, 1996: 169-195.

[24] Donnelly differentiates radical cultural relativism that defines culture as the only source of the validity of moral rights and rules, from week cultural relativism, according to which human rights are prima facie universal, but culture is seen as a limited source of deviation, primarily on the level of interpretations and forms in which law will be applied. (Donnelly, 1984: 401). He thinks that the Universal Declaration on Human Rights and the two international pacts on human rights support week cultural relativism.

recognized human rights since the European imperial standard of civilisation of the late 19th century (Donnelly, 1998: 3). For instance, in 19th century China, a number of unfair treaties led to the recognition of the «exterritorial jurisdiction» of the foreign forces. According to those treaties, when the rights and interests of foreign citizens were violated by the Chinese, the Chinese authorities were obliged to organize a trial based on strict Chinese laws. On the contrary, when foreign citizens violated the rights of Chinese people, they were extradited to their home countries. (Shen, 2000-2001: 437). The norms that are applied without an exception are less likely to be discriminating in action. Most of the recognized human rights meet this criterion (Donnelly, 1998: 21). Human rights are based on the perception of equality and autonomy and represent an efficient response to many threats of human dignity launched by the modern economy and state (Donnnelly, 1998: 20). Their foundation is also the moral thesis that we are all equal, which gives us the right to certain goods, services and protection (Donnelly, 1998: 21).

The Vienna Declaration and Programme of Action confirmed the universality of human rights, para 1 item 1 of the Vienna Declaration states that: «The World Conference on Human Rights reaffirms the solemn commitment of all States to fulfil their obligations to promote universal respect for, and observance of, all human rights and fundamental freedoms for all in accordance with the Charter of the United Nations, other instruments relating to human rights, and international law. The universal nature of these rights and freedoms is beyond question»[25]. On the other hand, it also confirmed the need for taking into account the diversity of cultures, para 1, item 5 «All human rights are universal, indivisible and interdependent and interrelated. The international community must treat human rights globally in a fair and equal manner, on the same footing, and with the same emphasis. While the significance of national and regional particularities and various historical, cultural and religious backgrounds must be borne in mind, it is the duty of States, regardless of their political, economic and cultural systems, to promote and protect all human rights and fundamental freedoms.»

CONCLUDING REMARKS

The notion of culture comprises a too indefinite and ambiguous series of events. In this paper it is primarily used to denote collective beliefs, attitudes and values that direct action of community members. Due to great social significance of culture, it appears to be a subject of human rights, i.e. the right to culture. According to the time of their genesis, cultural rights seem to be newer rights,

[25] Vienna Declaration and Programme of Action, adopted by the World Conference on Human Rights, Vienna, 14-25 June 1993, A/CONF.157/23 of July 6, 1993.

and on an international level they are expressed in the Universal Declaration of Human Rights (1948), which makes them a lot younger than civil and political rights. Nowadays, these rights are widely accepted, not only regarding treaties but also considering constitutions.

Cultural relativism should not be a reaction to human rights. Regardless of historical origin, the international protection of human rights should have the same meaning in the East and West. Human rights are derived from the very core of human nature and they should be the same for all people, regardless of origin, race, sex, religion or colour of skin etc. Cultural relativism is not supported by the basic documents of International Law. Although International Law foresees limiting certain rights, these can be restrained only under special circumstances (wars, natural catastrophes), but particular rights can be abolished under no circumstances (e.g. the right to live, the prohibition of torture, brutal or humiliating treatment). The issue of human rights has been particularly popular recently as a number of ethnic groups, minorities or nations in multiethnic states call for greater "cultural rights" and "cultural autonomy". These demands may gradually turn into demands for self-determination including separation, which might devastate the edifice of some states and, then, the entire system of the United Nations.

At the end of the 21st century we are facing a new challenge – human rights or how to integrate culture into the universality of human rights. This is essential since tradition and culture are exceptionally important when promoting and protecting human rights. As Alston claims «*We must recognize that the reflexive, often dogmatic, admonitory, and homogeneous approach.... will be less productive, and achieve far less enduring results then a more sensitive, open, and flexible approach which situates the goals sought within the society in question*» (Alston, 1994: 383). However, taking culture into consideration is not the same as cultural relativism. This only sheds light on the fact that true universality has to develop the practice of moral and philosophical discussions in a real cosmopolitan way, accompanied with the awareness what is to say on them in various cultural and religious perspectives (Waldron, 1999: 137) Discussion and dialog between cultures should be refreshed, not only by searching for existing values but also by seeking ways how to create them. Otherwise, we might be accused of the severest form of «moral imperialism». This paper is a contribution to the research of international human rights protection, cultural phenomena and cultural rights.

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Abusing or abiding building bye-laws: A Case Study of Private Housing Renovation in Malaysia

Hasniyati Hamzah, Ainoriza Mohd Aini, Noor Rosly Hanif and Wan Nor Azriyati
Department of Estate Management
Faculty of the Built Environment
University of Malaya
Kuala Lumpur, Malaysia
Email: hasniyati@um.edu.my, ainoriza@um.edu.my

Abstract

It is widely acknowledged that renovation works on private housing is a common activities undertaken by house owners in Malaysia. Nevertheless, little study has been carried out on the owners' motivations to renovate and their adherence to relevant building regulations in the process. This paper attempts to identify the housing elements in which there are high levels of enhancements. It also aims to investigate on the traditionally held view that high level of home renovation indicates low housing satisfaction level. Additionally, it clarifies on those homeowners' levels of awareness and adherence to the regulatory framework. Drawing upon a case study of a private housing scheme in Kuala Lumpur, the study explores a list of renovation motivations undertaken by house owners. The findings indicate that aesthetic and security are two key underlying motivations for home renovation. The paper concludes with suggestions to policymakers and developers to enhance the security features of new housing units and thus, increase housing satisfaction.

Key Word: *Home renovation, housing satisfaction, regulatory framework*

INTRODUCTION

Home renovation, or more aptly, home improvement is big business, not only in the United States of America (NAHB, 2005) but also in small countries like Malaysia. For the purpose of this paper, home improvement is taken to encompass, *inter alia*, renovation and extension. Renovation generally involves refurbishment, redecoration and remodelling works whilst extension comprises an expansion in the original structure of the building. Home improvement works may not necessarily change the original structure of a building but generally will affect the property in both tangible and intangible ways. The immediate and

most obvious result from home improvement is the physical aspect whereas the intangible impact may be reflected in the property value post-improvement.

In Malaysia, it is common for home-owners to carry out improvement works, be it on an older property in want of a cosmetic job or even on standard houses recently completed by developers. Thus, the main aim of this study is to investigate on the capital improvement decision of home-owners to assist housing developers and policy makers in improving design and construction.

This paper examines the trend of home improvement in Malaysia, vis-à-vis the various objectives and motivations for home-owners to improve their dwellings. It also seeks to shed some light on the level of homeowner's awareness pertaining to legal barriers to home renovation. Above all, it intends to provide some enlightenment to the level of education and awareness with regards to building laws in a country undergoing rapid development such as Malaysia.

The paper begins with general background to home renovation to provide an insight into the phenomenon. It will attempt to illuminate on the different reasons why homeowners opt to renovate. Next, provisions in local housing regulatory framework concerning home renovation are outlined, with focus on terraced houses. For this purpose, a case study on a private housing scheme in Kuala Lumpur, Malaysia is undertaken. The case study provides an understanding on the level and types of home renovation undertaken by the homeowners and the owners' observation of local building laws in doing so. Structured questionnaires were carried out with 38 residents of double storey terraced houses in a private housing scheme in Kuala Lumpur. Prior to that, the residential scheme was surveyed and the houses that had been renovated were identified. The residents were then chosen at random.

HOUSING WELL-BEING AND HOUSING SATISFACTION

It has been argued that traditionally, home ownership is considered a major indicator of economic well-being at both the household and market levels (Megbolugbe and Linneman, 1993). Megbolugbe and Linneman further viewed possession of a home as a 'stabilising and conservative influence that reinforces thrift, industriousness, occupational and geographical stability, good citizenship and other virtues, while providing a sense of economic security.'

From the above, it may be inferred that home ownership is economically desirable and housing satisfaction should rank high in the research priority to assist policymakers and developers in meeting housebuyers' housing preferences.

Grzeskowiak et. al. (2006) defined housing well-being as the home resident's cumulative positive and negative affect associated with home use, maintenance,

possession, purchase, preparation of the current home, and the selling (disposal of the previous home). It is more clearly shown in the following Figure 1.

Housing well-being is highly associated with housing quality. In a study by Grzeskowiak et. al. (2006), it was established that the two primary drivers of perceived housing quality of life are satisfaction of home use and ownership. The study also proved that among factors influencing those primary drivers are satisfaction with home preparation for use and home maintenance. Thus, the process of customising or preparing the home for personal or family use is considered to be one important aspect of home use and ownership as far as housing well being is concerned.

Figure 1 : Six Indicators of Housing Well Being

Stage of home-ownership	Indicator
Acquisition	The home is bought with the least amount of effort
Preparation	The home is prepared for use to meet the needs of the new occupants
Possession	Ownership signals status and enhances the homeowner's financial portfolio
Consumption	The home serves the housing needs of the residents
Maintenance	The maintenance, renovation, and repair in the home are minimal, least costly, and effortless
Disposal	The sale of the home is transacted with the least amount of effort and most financial gain

Source : Grzeskowiak et. al. (2006)

HOUSING RENOVATION MOTIVATIONS IN GENERAL

Flanagan et. al. (1989) stated that the main purposes for home renovation are physical weakness and building obsolescence caused by function, technology, economy, social, legal, aesthetics and view, an opinion concurred by Zavadskas et. al. (2004). These motivations were explored by latter researchers, revealing that there might be more layers to home renovation that may not tally with traditionally held presumptions (See Davis, 2004). The cost-benefit ratio optimisation argument forwarded by Zavadskas et. al. (1998) also may explain the tendency of home renovation by owner-occupiers. It assumed that owners sought for maximum benefit at the minimum cost, at the same time embracing economic, social, legislative, moral and other aspects.

Another interesting viewpoint by the same author is that the practice of maintenance and refurbishment of old houses is actually linked to the government policy to control demolition and reconstruction which is undesirable to the environment. Fiscal instruments including tax and subsidies are used to compel the owners to take care of the buildings their own. Property gains tax, i.e. tax at

the point of asset disposal, is a mechanism that could promote long-term home ownership and along in the process may stimulate home renovation.

Hay (1981) presented an interesting theory on property rehabilitation (which is assumed to encompass to a certain degree home renovation and improvement). He argued that both *existing residents and in-migrants* initiated the rehabilitation process for their own continued use and *temporary residents* or *commercial developers* embark on such projects with the main purpose of making a profit. In his interesting graphical analysis of spontaneous home improvement, he made the primary assumption that all residents and would-be residents of a city have a series of housing preferences which include, *inter alia,* the size of a house, number of rooms, standard of installed facilities and space for car. Nonetheless, he proposed that these preferences which are translated into *housing standards* are not static and that a lower housing quality may be accepted for a higher *environmental quality* (characteristics which a house shares with its neighbours).

More importantly, Hay established two assumptions for established residents. Firstly, he theorised that any loss to the environmental quality need to be compensated by a major increment in housing standards and secondly any attempt to improve housing quality by re-locating will also involve an additional cost. These, compounded with growth in demand and purchasing capacity as theorised by Zavadskas et. al. (1998), may result in the request for higher quality buildings. These pre-requisites to higher housing standards are highly applicable to the current housing market in Malaysia, especially in the capital city where terraced house prices.

From Hay's second proposal of profit-making, it may be expounded that people renovate to reap financial rewards from their investments. Zavadskas et. al. (2004) however rationalized that the market value increment of the renovated property should exceed the renovation costs and the costs to not exceed the market value of a newly-built building for any profit to be made of the project. It is proven by the latter's study that the increase in the price of dwelling after renovation may be expected if the market price and cost of investment of the renovated property is 20-30% lower than the value of a newly-built building.

Megbolugbe and Linneman (1993) presented a different outtake on the home renovation objectives. It is observed that not only do owner-occupied dwelling units possess greater environmental quality and amenities, they also experience more improvement projects by the homeowners to suit their tastes.

Home renovation is also seen to reflect positive social changes (Zavadskas et. al., 1998 and Davis, 2005). It was established in a study by Davis that home refurbishment indeed signalled the ultimate personal freedom in the post-Maoist China where furnishing a flat and purchasing items to improve comfort,

value or distinction gained a salience unimaginable in the previous decades of *danwei* (work-unit) controlled housing (Davis, 2005). The interesting study also revealed a more profound insight into the consumer culture of the 'new' China which 'simultaneously incorporates contradictory experiences of emancipation and disempowerment'.

Presenting a different perspective, Zavadskas et. al. (1998) submitted a simple yet persuasive argument that low standards of comfort (i.e. improper moisture content and temperature, harmful building materials used, etc) may threaten human health. Although worth noting, this theory is seen to have a greater impact on countries with more intense climatic conditions but not in a moderate climate like Malaysia. Similar studies by Rahmat et al (2005) and W Yusof et al (2005) in two different states in Malaysia showed that the main reasons for home renovation is to enhance comfort.

'CUSTOMER FOCUS' AND HOUSING CUSTOMISATION

The more mature UK housebuilding industry has adopted the concept of 'customer focus' borrowed from other manufacturing and service sectors (Barlow and Ozaki, 2003). However, the 'customer focus' notion is seen to be ill-defined and includes a wide-range of other concepts such as 'good service', 'customer satisfaction', 'customer loyalty' and 'customer empowerment' which Barlow and Ozaki (2003) pointed out unsuitable in the housebuilding sector. 'Customer focus is 'an organisation's ability to deliver high levels of customer satisfaction' (Barlow and Ozaki, 2003) and basically deals with meeting customer needs. The argument is that customers, whilst seeking some basic standards at the same time also want 'some individual recognition and custom treatment'. (Lovelock, 1988).

Housing customisation attempts to address individual needs by incorporating their preferences not only in design and decorative features but also housing-related services, such as insurance and maintenance in the sales package. Having said that, customisation in the UK mainly involves limited choice over internal fit-out compared to countries like Japan (Barlow and Ozaki, 2001). Amongst limitations to housing innovations in UK are rigid local authority planning and design guidelines. Another restraint to innovation is highly conservative mortgage lenders wary of innovative designs that may affect future marketability of the property.

The housing sector in Malaysia is has not reached its maturity compared to the UK. Mass customisation would be too ambitious a concept to embrace at this stage but the more palatable limited customisation could be adopted by developers aiming at a competitive advantage in a highly competitive market

such as Malaysia. The planning and design legal framework is less rigid than UK, enabling more space to manouvre by Malaysian developers. Design innovation that incorporates as much as possible homeowners' preferences may provide a competitive edge over others. Economies of scale are a negligible limiting factor as property has unique characteristics unlike other products.

SETTING THE CONTEXT

The latest Property Market Report showed that terraced units formed almost 70% of the new launches (The Valuation and Property Services Department). It is also confirmed that terraced houses were the most favoured type making up 41.1% of the transaction volume in the first half of 2006. Unsurprisingly, the capital city of Kuala Lumpur consistently ranked first in the national All Houses Price Index. Kuala Lumpur also dominated the range of terraced house prices, showing almost quintuple the price in the bottom-most state. The prices of terraced houses in Kuala Lumpur have shown a regular upward trend due to sustainable demand. This is the general inclination regarding terraced houses demand and pricing that establishes the background to this study.

The property taxation regime in Malaysia is friendly to the long-term homeowners. The Real Property Gains Tax is applied using staggered rates of taxation of 0 to 30% on individual homeowners depending on the number of years the property was held. In addition, renovation and extension costs may be deducted against the disposal price in the calculation of gain. This is indeed a significant incentive for owners who hope to increase the value of their homes through renovation.

From the above, it is not surprising to note that approximately seven out of every ten terraced houses in Malaysia are extensively renovated (Wong, 2006). Since terraced houses are the most popular type of housing in Malaysia, it is indeed significant to examine the home renovation trend of these houses. This paper seeks to provide an understanding as to the motivations for home renovation, the adequacy or otherwise of the housing designs and homeowners' awareness of the legal requirements in home refurbishment.

THE STANDARD DOUBLE STOREY TERRACED HOUSE

A typical double storey terraced house traditionally measures 6.1m x 13.5m in dimension. In recent years however, developers have taken notice of buyers' preference of a wider unit and are now regularly offering 6.7 x 13.5m units. The layout plan of a typical double storey terraced house is may be referred to attached Appendix 2.

A standard unit accommodates living, dining, kitchen, a bedroom, a utility and a bath at the ground floor. The first floor usually accommodates a master bedroom with an en-suite bath, two bedrooms and a bath. The external envelop an internal partitions are typically made of bricks. The main entrance is normally of sliding aluminium door with fixed glass panel whilst other doors are usually of timber flush. Windows are commonly adjustable glass louvers. The floor is usually finished with either cement rendering or ceramic tiles, depending on the price charged. Ceilings are typically of plaster board or plain plaster.

HOME RENOVATION TYPES IN MALAYSIA

This paper divides home improvement into two broad categories namely renovation and extension to dwelling unit as typified in most states in Malaysia. It furthermore distinguishes renovation as improvement on the aesthetic and security features of the building whereas extension is said to involve improvement in size. Building works that fall under each category are depicted in Figure 2.

Figure 2 : Home Renovation Types in Malaysia

Category	Type of Building Work
Interior renovation	
	Living room renovation
	• Cabinet under staircase installation
	• Flooring replacement
	• Door/window replacement
	• Plaster ceiling with cornices installation
	Bathroom renovation/addition
	• Flooring/wall replacement
	• Bath fixtures and fittings installation
	Bedroom renovation/addition
	• Built-in wardrobe installation
	• Wall re-positioning
	• Attic addition
	• Door/window replacement
	Kitchen renovation
	• Flooring/wall replacement
	• Built-in-cabinet installation
	• Door/Wall installation
	Staircase renovation
	Arch/wall installation between living and kitchen
Addition to dwelling unit	Front portion
	Kitchen
	Car porch
	Brickwall fencing
	Retaining wall

Others	Water pipe installation
	Water
	Drainage/sewerage system
	Land filling
	Landscaping including turfing
	Re-wiring all electrical appliances including point installation, cabling, earthing, larm system and lightning conductor system.
	Floor grinding
	House painting
	Wall papering
	Building demolition
	Construction waste disposal

THE MALAYSIAN BUILDING REGULATION FRAMEWORK

The main legislation that governs any building work is the Street, Drainage and Building Act 1974 (Act 133). Section 70 of the Act obliges a person who wants to erect any building on his land to firstly obtain permission from the local authority. The owner of the building must also submit relevant plans before erecting any building.

Activities construed as erecting a building include the above renovation and extension works and are defined under Section 70(16) of the abovementioned Act as per Figure 3.

Figure 3 : Activities Construed as Erecting a Building

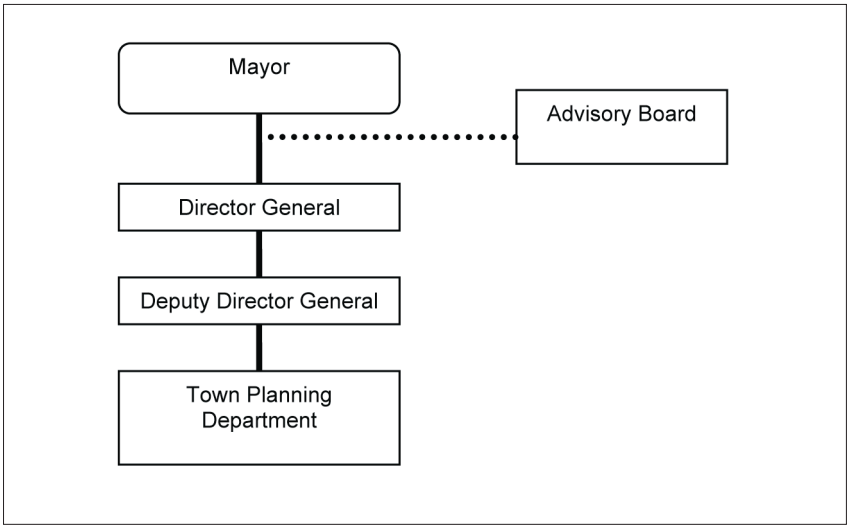
Activity	Section
Adding or altering any existing building	Section 70(16)(b)(ii)
Deviation either before or after the completion of the building from the original plans approved by the local authority	Section 70(16)(f)
Renewing or repairing any existing building by way of renewal, reconstruction or erection of an outer or party wall to the extent of one storey in height	Section 70(16)(h)
Demolishing and reconstructing or adding to a building that involve more than : (a) Half the area of the wall or partition (b) Half the area of the floor (excluding ground floor) or roof	Section 70(16)(i)
Constructing an additional storey or storeys or renewing, reconstructing or erecting an outer or party wall of the ground to second floor up to the extent of one storey in height	Section 70(16)(j)

There is also a provision under Section 79 of the same Act for a written permission to be obtained prior to erecting any partition, compartment, or other structure in any building. The body responsible to monitor building works including renovation and addition to a building is the local authority. All building activities need to have authorisation from the local authorities prior to commencement. Even though local authorities are given wide powers in framing

the control, enforcement and guidelines of such activities, there are still minimum standards to be adhered to based on legislations such as the Streets, Drainage and Building Act 1974 and the Uniform Building Bylaws 1984.

The City Hall of Kuala Lumpur ('CHKL') is identified to be the relevant local authority in this study. The organisation structure of the CHKL relevant to renovation and addition work is clearly depicted by Figure 4.

Figure 4 : City Hall of Kuala Lumpur Building Works Organisation Structure



Source : The City Hall of Kuala Lumpur

The procedures for renovation and extension of terraced houses may be divided into two categories depending on the type of building work; applications via the permit counter and plan submission to the Town Planning Department.

The former method concerns minor building works on terraced houses and is considered an instant application because homeowners only have to choose one out of 23 sets of the Town Planning Department's prescribed plans. According to CHKL's record, about 2,176 of those sets of plans were sold in 2004 and 2,320 sets in 2005. Although limited in design, it has the advantage of instant approval i.e. one day via the permit counter. This procedure also excludes townhouses, terraced houses with double frontage and cluster houses.

For renovation or addition outside the 23 standard plans, plans may be submitted by a registered architect for approval by the Building Planning Committee. This entails submitting a completed Planning Approval Application Form together with necessary documentations and proposed building drawings to the Building Planning Approval Unit. Failure in adhering to the above law may result in stopwork order, warning notice and/or ultimately demolition notice. In

addition, there are legal provisions of fines and/or a jail term for offenders as per Section 70(1) and (11) Streets, Drainage and Building Act 1974.

THE CASE STUDY

The study concerns Taman Melati, a housing estate developed by a semi-government company. The developer's track record span over 30 years; having built approximately 17,000 housing units within several states of Peninsular Malaysia.

Taman Melati is located near the outskirts of the capital city of Kuala Lumpur. The housing estate was developed and fully completed in 1988. Amongst facilities and amenities available in that area are shops, police station, mosque, petrol station, schools and public transportation such as buses and light rail transit. It also has good road network connecting it to other areas. It is a low-to-medium rise residential development comprising double storey terraced, townhouse, flat and apartment. This study mainly concentrates on the renovation and addition to double storey terraced houses.

71% of the respondents are male, which is important because typical of the patriarchal Malaysian household they are the head of the family and are responsible for any home renovation decisions. Majority of respondents is between the 31 to 50 years of age, again reflecting the suitability of the sampling as they are the economically active group. Out of the total 38 respondents, 89% of them are home-owners and 61% are above the medium-income bracket.

RENOVATION MOTIVATIONS

The study showed that a high portion of respondents have carried out renovation work on their houses (82%). This concurs with the theory that owner occupied units experience more improvement work than rented units. The reason most cited is home renovation to increase housing satisfaction as 79% agreed that they seek housing satisfaction through renovation. Majority of the respondents (77%) stated that they renovated after moving into the house whilst only 23% said that they renovated prior to moving in. Most of them cited financial constraints as barriers to renovating prior to moving in. About 84% used contractors to undertake renovation works.

Most of respondents disagreed that large household size is the reason for their renovation, supported by the fact that 87% of respondents have the household size of 6 persons or less. Majority of the respondents is confident of the positive effect of renovation upon property value as 77% answered in the affirmative when queried whether their home was renovated to increase it value.

Renovation types

Figure 5 conveniently tabulated the types of home renovation carried out by the respondents. These are then divided into three general categories namely *size*, *aesthetic* and *security* for purpose of identification and analysis.

Figure 5 : Types of Home Renovation

Activity	Percentage respondent	Element
Dining room extension	67%	Size
Kitchen extension	66%	Size
Bedroom extension/addition	72%	Size
Living room extension	57%	Size
Car porch extension	53%	Size
Balcony addition	69%	Size
New lighting	87%	Aesthetic
New flooring	89%	Aesthetic
New paint	89%	Aesthetic
Window metal grille installation	86%	Security
Door metal grille installation	81%	Security
Burglar alarm installation	76%	Security

Housing preference	Average Percentage
Size	64%
Aesthetic	88.33%
Security	81%

It may be seen from the above findings that most homeowners carried out renovation or improvement works which are geared towards enhancing the aesthetic aspect of their homes. Security is also a major consideration although it must be pointed out that some window and door grilles could also be described as more home-décor items rather than strictly crime-prevention tool. The study also debunked size as one of the top housing preferences. This may be explained by the fact that structural renovations involve high expenditure which could act as a significant deterrent. Zavadskas et. al. (2004) succinctly explained that there is a ceiling to renovation costs in renovation investment considerations.

REGULATORY AWARENESS AND ADHERENCE LEVEL

One of the aims of this study is to ascertain whether home-owners in the study area possess the awareness as to the local building law. Figure 6 shows a high level of awareness as to the local building laws as a high portion (90%) of the home-owner surveyed applied for approval from the local authority prior to renovating their homes. This may illustrate a higher level of education and affordability of home-owners to do so as compared to rural areas. It is suggested for a similar study to be carried out in a less urban situation, for example, a town

in the east coast of Peninsular Malaysia. However, only 87% of respondents have been granted building approval from CHKL (as shown in Figure 7).

Figure 6: Application for approval from CHKL

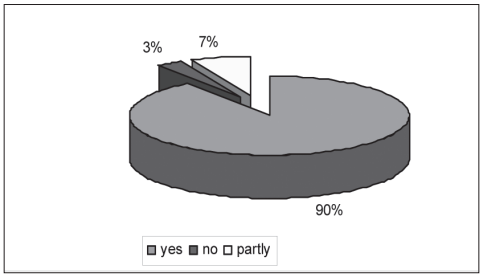
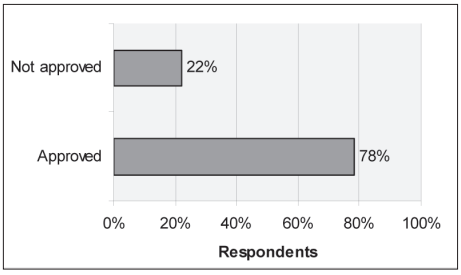
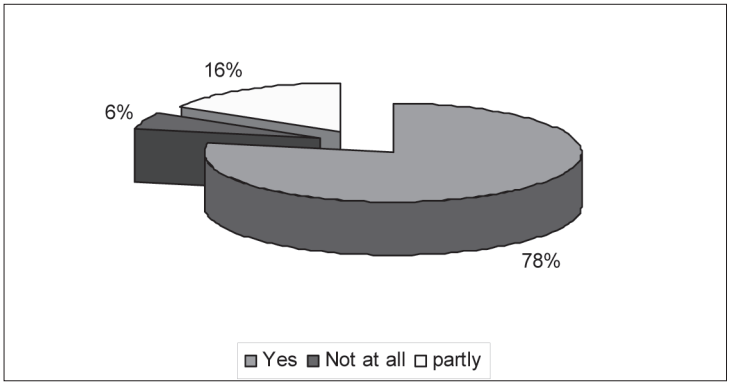


Figure 7: Building work approval granted by CHKL



When asked whether renovation work have been carried out according to the approved building plan by CHKL, only 78% of respondents agreed whilst 16% of respondents conformed partly on the same matter (As shown in Figure 8). This shows that majority of the respondents abide to the building law.

Figure 8: Conformation to approved building plan



CONCLUSION AND RECOMMENDATIONS

Unlike the more established UK housing sector, housing customisation has yet to make its mark in Malaysia. Nonetheless, post-sale renovation by homeowners is the norm, signifying unmet housing standards. There is a need for Malaysian developers to meet customers' needs if the 'customer focus' is to be adopted in line with the UK market.

This study demonstrated that the majority of respondents, who mainly consisted of owner-occupiers, undertake home improvement projects on their units. It suggests that residents have a series of housing preferences or standards and will renovate to increase their housing satisfaction. Aesthetic is perceived as

the most valued housing standard, followed by security. These are the elements that home-owners seek to enhance in their dwelling units. Whilst taste is subjective and may not be easily predicted, security is an aspect which could be more readily improved upon. This is not surprising as the most basic security measures in Malaysian homes viz. door and window metal grilles are usually not installed in standard units.

Thus, policy makers and developers should take this into consideration as it is proven that homeowners highly value a more secure housing environment. Home security is also the buzzword in the housing industry in Malaysia as reflected by the rise of gated community residential schemes nationwide. The findings of this study also suggest that homeowners possess a high level of awareness as to the local building laws. A high portion of the respondents applied for approval from the local authority prior to renovating their homes and non-compliance level is low, signifying a higher level of awareness and willingness of home-owners in the capital city to observe the law. However, a more meaningful analysis would be achieved if a comparison study could be undertaken. A second part of a similar study is proposed to be carried out in a less developed town elsewhere in Malaysia to discover if a similar adherence level is observed.

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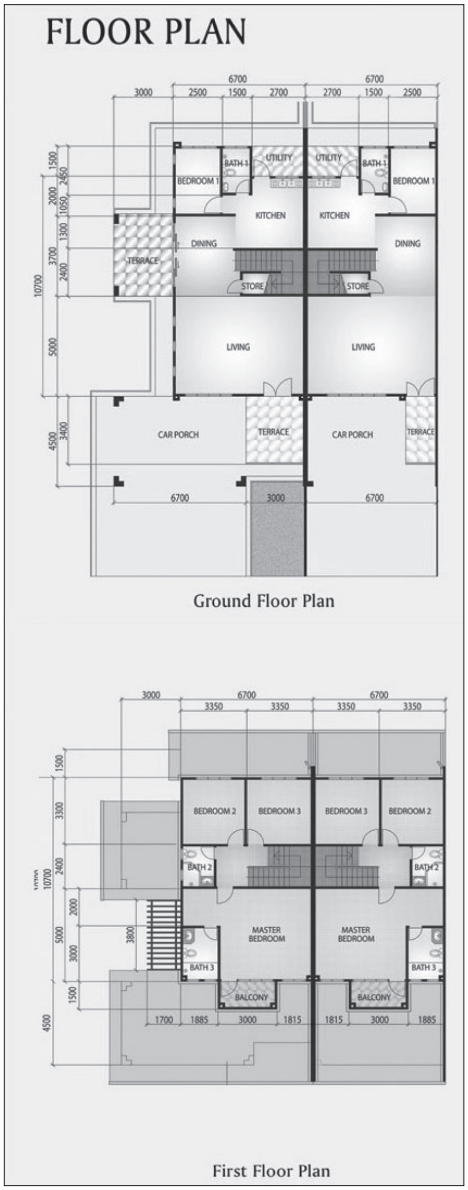
Appendix 1: Layout Plan of a Typical Double storey Terraced House



Multinational Corporation and Human Rights Protection: In Search of Regulatory Framework

Patricia Rinwigati Waagstein
Ph.D. Candidate
Faculty Of Law
Uppsala University
Sweden
Email: Patricia.Rinwigati@jur.uu.se

Abstract

One of the greatest challenges in the discourse of business and human rights is how to regulate human rights. In the last decade, there have been two trends of regulatory framework: regulation and deregulation. The former refers to the legal instruments which are legally binding for corporations. This concept uses the top down approach where States or other legitimated bodies interfere to rule on or limit the conduct of corporations. The latter does not mean that there is no regulation available, but rather refers to the self-regulation instrument: instruments issued by non-State organisations, corporations, or other 'soft law' instruments.

This article will address the former issue; namely, the question of whether an adoption of legally binding instrument specifically pertaining to corporate human rights responsibility is visible. The method used is based on the criteria adopted by the General Assembly; namely, normative consistency, fundamental character, sufficient precision, realistic enforcement, and international support which serve as parameters on assessing the visibility of adopting new legally binding instruments.

Key words: *Human Rights, Corporate Responsibility, Non-state actor, Multinational/ Transnational Corporation/Enterprises*

1. INTRODUCTION

One of the greatest challenges in the discourse of business and human rights is how to integrate human rights into business. There has been a wave of international agreements, proposals, and campaigns associated with human rights and business concepts. The regulatory or legalistic approach is one of the most popular ones, and the discourse among scholars and stakeholders reveals that this approach is

absolutely necessary. The question is how to regulate multinational corporations[1] in order to ensure effective international legal protection. This paper will address the question of whether an adoption legally binding instrument specifically pertaining to corporate human rights responsibility is visible.

2. MINIMUM REQUIREMENTS FOR THE ADOPTION OF LEGALLY BINDING INTERNATIONAL INSTRUMENTS

There have been a lot of discussions and proposals on how to safeguard human rights by ensuring effective international legal protection.[2] Some common criteria on setting standards in the field of human rights have been addressed by the General Assembly in its ninety-seventh plenary meeting. It maintained that a new international instrument in the field of human rights should:

a. be consistent with the existing body of international human rights law;
b. be of fundamental character and derived from the inherent dignity and worth of the human person;
c. be sufficiently precise to give rise to identifiable and practicable rights and obligations;
d. provide, where appropriate, realistic and effective supervisory machinery, including reporting system; and
e. attract broad international support.[3]

These important minimum requirements must be taken into account during the drafting process if the adoption of a special legally binding instrument dealing with corporate human rights responsibility should be called for at some time in the future. The following section discusses each of the minimum requirements.

2.1. Normative Consistency

Normative consistency means that a new legally binding instrument should be consistent with the existing human rights instruments. It also covers the prohibition of duplication of the existing human rights instruments. The legal consistency refers to two issues: the applicability of international law especially

[1] Multinational corporation means "a cluster of economic entities operating in two or more countries – whatever their legal form, whether in their home country or country of activity, and whether taken individually or collectively" see Sub Commission on the Promotion and Protection of Human Rights United Nation Commission on Human Rights, "Draft Norms on the Responsibility of Transnational Corporations and Other Business Enterprises with Regard to Human Rights," (2002). The terms 'multinational' and 'transnational' are used simultaneously.

[2] Philip Alston, "Conjuring up New Human Rights: A Proposal for Quality Control," *American Journal of International Law* 78 (1984).

[3] U.N.G.A.Res.41/120, "Setting International Standards in the Field of Human Rights," ed. General Assembly (1986).

human rights instruments to corporations and the standards and scope of corporate responsibility including the limitations. To examine these it is important to go through all the existing instruments which can directly or indirectly impose human rights obligation on corporations, as well their commentary and interpretations.

First, the legal consistency can be assessed by referring to the applicability of international law to corporations. In the 'inter-nation' system, only State has been the subject of law, and other entities were objects. This means that only the State had rights and obligations under international law; there was no possibility of discussing non-State actors as part of the 'inter-nation' community. Consequently, international law including international human rights law has been applied and codified in accordance with this concept. However, the International Court of Justice (ICJ) in its advisory opinion on the Reparations for Injuries Suffered in the Service of United Nations confirmed that the concept of being subject of law is not static. The present subjects of law, its nature, and its quality depends on the needs of the community.[4] Although the term 'the needs of community' is subjected to various interpretations, this ICJ's advisory opinion indicates that there is the possibility that non-State actors can be subjects of law or be legal persons with the variation of quality of rights and obligations as well as personality depending on 'the type of entity concerned, its claims and expectations, functions and attitude adopted by the international community'.[5] The inter-governmental organisation is a common example of this exception. Moreover, the position of a non-State actor, especially an individual, became stronger due to the judgments of the Nuremberg and Tokyo tribunals and several treaties that require individual responsibilities. The judgment in the Nuremberg trial concludes that: 'international law imposes duties and liabilities upon individuals as well as upon States have long been recognised'[6] In sum, a certain 'personality' has been granted to non-State actors such as intergovernmental organisations and individuals; therefore, international law directly applies to them.

The next question is whether international law also gives a certain personality to corporations, especially multinational corporations. Does international law bind corporations as well? There have been two ways of looking at the issue of applicability of international law to corporations: indirect and direct. The ICJ

[4] "Reparations for Injuries Suffered in the Service of United Nations," in I.C.J. Report (International Court of Justice, 11 April 1949).

[5] Malcolm Shaw, *International Law*, 4 ed. (Cambridge: Cambridge Distribution, 1997), pp. 179 & 249.

[6] Andrew Clapham, *Human Rights in Private Sphere* (Oxford: Clarendon Press, 1999), pp. 135 - 149, U.N.O.H.C.H.R, *Business and Human Rights, an Update for the Global Compact Meeting* (New York, 26 July 2000).

case concerning Barcelona Traction recognises corporations as analogous to the individual: a national of a State,[7] which has separated rights and obligations under national law.[8] Therefore, corporations are entitled to the right of diplomatic protection which may be exercised by the relevant State on a multinational corporation's behalf.[9] This may also give rise to State responsibility for the conduct of a multinational corporation in the State's own territory that impacts adversely upon another State so as to constitute a breach of international law.[10] This construction concludes that corporations are not subject to international law; therefore, do not direct contact with international as the conventions and customary rules expressing rights and obligations depend upon enforcement by States.[11] In human rights treaties, this construction has been commonly accepted. States are responsible for protecting human rights against any violations by private actors including corporations. Under 'the obligation to protect', States have an obligation to regulate corporations in conformity with international standards, and ensure that such standards are implemented by corporations.[12]

Can international law, particularly human rights law, be directly applied to corporations? One argument states that there is no prohibition that international law can grant certain rights and obligations to non-State actors directly.[13] In fact, the role of non-State actors becomes apparent at international level and international law has granted some qualifications/personalities which qualifies non-State actors as participants.[14] Moreover, although treaties are not designed to deal with corporations, history has proved that multinational corporations can, in practice, violate human rights and be complicit with States in violating human

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[7] "Barcelona Traction, Light and Power Company, Limited (Belgium V. Spain)," in *I.C.J. Report* (International Court of Justice, Judgment, 1970), para. 70.

[8] *Ibid*.

[9] *Ibid*., para. 33.

[10] ILC International Law Commission, "Draft Articles on State Responsibility of States for Internationally Wrongful Acts," (U.N. General Assembly, 2001), Arts. 1-3, 5-9, 11, Fleur Johns, "Invisibilility of the Transnational Corporation: An Analysis of International Law and Legal Theory," *Melbourne Law Review* 19 (1993-1994): pp. 894 & 895. .

[11] Ian D. Siderman, *Hierarchy in Internatinoal Law, the Human Rights Dimension* (Antwerpen: Intersentia, 2001), pp. 187 & 188.

[12] Committee on the Rights of the Child, "General Comment No. 5, General Measures of Implementation on the Rights of the Child (Arts. 4, 42, and 44, Para. 6)," (2003), paras. 42 - 44, Human Rights Committee, "General Comment 28, Equality of Rights between Men and Women (Article 3)," (2000), para. 31.

[13] John Ruggie, *State Responsibilities to Regulate and Adjudicate Corporate Activities under the United Nations' Core Human Rights Treaties: Prepared for the Mandate of the Special Representative of the United Nations Secretary-General on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises* (Kennedy School of Government and Harvard Law School, 12 February 2007).

[14] *Nicola Jägers, Corporate Human Rights Obligations: In Search of Accountability (Antwerpen: Intersentia, 2002).*

rights. Therefore, the binding nature of international instruments should not be seen only from the procedural matters – that corporations cannot participate in the legal making process – but also from the substantive nature that human rights should be respected by all actors, either State or non-State. For that purpose, distinction between human rights as substance and procedure is crucial.

In relation to the applicability of human rights treaties, the word 'corporation' or 'multinational corporation' is not specified in most human rights treaties since they were not designed to accommodate violation of human rights by corporations. Only a few refer directly to 'enterprises/corporations', such as in Article 2, Paragraph (e) of Convention on the Elimination of Discrimination of All Forms of Discrimination against Women (CEDAW) which prohibits discrimination against women by an 'enterprise'. The other example is the Optional Protocol to the Convention on the Rights of the Child (CRC) on the Sale of Children, Child Prostitution, and Child Pornography which requires States to take action against the sale of children, child prostitution, and child pornography by all actors including 'legal persons'. The International Convention on the Rights of Persons with Disabilities has also mentioned 'private enterprise' in Article 4[15] and 'private entities' in Article 9.[16]

In provisions dealing with fundamental rights, most treaties utilise general terms such as 'individual', 'person', 'people', or 'organ of society'. The moot point is whether these terms can be interpreted in a way that could cover corporations. One method would mean including a corporation as a part of 'every individual'[17] or of 'every organ of society'.[18] A second method would be to assume that any rights, without any reference to those who owe a corresponding duty, can be understood to impose duties on corporations. The last method would be to use the assumption from the peremptory norm and/or customary international law that all rights in treaties which have the character of customary law or *jus cogen* automatically impose obligations on corporations.

The applicability of the treaties to corporation is mainly developed by many treaties' bodies through general comment. The Human Rights Committee

[15] Article 4 requires States parties 'to take all appropriate measures to eliminate discrimination on the basis of disability by any person, organisation or private enterprise.'

[16] Article 9 requires that States ensure private entities offering public services and facilitates 'take into account' accessibility to persons with disabilities. See also Ruggie, para. 13.

[17] Paragraph 5 of the Preamble of International Covenant on Civil and Political Rights and International Covenant on Economic, Social, and Cultural Rights, G.A. Res 2200 A (XXI), 21 UNGAOR Supp. (1016) at 49, UNDoc. A/6316 (1966), 993 U.N.T.S 3, entered into force 3 Jan. 1976. The direct references to the applicability of the principle of horizontal effect of human rights is also found in safety clauses as articulated in Art. 5 of the ICCPR, Art. 29 of the UDHR, and Art. 5 of the ICESCR

[18] "Universal Declaration of Human Rights," in *U.N.G.A. Res. 217A (III) U.N. Doc. A/810* (1948)..

provides interpretations of some articles based on the nature of each right which acknowledges the obligation of non-State actors. Torture, under Article 7 of the International Covenant on Civil and Political Rights (ICCPR), has been interpreted by the Human Rights Committee as extending the obligation to private actors.[19] General Comment No. 18 on the non-discrimination principle states that the meaning of discrimination in the covenant covers discrimination practised by public authorities, by the community, or by private persons or bodies. This interpretation is applicable to entire articles, specifically to Articles 26 and 2. Consequently, a corporation is also bound by this principle in dealing with its operations. In relation to Article 17 of the ICCPR for the right of every person to be protected against arbitrary or unlawful interference with his privacy, family, home, or correspondence as well as against unlawful attacks on his honour and reputation, the Committee comments that 'this right is required to be guaranteed against all such interference and attacks whether they emanate from State authorities or from natural or legal persons'. Moreover, General Comment No. 27 states that 'the State party must ensure that the rights guaranteed in article 12 are protected not only from public but also from private interference'.[20]

Like the ICCPR, the International Covenant on Economic, Social, and Cultural Rights (ICESCR) also imposes obligations on corporations in various articles. In relation to international assistance, the ICESCR does not specifically define what the international community in the context of cooperation means. The ICESCR only requires that a State party to the covenant take steps individually and through international assistance and cooperation, especially economic and technical.[21] However, the Committee interprets 'international community' in the broader sense, meaning it is not only a State,[22] but also United Nations' bodies,[23] and other actors in the private sector[24] including employers,[25] enterprises, and other non-State actors.[26] Moreover, the direct reference to private obligations,

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[19] Human Rights Committee, "General Comment No. 20, Article 7,," (1992), para. 2.

[20] Human Rights Committee, "General Comment 27, Freedom of Movement (Art. 12)," (1999), para. 6.

[21] Article 2, Paragraph (1), Arts. 11, 15, 22, and 23 of the International Covenant on Economic, Social, and Cultural Rights.

[22] The Committee of Economic, Social, and Culture, General Comment No. 3, Paragraph 14 and General Comment No. 4, Paragraph 19.

[23] Article 22 of the Covenant and Social Committee on Economic, and Cultural Rights, "General Comment 2, International Technical Assistance Measures " (1990).

[24] Social Committee on Economic, and Cultural Rights, "General Comment 4, the Right to Adequate Housing," (1991), para. 14.

[25] Social Committee on Economic, and Cultural Rights, "General Comment No. 5, Persons with Disabilities " (1995), paras. 11 & 12.

[26] Social Committee on Economic, and Cultural Rights, "General Comment 12, Right to Adequate Food," (1999), para. 20, Social Committee on Economic, and Cultural Rights, "General Comment 14, the Right to the Highest Attainable Standard of Health," (2000), paras. 42, 40, and 51,

especially corporate obligations, is specified in the interpretation of Article 11 on the rights to adequate standards of living, including right to food, rights to house, and right to water. The Committee states that the responsibility goes beyond State actors.[27] It implies that violations of the right to food and right to health can occur through direct action of States or other entities. In relation to the right to health, the Committee also infers Article 12 as imposing obligations on non-State actors. The obligation is not to interfere with the guarantees in Article 12. Moreover, Article 2 of the Covenant regarding the principle of non-discrimination has been interpreted as also applying to non-State actors.[28] This principle is applicable to all articles in the covenant. Last, the general comment No. 18 paragraph 52 reconfirms the responsibility of other actors to ensure the realisation of the right to work.[29]

However, the Human Rights Committee and the Committee on Economic, Social, and Cultural Rights have not been consistent on applying the direct applicability of human rights treaties to corporations. General Comment No. 18 of the Committee on Economic, Social, and Cultural Rights states that the ICESCR does not bind multinational enterprises.[30] Similar commentary is also found in General Comment 31 of the Human Rights Committee, which states that the Covenant 'is only binding on States [Parties] and do not, as such, have direct horizontal effect as a matter of international law.'[31] The inconsistency of these two treaty bodies has created confusion on assessing whether these two covenants actually impose direct or indirect obligations on corporations. Such consistency also implies that that the traditional State-centrist approach is still dominating.

The applicability of the principle of human rights obligations of non-State actors is more apparent in the conventions on discrimination and labour. Article 2 of the CEDAW rules out any person, organisation, and enterprise from discriminating against women.[32] Article 2, paragraph (1) (d) of the 1965

Social Committee on Economic, and Cultural Rights, "General Comment 15, the Right to Water," (2002), para. 42.

27 *Ibid*.

28 Committee on Economic, "General Comment No. 5, Persons with Disabilities ", paras. 11 & 12, Social Committee on Economic, and Cultural Rights, "General Comment 13, the Right to Education," (1999), para. 6b.

29 Social Committee on Economic, and Cultural Rights, "General Comment 18, Article 6: The Equal Right of Men and Women to the Enjoyment of All Economic, Social, and Cultural Rights " (Thirty-fifth Session, 2006), para. 51.

30 Ibid., para. 52.

31 Human Rights Committee, "General Comment 31, Nature of the General Legal Obligation on State Parties to the Covenant," (2004), para. 8.

32 Article 2, Paragraph (e), Convention on the Elimination of All Forms of Discrimination against Women, adopted by the General Assembly of the United Nations. GA Res. 34/180 of 18 December

Convention on the Elimination of All Forms of Racial Discrimination also forbids 'racial discrimination by any persons, groups, or organisation'. In labour law, the good examples are instruments of the International Labour Organisation, which sometimes refer to who the duty-holders are, namely the State and employers. Its tripartite structure, which included representatives of employers and workers alongside the representatives of governments, was reflected in the norms it produced in connection with labour relations.

The direct applicability of human rights norms to corporations has been developed more in a regional context. In the European Convention on Human Rights there are several articles imposing private duties to respect human rights. Article 17 is aimed at imposing private obligations on individuals or groups, not allowing them to invoke any rights within the convention for impairing other rights.[33] Articles 8, 9, 10, and 11 refer to the restriction as being 'in accordance with law and are necessary in a democratic society…for the protection of the rights and freedoms of others.' This restriction can be interpreted to oblige anyone to respect others' rights.[34]

The American Convention on Human Rights (ACHR) and the African Charter on Human Rights and People (ACHRP) are unique in the sense that they express the obligations of non-State actors, particularly individuals, explicitly within the body of the text. Article 32 of the ACHR refers to the personal responsibility which every individual has to his family, his community, and to mankind. This concept serves as a limitation of the realisation of human rights.[35] The ACHRP goes even further by elaborating the concept of duties in Articles 27, 28, and 29.

The direct applicability of human rights norms is apparent in the context of non-binding agreements[36] and private initiatives.[37] These instruments directly bind corporations without referring to any State. Although these instruments reflect the expectation of civil society and States toward corporations, they lack legal status under international law but their presence is inevitably important. They can inspire, highlight, sharpen, modify, and even supersede the existing

1979, entry into force: 3 September 1981.

33 European Court of Human Rights, Lawless v. Ireland (no. 3), Paragraph 7.

34 Andrew Clapham, "The Drittwirkung of the Convention," in *The European System for the Protection of Human Rights*, ed. F. Matscher R.St.J. Macdonald, H. Petzold (Boston: Martinus Nijhoff Publishers, 1995), pp. 163 - 167. pp. 163–167

35 Article 32, American Convention on Human Rights

36 The United Nations came out with Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regards to Human Rights; the International Labour Organisation has produced the ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy; the OECD has the OECD Guidelines for Multinational Enterprises; and the European Parliament adopted a Code of Conduct for European Enterprises operating in developing countries.

37 Kimberly Process, etc.

standards. In this case, non-binding instruments can actually act as a co-regulation as they lay new standards or precedents.

In sum, the discussion on the applicability of human rights instruments involves two issues. First, as the concept of corporate social responsibility is still developing, there has been inconsistency on looking at the issue. On one hand, there is pressure from civil society to include corporations in human rights discussions, and on the other hand, the traditional human rights approach referring to the relationship between State and individual is still dominating. Secondly, the discussion on corporate human rights responsibility has a more social than normative nature as most of the references refer to the 'non-binding' instruments such as governmental acts and commentaries as well as other private instruments.

The second issue of legal consistency requirements refers to the standardisation of corporate human rights responsibility. To what extend do multinational corporations have human rights obligations? The obligation to respect has been the minimum human rights obligation.[38] The question is whether 'obligation to respect' carries a customary nature. In the case of *Prosecutor v. Anto Furundzija* states that States should delegitimise any legislation, or administrative or judicial acts authorising torture.[39] This means that the obligation arising from customary/ *jus cogens* is negative (not to violate) and positive. 'Negative' means that State shall not violate the *jus cogens* and customary norms. At the same time, States are expected to be 'active' by incorporating the norms into their State practices (treaties and national legislation). This includes the State's responsibility to try and punish those who participate in the commission of an offence.[40] In this case, it can be concluded that, in principle, the obligation to respect has *jus cogens* and customary character which is derived from the *erga omnes* character of certain human rights[41] Moreover, as certain human rights which have *jus cogens* and customary international characters may give arise to individual responsibility, every individual, including a corporation, is legally bound by *jus cogen* and/or customary international law. The nature of obligation is negative, meaning not participating in the commission of any acts which are prohibited in international law.

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[38] Sigrun I Skogly, *The Human Rights Obligations of the World Bank and the International Monetary Fund* (London: Cavendish publishing 2001).

[39] Int. Tribunal for Former Yugoslavia, IT-95-17 /1-T *Prosecutor v. Anto Furundzija*, para.155.

[40] *Ibid.*, para. 156.

[41] In the case of *Communities of Jiguamiando*, Judge A. A. CanÇado Trindade supports this assumption, stating that the erga omnes character of human rights protection should be complied with by not only the State, but also by third parties such as individuals or groups, including irregular armed groups of any kind – since in many situations of armed conflict the danger comes not only from the State but also from other organisations. IA Ct. HR (Ser. E) (2003) on the case of the *Communities of the Jiguamiando and the Curbarado*, Order of the Court of 6 March 2003.

The possibility to impose 'human rights' obligations to protect and to fulfil on multinational corporations has been subjected to many scholarly debates; no common agreement has been reached on the issue. References to corporate obligations to protect and fulfil can be found in various voluntary initiatives which lacks of legally binding nature.[42] The obligation to protect means that a corporation has to take actual measures to prevent the violation of human rights within its sphere and within its companies and in relations with third parties, namely partners or subsidiaries. [43] For such purposes, a company has to take into account the human rights implications of its actions and further incorporate human rights into its internal standards policy.[44] The obligation to fulfil requires a corporation to take necessary action to ensure that each person within its sphere obtains satisfaction of those needs. This includes the fulfilment of human rights to employees, the stakeholders, the customer, the society which is affected by its operations and the society in general as a beneficiary of environmental rights.[45]

The last issue on the discourse of normative consistency refers to the limitations of corporate human rights responsibilities. There is no common acceptance on what the limitations of corporate responsibility are. The ICCPR, UDHR, and the ICESCR do not specify any limitation on corporate responsibility. The limitation itself can be interpreted in the context of State responsibility, meaning that corporate responsibility can only be held directly through the State. Direct limitation is found in Article 1 of the UN Draft Norms on Responsibility of Transnational Corporations and other Business Enterprises and the first principle of global compact: 'within their respective spheres of activity and influence'. However, neither the Draft Norms nor the Global Compact Principle itself further elaborates what is meant by this concept. Some scholars have interpreted

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[42] The United Nations Norms on the Responsibility of Transnational Corporations provides variety of corporate obligations: to promote, to secure the fulfilment of, to respect, ensure respect of, and to protect human rights. The ILO Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy requires corporation to respect the sovereign rights, obey the national laws and regulations, give due consideration to local practices and respect relevant international law. The UN Global Compact call for corporation to support and respect the protection of international human rights within their sphere of influence.

[43] Levi Strauss, in its 'Global Sourcing and Operating Guidelines', says that the company will only do business with partners that adopt certain employment, health, and safety standards. Similar statements have also been made by The Body Shop, Reebok, and British Petroleum. Jägers, pp. 82 - 84.

[44] The example is a commentary on paragraphs 3 and 4 of UN Norms on the Right of Security Personnel, that transnational corporations and other business enterprises shall establish policies to prohibit the hiring of individuals who are known to have been responsible for human rights or humanitarian law violations. Commentary on the Norms on the Responsibilities of Transnational Corporations and other Business Enterprises with Regard to Human Rights, U.N. Doc. E/CN.4/Sub.2/2003/38/Rev. 2(2003)

[45] Jägers, pp. 84 & 85.

this concept as referring to the proximity of the corporation. It is not clear whether the proximity refers to the effect of corporate activities or just the relationship with corporations or both. Young suggest that the limitation should be based on the reasonableness and the parameter to measure the reasonableness relies on connection, power, and privilege.[46] It implies that the responsibility of corporations should be in conformity with its connection, power, and privilege in society.[47]

The next question is whether a new legally binding instrument will actually be a repetition of international human rights instruments especially as a duplication of the UN Draft Norms on Responsibility for Transnational Corporations and Other Business Enterprises. The fact that a new legally binding instrument will actually cite many rights protected in various different instruments is inevitable. What makes a new legally binding instrument different from other human rights treaties is the nature of the perpetrator, namely private actors; the operational level of obligation, namely extraterritorial; and the nature of issue namely, private–business.

2.2. Fundamental Character

A legally binding instrument pertaining to corporate human rights responsibility should be of a fundamental character and derive from the inherent dignity and worth of the human person. In other words, corporate human rights responsibility should have fundamental character in order to adopt a legally binding instrument.

The fundamental character of corporate human rights obligation is directly derived from the ultimate nature of human rights. Human rights are universal as their universality is rooted in inherent dignity and the inherency of rights, as the Universal Declaration on Human Rights states: 'Human rights and fundamental freedoms are the birthright of all human beings and the nature of these rights and freedom is beyond question.'[48] Consequently, the obligation to protect human rights in a fair and equal manner, on the same footing, and with the same emphasis without conditions attached, is a must.[49] Furthermore, the Human Rights Committee states that the obligation to promote universal respect for, and observance of, human rights and fundamental freedom is an *erga omnes*

[46] Iris Marion Young, "Responsibility and Global Labor Justice," *The Journal of Political Philosophy* 12, no. 4 (2004): pp. 385 - 388.

[47] Ibid.

[48] "Universal Declaration of Human Rights."Article 1 and Preamble.

[49] Paragraph 4 of the Vienna Declaration, World Conference of Human Rights, Vienna, 14–25 June 1993, UN Doc. A/CONF.157/24 (Part I) at 20 (1993), Committee, "General Comment 27, Freedom of Movement (Art. 12)," para. 6. Human Rights Committee, "General Comment No. 27, Freedom of Movement (Art. 12)," (1999), para. 6.

obligation.[50] Therefore, it calls for respect for and observance of human rights and freedom from everyone including corporations.[51]

2.3. Sufficient Precision

A legally binding instrument should be capable of sufficiently precise formulation to give rise to identifiable and practicable rights and obligations. The level of preciseness of the various rights and obligation will determine the protection and *justiciability* of rights and surely will establish minimum levels of obligation and its enforcement. Such determination is important in terms of preventing human rights violations by multinational corporations, but also in providing adequate reparation in cases of human rights violations.

To attain the precise meaning of existing standards of obligation, preparatory works and research as regards the precise meaning of existing standards should be conducted. So far, such efforts have been the main issue in the discourse of human rights and corporations by various stakeholders. Based on such consultations, there are some important issues that should be addressed by a new legally binding instrument.

First, a determination of the legal status of non-State actors is a crucial point in drafting a legally binding instrument. Such confirmation and clarification are important in order to determine how and in what sense the new international legally binding instrument can be applicable to corporations. Currently, there is no common interpretation on the legal status of multinational corporations and the applicability of international law to non-State actors. Non-State actors including corporations are viewed as legal subjects of national law therefore its responsibility can be held through States. In this sense, international law is more 'relevant' to private actors than 'applicable' to private actors. The exception can be interpreted in relation to customary international law and *jus cogen*. On the contrary, in the existing code of conduct and UN Draft Norms, most provisions start with 'Enterprise should'. This implies that the vast majority of the provisions of the current UN Draft Norms are similarly addressed to multinational corporation directly without intermediaries of their home and host countries.

The second issue is more about the clarification of the obligation covering the scope of obligation (covers human rights, labour rights, environment, or all of these); nature of obligation (voluntary, non-voluntary, or obligatory), source of origin (internal or external); level of operation (municipal, regional, or international); and the amplitude of obligations (merely negative, or both

[50] Committee, "General Comment 31, Nature of the General Legal Obligation on State Parties to the Covenant."

[51] '[this right] is required to be guaranteed against all such interference and attacks whether they emanate from State authorities or from natural or legal persons'

negative and positive obligations) and the limitation.[52] The clarification should also determine the nature of such obligation whether it serves as maximalist or minimalist standards. These problems are not clarified clearly in existing human rights treaties nor in their interpretation.

Moreover, a new legally binding should also highlight the concept of 'complicity' and 'within the sphere of influence'. These two concepts have been introduced in the United Nations Draft Norms and UN Global Compact. The concept of complicity is not something new as it is a national concept which allows one who did not commit a wrongful behaviour/offence to be held liable for the conduct of an associate who physically perpetrated the offence/crime. However, this principle is being developed in international law and civil law as well. It implies that every entity/individual should not aid or assist human rights violations. Then, the questions arise: when are corporations complicit with human rights perpetrators? What are the elements needed in order to determine their participation? What are the consequences arising from this situation? What is the difference between complicity and joint responsibility? Lastly, is the complicity concept useful for determining corporate responsibility? These are issues that have to taken into account in determining the limitation of corporate obligations.

If domestic regulation is to be effective, the question of jurisdiction needs to be resolved in favour of a broad approach allowing cases to be heard where multinational corporations are headquartered or their assets are kept. This is so that liability may be established and reparation orders enforced. Therefore there is a need to further scrutinise extraterritorial principles in international and national law. Although the principle of extraterritoriality has been part of human rights discourse, its interpretation and its application is rather limited in the sense that it includes only case referrals, the actual jurisdiction and the protective jurisprudences as exceptions of the principle of territoriality. The absence of this issue in many non-binding instruments and self-initiative shows that the principle of extraterritorial effect is not developed yet in the context of human rights. As the need to identify the extraterritorial effect of human rights is emerging, a legally binding instrument should actually include this effect and clarify the content and conditions for applying the concept, as well as its limitation.

The last point refers to the concept of the limited liability of corporations which has been commonly accepted in every legal system. This principle recognises corporations as a separate juridical entity with their own rights and duties distinct from those of their shareholders. In cases of corporate human rights responsibility where parent and subsidiary are seen as two separate legal

[52] Surya Deva, "Acting Extraterritorial to Tame Multinational Corporations for Human Rights Violations: Who Should 'Bell the Cat'?," *Melbourne Journal of International Law* 5 (2004).

entities, both are directly liable only for conduct traceable to their own officers, directors, and employees. There is no way of invoking the responsibility of the parent company. These rigid applications of the principles of separate personality and limited liability have been used by the parent companies in corporate groups to defeat claims of human rights abuses. Exception to such a principle is allowed; however there is no common acceptance of when and how the exception clause can be invoked. Some cases reveal that such arguments depend on the applicable principles of domestic laws and subjectivity of the authorities.[53] This indeed creates a problem in enforcing corporate liability. Therefore, in the preparatory work, the drafter of a new legally binding instrument should actually examine the possibility of invoking 'human rights' as the exception to lift the veil of corporate limited liability. By adopting human rights as an exception clause, ensuring corporate responsibility may be easier.

These issues above have to be addressed carefully in drafting a legally binding instrument. Moreover, the drafter of such instruments should also take into account the nature and range of problems and solutions identified, analysed, and proposed by various stakeholders including the special representatives on human rights and business. Their information and findings may also throw light on how the obligation should be drafted.

2.4. Realistic and Effective Supervisory Machinery

The legally binding international instruments should provide, where appropriate, realistic and effective supervisory machinery. This raises the question of the type of supervisory machinery and the authority. Relating to the former, the implementation machinery should provide for such legal techniques and methods as procedure for developing standards, State reporting, the handling of complaints as well as fact-finding, and conciliation procedures. However, taking into account the nature of the problem which arises in relations between private actors namely individuals and business actors, non-legal techniques and methods are also called for. The latter invokes many debates on which body is suitable to supervise corporate performance.

The clarification of such issues is important in order to determine whether the legally binding instrument would take the form of a separate convention or an optional protocol to an existing instrument. In case a protocol is opted for, the supervisory mechanism would be that of the instruments to which it is attached. On the contrary, if a treaty is adopted, the possibilities would be either to create a new treaty body with a separate mechanism or utilise the existing one.[54]

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[53] *Ibid*.

[54] Bahiyyih G. Tahzib, *Freedom of Religion or Belief* (The Hague: Martinus Nijhoff Publishers, 1996).

In the present context, it is helpful to first list the key existing international human rights supervisory mechanisms within United Nation systems.

UN System	Name of Supervisory Bodies
Charter Based Organ	International Court of Justice
	Human Rights Council (2006)
Treaties Based Organ	Committee Against Torture
	Committee on Economic Social and Cultural Rights
	Committee on the Elimination of Discrimination against Women
	Committee on the Elimination of Racial Discrimination
	Committee on the Rights of the Child
	Human Rights Committee
	Committee on the Protection of the Rights of All Migrants Workers and Members of their Families

The procedures available are not likely to be suitable for enforcing corporate human rights obligations in relation to reparations due to two reasons. First, the focus is on the State as violator. Therefore, the usage of this procedure will need to fit into the concept of corporate responsibility within the framework of State responsibility. No room has been made for the possibility that other actors may be responsible for human rights abuses. Secondly, the procedure concerns public issues rather than individual case. Hence, it is difficult to utilise this model to address the group or individual interests.

The other option to enforce corporate human rights obligations is through the Human Rights Council. The question of whether the Human Rights Council will carry on these three procedures in countering human rights violations as its predecessor did or whether the Human Rights Council will modify them is not yet clear as the Council has just completed its first session. However, this opportunity should be used to introduce the prospect of creating a mechanism which may invoke corporate responsibility either through individual complaint procedures or other procedures in which it could function preventatively, in that the typical shaming from this institution may have an adverse effect on future policies.[55] It may be more likely that corporations would take criticism from a group of high-level UN experts seriously and then try to avoid similar embarrassment in the future.[56] Thus, one could establish a working group that would receive communications from individuals and organisations, pointing to adverse the effects of the operations of corporations, and publishing the findings. Simultaneously, the working group could also offer services to multinational corporations and local corporations on how to integrate human rights into business and may request assistance from the Office of the High Commissioner

[55] Skogly.
[56] Ibid.

for Human Rights in the form of seminars, training courses, and clinics, as well as advice from experts. Moreover, the working group could actually go further by building up partnerships with other governmental organisations, non-governmental organisations, and corporations. The Council, through its working group, could also act as an intermediary between host and home countries. The goal is to establish formal and informal cooperation between home and host countries in order to diminish the procedural hurdles in addressing corporate human rights responsibility in either one of these countries.

Another way of implementing this is through States. In this case, a legally binding instrument should include a provision obliging State parties to adopt immediate and effective measures. The National Contact Point system established by the Organisation for Economic Co-operation and Development (OECD) is a good example where every member State of OECD should establish a 'contact points office' which serves as a forum for developing standards and contributing to the resolution of issues that arise relating to the OECD guidelines. The new legally binding instrument can also adopt a system whereby each State Party to the convention should establish an 'office' to ensure that the obligation of the new legally binding instrument will be implemented by corporations and States. The office could also act as a mediator between national legal systems in order to harmonise different procedural laws which can diminish the problem arising in bringing the case before different jurisdictions. The role of such an 'offices' could also be further developed with special complaint procedures.

In short, if a legally binding instrument will be adopted, implementation should be pursued by all stakeholders including (1) transnational/multinational corporations or other business enterprises; (2) business groups or trade associations; (3) unions; (4) NGOs; (5) intergovernmental organisations; (6) States; and (7) the United Nations. As indicated periodically in the following paragraphs, effective implementation may result from the coordinated efforts of groups in one or more of the categories. In this case, the nature of obligation is obligatory; however, the implementation can be both obligatory and voluntary.

2.5. Broad International Support

Broad international support means that the product of the drafting process will be both legally sound and transformed into practice by State parties only with support of a large number of countries.[57] This implies that the draft resolution embodying the instruments developed should first of all be capable of achieving at least favourable votes of the majority of the United Nations member States present and voting.[58] After the adoption, the entry into force of the instrument

[57] Tahzib.
[58] Ibid.

would require a designated number of States to ratify or accede to that instrument. This process applies not only to a convention, but equally to all legally binding instruments including the optional protocol.

Gaining support from States on the adoption of a legally binding instrument on corporate human rights responsibility will be very challenging and difficult. This is due to several reasons. First, economics is of important national interest. Consequently, many States consider that regulation will actually jeopardise national interests as limiting corporate behaviours will discourage foreign investment.

Secondly, corporations are not and should not replace the role of States. Imposing obligations other than business obligations is considered as interference in the State's affair. Therefore, corporate obligations are only subject to national law.

Thirdly, as mentioned earlier, a multilateral convention regarding the conduct of multinational corporations would require protracted negotiations, followed by additional delays pending ratification or accession. Moreover, it would bind only those States that ultimately chose to accede; even between State parties, its uniformity might have been undercut by reservations. Especially some countries could be expected, in the end, to remind outside the treaty scheme, or to accept it only subject to crippling reservations.[59] Therefore, the practical assumption is that a legally binding convention creates more problems than solutions.

Fourthly, the strongest objections are coming from some business actors and business associations where they will surely lobby States to give up the idea of the adoption of a legally binding instrument. For many business communities, limitation will discourage investment. Having more regulations reduces the flexibility of doing business. Moreover, prescriptive regulation is not easily adaptable to the different circumstances and resources of individual companies as there is no 'one size fits all' model to cope with the different situations facing businesses, for example, in the extractive sector and the apparel industry. In the long term, this will damage the interests of developing nations. Furthermore, due to their political nature, business groups reject the idea of having the UN as the authorised delegation in dealing with corporations' responsibility. They doubt that sanctions will be fairly applied by an organisation such as the UN, renowned for bureaucratic mismanagement.[60] Finally, the business community prefers self-regulation where they can be involved in the process of adoption. In this process, their present becomes the subject rather than merely an object.

[59] Hans W. Baade, "The Legal Effects of Codes of Conduct for Multinational Enterprises," in *Legal Problems of Codes of Conduct for Multinational Enterprises*, ed. Norbert Horn (Devender: Kluwer, 1980), p. 9.

[60] Ibid.

On the other hand, NGOs and civil society activists have been campaigning in support of a legally binding instrument. Their arguments are based on some reasons. First, most soft laws and self regulations lack 'uniform language' and are 'unclear' or 'inadequate' in establishing concrete guidelines for the implementation of standards. Moreover, such instruments do not provide any enforcement or supervisory mechanisms; therefore, they don't provide adequate reparation in cases of human rights violation. Secondly, not all of the frameworks in question are legal, in the strict sense of the term, or at least a broader and less definite understanding of the law is needed to account for it. The lack of normative framework remains the issue for businesses which will not adopt a code of conduct on their own. Creating, adopting, and implementing a code of conduct takes time, money, and initiative on the part of the transnational corporation or other business enterprise, and many businesses may not be willing to make this type of effort.[61]

3. Conclusion

Of the General Assembly's five minimum requirements for the adoption of new international 'human rights' instruments, the requirement concerning fundamental character can be met. In order to satisfy the requirement concerning sufficient precision, further preparatory works and research are necessary.

There are many reasons to be particularly apprehensive about whether the normative consistency requirement can be successfully met. On the one hand, there is a general consensus on the need to include the concept of corporate human rights obligation in international law which is articulated in various self-regulations and scholars' discussions; on the other hand, the treaty's interpretation and jurisprudences towards the inclusion of corporation in human rights treaties are still sporadic and unsystematic. The tendency is still to hold the classical relationship between State and individual. Therefore, the chance of meeting the consistency of international law appears slim.

In addition, it is unclear whether the requirements concerning the realistic and effective supervisory machinery and the broad international support can be satisfied. The fulfilment of the broad international support requirement is to a large extent dependent on the issues that would be included in the instruments. In conclusion, most minimum requirements cannot readily be met. This indicates that a legally binding instrument is not feasible in the near future. However, it does not mean that the need to have one disappears. Therefore, discussion,

[61] U.N.Doc.E/CN.4/Sub.2/2002/X/Add.1 and U.N.Doc.E/CN.4/Sub.2/2002/WG.2/WP.1/Add.1, "Human Rights Principles and Responsibilities for Transnational Corporations and Other Business Enterprises, Introduction," ed. Sub-Commission on the Promotion and Protection of Human Rights Commission on Human Rights (2002).

literature, and debate should be encouraged to make the need become reality or searching for other ways of regulating corporation especially multinational corporation should be considered.

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The status of social rights in the EU

Izabela Justynska
Ph. D. candidate
Department of Human Rights Law
Nicolas Copernicus University,
Torun, Poland
E-mail: izabelcia-1980@o2.pl

Abstract

Social rights protection was interrelated to the economic activities of the European Communities from their establishment. The European Communities have been bound by the universal human rights protection system as well as the European human rights protection system as a result of the ECJ case law. Gradually, together with the process of building of the single European market and the new accessions to the European Communities (later the European Community and the European Union), the fundamental human rights, including social rights were expressed in the treaties, first in the Single European Act.

The preparation for the next accessions brought about next changes concerning human rights protection in the Treaty on the EU and the Treaty establishing the European Community. After the attempts of the EU to accede to the European Convention for the Protection of Human Rights and Fundamental Freedoms the decision to establish a catalogue of fundamental rights of its own was taken. It did not take a long time to prepare the EU Charter of Fundamental Rights, in which social rights were included. The decision to make it binding on the EU Member States is still under discussion. It is to be a part of the Constitution for Europe that hasn't been ratified yet. The process of ratification of this Constitution has opened a new political debate concerning inter alia social matters in the context of next accessions to the EU.

Key words: *Social rights; enlargement; ECJ case-law; equality; evolution*

I. INTRODUCTION

Before the Second World War thus, before the establishment of the United Nations (UN), the Council of Europe and the European Communities, the question of social rights was undertaken in the context of the abolishment of slavery and the establishment of workers' rights also in Europe[1].

[1] See the Convention on slavery signed in Geneva on 25. 09. 1926, in force since 09. 03. 1927; the activity of the International Labour Organisation can be followed here as well

After the Second World War the most important was to rebuild destroyed Europe and establish new peaceful political and legal order in the world. The main achievement was the UN Charter, signed on 25. 06. 1945. Apart from the protection of human rights as one of the UN's principles and goals, the UN Charter constituted the task of building a codification of human rights[2].

The first success was the Universal Declaration of Human Rights proclaimed in 1948. It was clear that there must be universal treaty standards of human rights. In this context the Universal Declaration was, together with the International Covenants, an element of the so called "International Charter"[3]. It was the first document specifying a catalogue of fundamental rights and freedoms of an individual, also in the field of social rights[4]. It became a source of inspiration for the constitutional regulations in many countries. The constitutional traditions influenced social rights protection in the European Union.

Shortly after the proclamation of the Universal Declaration of Human Rights the system of the Council of Europe[5] was established and it became the most crucial in the field of human rights protection in Europe. Today about fifty European countries are parties to the Statute of the Council of Europe, including many countries of Eastern Europe from the former Soviet Block and also Russia[6].

The new international legal and economic order based on peaceful cooperation of the European countries was created when the Paris Treaty establishing European Coal and Steel Community was signed on 18. 04. 1951 (entered into force 23. 07. 1952) and then the Rome Treaties establishing European Economic Community and EURATOM were signed on 25. 03. 1957 (entered into force 1. 01. 1958). Thus the very specific legal order – the European Community legal order was begun. This new legal order paid a tribute to the UN Charter by referring to it in the preamble to the EEC Treaty[7]. It was later bound to relate to the regional system of the protection of human rights.

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2 See art. 55 and 56 of the UN Charter

3 The International Covenant on Economic, Social and Cultural Rights was signed in 1966, in force since 1976

4 See art. 22-27 of the Universal Declaration

5 The Statute of the Council of Europe was signed in London on 5. 05. 1949, in force since 3. 08. 1949

6 Poland has been the Council of Europe Member since 26. 11. 1991 and Russia since January of 1996. To become a party to the Statute of the Council of Europe it is required to deposit ratification documents or accession documents.

7 Later the EU shows its attachment to the UN Charter principles in Art. J.1 of the Treaty on EU.

The Treaties establishing the European Communities (EC) aimed at the development of the living conditions of the six original Member States[8]. They did not mention specific social rights. The protection of those rights in the EC law is the effect of the case-law of the European Court of Justice (ECJ). It is ECJ that has developed fundamental human rights protection through an inspiration from the constitutional traditions of the Member States[9] and some international treaties of which they are signatories or on which they have collaborated[10]. The fundamental human rights protection was accepted as the general principle of the European Community law[11].

In the 1970s the EC experienced certain attempts to weaken the status of the European Community law as far as the human rights protection is concerned, which is well illustrated by the *Solange I* case of the Federal Consitutional Court of Germany[12]. According to the *Bundesverfassungsgericht* the actions and acts of the EC institutions were to be in compliance with the catalogue of the fundamental rights guaranteed in the German Constitution and the control was to be conducted as long as the EC would not have a binding catalogue of fundamental rights of its own, adequate to this of the German Constitution.

EC law has been under strong influence of both French and German law, which have 'strong' constitutions. It is probably due to that fact that between 1958 and 1978 about 45 percent of cases referred to the ECJ on the base of Art. 177 of the EEC Treaty originated from German courts and tribunals[13]. In 1972 the Accession Treaty between the original six Member States of the EC[14] and Denmark, Ireland and the United Kingdom was signed. In 1979 Greece joined the EC. The significance of human rights for the European Communities law was clear by that time.

One of the most important and most frequently mentioned international treaty in the EU legal order, firstly by the ECJ, has been the European Convention for the Protection of Human Rights and Fundamental Freedoms (ECHR) signed on

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8 See the preamble and art. 2 and 3 (i) (j) of the Treaty establishing the EC; the preamble and art. 2 and 3 (e) of the Treaty establishing the ECSC; art. 1 and 2 (b) of the Treaty establishing EURATOM

9 Case 11/70: *Internationale Handelsgesellschaft mbH v. Einfuhr und Vorratsstelle für Getreide und Futtermittel*, (1970) ECR, 1125.

10 Case 4/73: *Nold v. Commission*, (1974) ECR, 491; in particular the European Convention on Fundamental Rights and Freedoms of the Council of Europe – see cases 60 and 61/84: *Cinetheque and others v. Federation nationale des cinemas francais*, (1985) ECR, 2605.

11 See case 29/69: *Erich Stauder v. City of Ulm*, (1969) ECR 419.

12 *Internationale Handelsgesellschaft mbH v. Einfuhr und Vorratsstelle für Getreide und Futtermittel (Solange I)* 29. 05. 1974 (Case No 2 BvL 52/71, BVerfG) in: *The Relationship Between European Community Law and National Law: the Cases*, ed. A. Oppenheimer, Cambridge 1994, p. 420-461.

13 M. Akehurst, *The Application of General Principles of Law by the Court of Justice of the European Communities*, in: The British Yearbook of International Law, Oxford 1982, s. 29-30

14 Belgium, France, the Netherlands, Luxemburg, Germany and Italy

4 November 1950 in Rome. Apart from it the European Social Charter signed in Turin on 18. 10. 1961 (entered in force on 26. 02. 1965) has also been a valuable source of inspiration in the interpretation of certain rights by the ECJ when applying the EC law. Both documents have been the source of inspiration for the general principle of the protection of human rights in the EC law, used as the condition of lawfulness of the EC acts and to fill the gaps in this legal system[15].

The system of the ECHR generally includes, the so called, "first generation rights", moreover it establishes some social, cultural and economic rights – "second generation rights" eg.: Art. 11 – freedom of association including the right to establish trade unions, Art. 1 of the First Protocol – right to property, as well as Art. 2 – right to education. The European Social Charter of 1961[16] in its Part III includes a group of seven rights – hard core provisions: Articles: 1, 5, 6, 12, 13, 16 and 19. The Member States are bound to choose five be binding and the rest of rights are non – hard core provisions. In general 10 articles of this treaty must be binding but there is a possibility to be bound by certain paragraphs as well – no less than 45.

Both treaties predict the establishment of the control bodies as a mechanism of supervision of the observance of the rights included. For the ECHR it is the European Court of Human Rights and for the European Social Charter it is the European Committee on Social Rights[17]. The interpretation of the rights included in these treaties by their control bodies is binding and acknowledged by the ECJ.

The attachment to the Council of Europe's treaties is emphasised not only by the ECJ but literally emphasized in the Treaty on European Union (EU) and Treaty establishing European Community[18]. Besides, the Treaty establishing the European Community predicts that the Community will establish every necessary forms of cooperation with the Council of Europe (art. 303).

II. FURTHER DEVELOPMENTS OF SOCIAL RIGHTS PROTECTION IN THE EU (SINGLE EUROPEAN ACT, MAASTRICHT AND AMSTERDAM TREATIES)

Social goals of the EU are very wide now but the social policy has always been crucial for the realisation of the common market[19]. Certain steps in this

[15] Poland ratified the ECHR in 1993 and the European Social Charter in 1997.

[16] There is a Revised European Social Charter signed on 3. 05. 1996, in force since 1. 07. 1999 that is to replace the European Social Charter with its Additional Protocols. For the time length these treaties function simultaneously.

[17] Initially: Committee of Independent Experts of the European Social Charter; European Committee on Social Rights since 1998

[18] See the preamble to the Treaty on European Union, as well as Art. 136 (117) of the EC Treaty

[19] See Art. 2 of the Treaty on EU, Art. 2 of and Art. 3 of the EC Treaty.

matter were undertaken by the Single European Act signed in Luxemburg on 17 February 1986, after Spain and Portugal joined the EC. The deadline of 1992 to establish single European market was set[20]. In the preamble of the Single European Act the Member States finally emphasized their attachment to democracy and fundamental human rights.

It is that moment, when the Federal Constitutional Court of Germany in case *Solange II*[21] changed its previous position and suspended its competence to overview the binding of the EC law in Germany as far as human rights protection in the context of actions of the EC institutions is concerned.

The Charter of Fundamental Social Rights of Workers signed on 9 December 1989 was the next important development in establishing social rights protection in the European Community legal order. Despite its non-binding character, this document has been a valuable source of inspiration for the Commission and the Council in undertaking further steps in order to implement the rights contained in the Charter of Fundamental Social Rights of Workers.

D. Lasok points out that desistance from the unanimity principle while drafting this document was unfortunate[22]. As a result the United Kingdom opted out and the Charter of Fundamental Social Rights of Workers was signed by eleven Member States[23].

Maastricht Treaty was the realisation of plans of the Single European Act. The whole common commercial policy was established in order to fulfil social goals of the new entity – the EU[24]. Besides the specific social policy of the EU there were other means by which the EU could reach its social goals. Important provisions on the European citizenship were included into the Treaties on the EU and establishing European Community[25]. Supranational cooperation was established in relation to the new Title IV in the EC Treaty regulating visas,

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[20] Already in the EEC Treaty Art. 2 set social goals as one of the tasks of the EEC, see also Art. 117 of the same treaty in connection with Art. 118, which deal with the social policy goals set as a program of a legal significance to be realised in cooperation between the Member States organised by the Commission. Interesting case on this matter: case 126/86 *Gimenez-Zaera v. National Social Security Institute*, (1987) ECR, 3697; Compare with the earlier case law, for instance: case 129/79 *Macrthys Ltd. V. W. Smith*, (1980) ECR, 1275, where the ECJ based its decision on Art. 119 (1) of the EEC Treaty, arguing that it is adequate to all forms of discrimination, not only sex discrimination, without the need to release additional regulations by the Commission or the Member States.

[21] Case *Solange II* of the Federal Constitutional Court of Germany of 22. 10. 1986

[22] D. Lasok, K. P. E. Lasok, *Law and Institutions of the European Union*, London 1994, p. 706

[23] In 1997 Great Britain decided to sign the Charter of Fundamental Social Rights of Workers.

[24] See Art. 4 (3a) in connection with Articles 3 (3) point 1 c, i, j, k, r and point 2 and Article 2 (2) of the EC Treaty.

[25] The Maastricht Treaty was signed on 2 February 1992, in force since 1 November 1993; see Art. 2 of the Treaty on EU and Art. 8 of the Treaty establishing EC;

asylum, immigration and other policies connected with the free movement of persons. It is important to mention that according to the Protocol added to Maastricht Treaty Ireland and the United Kingdom chose not to be affected by any means undertaken according to this new Title IV of the EC Treaty.

In Maastricht Art. F was included in the Treaty on EU and for the first time it was clearly emphasized that *the EU is established on the basis of the principles of freedom, democracy, respect for fundamental rights and freedoms and rule of law, the principles common to the Member States*[26]. In 1994 the next Accession Treaty was signed between the Member States of the European Communities and Austria, Sweden and Finland.

Further liberalisation of the free movement of persons was realised by the Amsterdam Treaty and inclusion of Title IV into the EC Treaty. Nevertheless, the most important implication of the Amsterdam Treaty was the development of Art. 6 (F) and Art. 7 (F.1) of the Treaty on the EU.

III. JURISPRUDENCE OF THE EUROPEAN COURT OF JUSTICE CONCERNING EQUAL TREATMENT OF MEN AND WOMEN

To illustrate some of the questions concerning social rights in the EU it is proper to refer to judgments, for instance those related to the principle of equal pay for men and women, equal treatment for men and women as regards access to employment, vocational training and promotion, and working conditions.

Judgment of 17 June 1998, in case C-243/95: *Kathleen Hill and Ann Stapleton v. The Revenue Commissioners and Department of Finance* represents the status after the ratification of the Maastricht Treaty. The ECJ stated that:

Article 119 of the EC Treaty and Council Directive 75/117/EEC of 10 February 1975 on the approximation of the laws of the Member States relating to the application of the principle of equal pay for men and women are to be interpreted as precluding legislation which provides that, where a much higher percentage of female workers than male workers are engaged in job-sharing, job-sharers who convert to full-time employment are given a point on the pay scale applicable to full-time staff which is lower than that which those workers previously occupied on the pay scale applicable to job-sharing staff due to the fact that the employer has applied the criterion of service calculated by the actual length of time worked in a post, unless such legislation can be justified by objective criteria unrelated to any discrimination on grounds of sex[27].

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[26] The attachment to democracy, rule of law and respect for fundamental rights were emphasized also in Art. J.1 point 1.

[27] Case C-243/95, *Kathleen Hill and Ann Stapleton v. The Revenue Commissioners and Department of Finance*, (1998) ECR, I-03739.

More recent judgment of the ECJ of 11 January 2000, in case C-285/98: *Tanja Kreil* on the equal treatment of men and women concerns limitation of free access by women to military posts in the *Bundeswehr* and represents the status after the ratification of the Amsterdam Treaty. The reference to the Court was made under Art. 177 of the EC Treaty (now Article 234 EC) by the *Verwaltungsgericht* Hannover, in Germany and it concerned the interpretation of Council Directive 76/207/EEC of 9 February 1976 on the implementation of the principle of equal treatment for men and women as regards access to employment, vocational training and promotion, and working conditions, in particular its Art. 2. The ECJ ruled: *Council Directive 76/207/EEC of 9 February 1976 on the implementation of the principle of equal treatment for men and women as regards access to employment, vocational training and promotion, and working conditions precludes the application of national provisions, such as those of German law, which impose a general exclusion of women from military posts involving the use of arms and which allow them access only to the medical and military-music services*[28].

In judgment of the ECJ of 13 July 2000, in case C-166/99: *Marthe Defreyn* the reference to the Court was made under Art. 177 of the EC Treaty (now Art. 234 EC) by the *Cour du Travail*, in Brussels and it concerned the interpretation of Protocol No 2 on Article 119 of the Treaty establishing the European Community, annexed to the EC Treaty, and Article 5 of Council Directive 76/207/EEC of 9 February 1976 on the implementation of the principle of equal treatment for men and women as regards access to employment, vocational training and promotion, and working conditions[29].

Ms Defreyn claimed that it is clear from the judgment in Case C-173/91: *Commission v. Belgium*, that the payment in question (unemployment benefit supplement) constituted 'pay' within the meaning of Article 119 of the Treaty. That article, rather than the Protocol, should therefore be applied, which would preclude that benefit from being granted only to male workers aged between 60 and 65 who were made redundant, whilst female workers made redundant within the same age range were denied it. The national court decided to refer the following question to the Court of Justice for a preliminary ruling: *Does the application of the Protocol on Article 119 of the Treaty preclude the action brought by Ms Defreyn from succeeding, inasmuch as it is founded on breach of Article 5 of Directive 76/207?*

In order to give a proper answer the ECJ first had to determine whether the payment at issue in the main proceedings constituted a benefit under an occupational social security scheme within the meaning of the Protocol.

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[28] Case C-285/98, *Tanja Kreil*, (2000) ECR, I-69.
[29] OJ 1976 L 39, p. 40.

The ECJ ruled:

1. Protocol No 2 on Article 119 of the Treaty establishing the European Community, annexed to the EC Treaty, applies to a payment such as the additional pre-retirement payment provided for by Collective Agreement No 17, rendered compulsory by the Royal Decree of 16 January 1975 and provided for in the Collective Labour Agreement of 23 May 1984 concluded within Joint Sub-Committee No 315.1.

2. An additional payment, as in the present case, constitutes 'pay' within meaning of Article 119 of the EC Treaty (Articles 117 to 120 of the EC Treaty have been replaced by Articles 136 EC to 143 EC) and is not covered by Article 5 of Council Directive 76/207/EEC of 9 February 1976 on the implementation of the principle of equal treatment for men and women as regards access to employment, vocational training and promotion, and working conditions[30].

Judgment of 29 November 2001, in case C-366/99: *Griesmar* concerned questions of social policy such as equal treatment for men and women – applicability of Article 119 of the EC Treaty or Directive 79/7/EEC. The reference to the Court under Art. 234 EC was made by the *Conseil d'État* (France), by decision of 28 July 1999, for preliminary ruling on the interpretation of Art. 119 of the EC Treaty, Art. 6 (3) of the Agreement on Social Policy[31] and Council Directive 79/7/EEC of 19 December 1978 on the progressive implementation of the principle of equal treatment for men and women in matters of social security[32].

Those questions have arisen in a dispute between Mr Griesmar, on the one hand, and the Minister for Economic Affairs, Finance and Industry and the Minister for the Civil Service, State Reform and Decentralisation, on the other, concerning the legality of the decree awarding Mr Griesmar a retirement pension.

The ECJ ruled: *Pensions provided under a scheme such as the French retirement scheme for civil servants fall within the scope of Article 119 of the EC Treaty (Articles 117 to 120 of the EC Treaty have been replaced by Articles 136 EC to 143 EC). Notwithstanding what is provided in Article 6 (3) of the Agreement on Social Policy, a provision such as Article L. 12 (b) of the French Civil and Military Retirement Pensions Code infringes the principle of equal pay inasmuch as it excludes male civil servants who are able to prove that they assumed the task of bringing up their children from entitlement to the credit which it introduces for the calculation of retirement pensions*[33].

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30 Case C-166/99, *Marthe Defreyn*, (2000) ECR, I-6155.
31 OJ 1992 C 191, p. 91.
32 OJ 1979 L6, p. 24.
33 Case C-366/99, *Griesmar*, (2001) ECR, I-9383.

A. Commentary on the case-law

The ECJ judgment in case C-243/95: *Kathleen Hill* was based on the Council Directive 75/117/EC of 10 February 1975 on the approximation of the laws of the Member States relating to the application of the principle of equal pay for men and women and on Art. 119 of the EC Treaty. This measures were to establish the principle of equal pay for male and female workers, nevertheless it is up to Member States to ensure this principle is applied.

The ECJ judgment in case C-285/98: *Tanja Kreil* showed that despite the changes brought about by the Amsterdam Treaty, the Council Directive 76/207/EEC of 9 February 1976 on the implementation of the principle of equal treatment of men and women as regards access to employment, vocational training and promotion, and working conditions still proves to be an appropriate means to preclude national legislation that is not compatible with EC law.

The ECJ judgment in case C-166/99 the ECJ shows that despite the fact that there are different grounds that could be applied in the case some preclude the others, like Art. 119 of the EC Treaty and Art. 5 of the Council Directive 76/207/EEC.

Case C-366/99 proves the fact that EC secondary legislation has been well developed as regards the implementation of the principle of equal pay for male and female workers, however Art. 119 and the Protocol No 2 on Art. 119 of the EC Treaty, annexed to the EC Treaty made a strong foundation to this principle.

Not only the adoption of certain secondary legislation measures is desired but also the most active approach of the Member States in the application of the EC law. Proper ECJ's and Court's of the First Instance interpretation of the provisions is above all crucial in the application of the EC law. It also enables the developments in treaty law[34].

IV. THE LATEST DEVELOPMENTS OF SOCIAL RIGHTS PROTECTION IN THE EU

In Nice the EU Charter of Fundamental Rights was proclaimed[35]. It can be called the biggest success of the human rights protection in the EU. The EU

[34] See especially articles concerning social rights protection in the EU: the preamble of the Treaty establishing the EC and art. 136, which recall the European Social Charter (1961) and the Charter of Fundamental Social Rights of Workers (1989) as well as: art. 2, 3, art. 12, 13 (1) (2), 41, 95, 125, 126, 127, 137 (1) & (2), art. 138, 141, 149, 150 and 251

[35] The decision on preparation of the EU Charter of Fundamental Rights was taken at the European Council Summit in Cologne on 3-4. 06. 1999; the last 18th session of the Convention preparing the EU Charter of Fundamental Rights took place in Bruxelles and the text of the project was approved on 2. 10. 2000; in final the proclamation of the EU Charter of Fundamental Rights by

Charter of Fundamental Rights includes all sorts of human rights, including a wide range of social rights, in particular in Chapter III and IV. The process of elaboration of this document was preceded by an unsuccessful proposal of EU's adherence to the ECHR. Finally the decision to prepare EU's catalogue was approved. For the time being it has a status of a declaration (soft law)[36].

The Treaty of Nice signed on 26. 02. 2001 (in force since 1. 02. 2003) has certain implications in the field of human rights protection. Especially, it enables the EU to take action already in case of *the risk of breach of the principles established in Art. 6 p. 1*, even before a *serious and persistent breach of the principles established in Art. 6 p. 1*. Of course certain other reforms, in particular structural as well as institutional were undertaken by the Nice Treaty in order to bring the EU closer to its citizens and prepare the EU for the next accession[37]. In 2003 the last Accession Treaty was signed (in force since 1. 05. 2004) between the fifteen Member States of the EU and ten new Member States: Poland, Czech Republic, Slovakia, Slovenia, Latvia, Lithuania, Estonia, Hungary, Malta and Cyprus.

Moreover, the Treaty of Nice included the Declaration on the future of the EU in which the discussion between all the interested parties is promoted, in particular in matters such as the status of the EU Charter of Fundamental Rights.

The draft Treaty establishing the Constitution for Europe was signed on 29 October 2004 in Rome[38]. It is still under discussion, as its ratification was rejected firstly by the referendum in France and the Netherlands. Thus, the status of social rights remains unclear, as the EU Charter of Fundamental Rights included in the Part II of the Treaty establishing the Constitution for Europe, does not have a binding force.

C. Closa describes a present situation in the following manner: *The rejection of the draft Constitutional Treaty in referendums in France and the Netherlands triggered a political crisis in the European Union. (...) The proposed Constitution was designed precisely as a response to the perceived shortcomings and defects of the Nice Treaty. The solution (i. e. the Constitution) has failed but this does not mean that the problems have disappeared. On the contrary, it is logical to assume that they persist and like Sisyphus, the EU must once again begin to push the boulder up the hill*[39].

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the Council, European Parliament and the Council has took at the European Council Summit in Nice on 7. 12. 2000.

36 The Court of First Instance referred to the EU Charter of Fundamental Rights for the first time in case T-54/99 from 30. 01. 2002.

37 See art. 12 and 13 of the Treaty establishing the EC as amended by the Nice Treaty

38 See version from 13. 10. 2004, Bruxelles CIG 87/1/04, RE.

39 C. Closa, *Sisyphus Revisited: Options for the EU's Constitutional Future*, U.S.-Europe Analysis Series, Washington DC 2005, p. 1-5.

The author mentions that there are proposals of the selective application of parts of the Constitution within the framework of Nice. According to him the EU Charter of Fundamental Rights could presumably be added to the existing Treaties without much opposition, even if it would require national ratification. C. Closa rightly points out that, some other constitutional reforms still meet both political and juridical difficulties. For instance, including the Minister of Foreign Affairs as part of the Commission could have implications in the field of social rights.

It is important to identify some of the reasons for the "no" vote to the ratification of the Treaty establishing the Constitution for Europe[40], like: fear of globalization, protest against enlargement, nationalism, anti-Turkish feeling, anti-government sentiment, etc. There are still many proposals to cope with the increasing diversity within the EU[41].

It should be emphasized that it is difficult to establish a higher level of protection of the social rights on the EU constitutional level. *Fields such as social policy require an all-inclusive effort, unless participants are willing to risk social dumping or are willing to re-establish market barriers within the Single Market*[42].

Therefore, the minimum standard of the protection of social rights established by the European Social Charter of the Council of Europe with European Committee on Social Rights guarding its observance, as well as the Charter of Fundamental Social Rights of Workers still seem to be the most inspiring, even more than the EU Charter of Fundamental Rights, for both ECJ and the Court of First Instance in observance of the EC Treaties.

It should be mentioned that social solutions are enriched by an interesting secondary legislation that has been introduced lately[43]. Further changes to the right of citizens of the Union and their family members to move and reside freely within the territory of the Member States were introduced by the Directive

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[40] The Treaty establishing the Constitution for Europe is technically a reform of the Treaty of Nice and thus, according to Art. 48 of the Treaty on EU, requires unanimous approval. C. Closa rightly points out that: *Under these conditions, ratification by any number of other member states will not suffice to bring the Constitution into force*. C. Closa, op. cit., p. 2, note 33.

[41] *(...) there are though, good reasons for keeping the process going: opinions of parliaments and citizens in the Member States that have not yet voted should be heard, so that they are put on a similar footing.* C. Closa, op. cit., p. 4, note 33

[42] Ibidem, p. 5, note 33; C. Closa also points out that: *with 25 members, unanimity seems a recipe for disintegration*.

[43] See directives: 80/987/EEC; 86/188/EEC; 89/391/EEC; 89/654/EEC; 90/269/EEC; 91/368/EEC; 91/383/EEC; 91/533/EEC; 92/85/EEC; 93/104/EEC; 94/33/EC; 94/45/EC; 96/34/EC; 96/71/EC; 97/81/EC; 98/59/EC; 99/70/EC; 2000/43/EC; 2000/78/EC; 2001/23/EC; 2001/86/EC; 2002/14/EC and 2002/73/EC

2004/38/EC of the European Parliament and of the Council of 29 April 2004[44]. On 13 December 2004 the introduction of the principle of equal treatment for men and women concerning the access to goods, services and the delivering of goods and services has taken place[45]. Moreover, on 5 July 2006 European Parliament and Council adopted Directive 2006/54/EC on introduction of the principle on equal chances and equal treatment for men and women as regards access to employment[46].

CONCLUSION

Social rights protection on the EU level is unquestionable. The proclamation of the EU Charter of Fundamental Rights was an important step in providing transparent and close to the EU citizens protection of the rights, including social rights. Nevertheless, structural and institutional changes within the European Community and EU Treaties are of much importance to complete the process of amending the system of social rights protection in the EU. The EU Charter of Fundamental Rights was to be included in the Treaty establishing the Constitution for Europe but this treaty is waiting for the ratification.

Despite the difficulties in this process we shall expect interesting case law on the social protection in the EU, as the EU Charter of Fundamental Rights was proclaimed as a *soft law*. It is clear that as long as there are reasons for the Member States of the EU to cooperate economically there are going to be questions about different social solutions in Europe, in particular in the context of the next accessions.

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Rating law in Malaysia: Are they paying fair rates?

Wan Nor Azriyati Wan Abd Aziz, Noor Rosly Hanif and Heng Chin Ing
Study of Urban and Regional Real Estate (SURE)
Faculty of the Built Environment
University Malaya
Kuala Lumpur, Malaysia
E-mail: wyati@um.edu.my or nroslyhanif@um.edu.my

Abstract

The property tax generates a significant proportion of local government revenues in many countries. It is the most commonly used source of municipal tax revenue in the developing world to fund those services whose collective benefits are enjoyed by the residents of the local community. In Malaysia context, this local tax known as rating is governed by the Local Government Act 1976. The act empowers all local authority to levy rates on all rate able properties within their boundaries. In determining the tax, the annual value is widely use as the basis rather than the improved value. This paper aims to elucidate the current practice of rating valuation in Kuala Lumpur including the methods used in rating valuation. The paper has two key objectives. First, drawing upon a case study of two distinct residential areas in Kuala Lumpur, it seeks to draw a distinction between scopes of services enjoyed by the landed property occupiers and the multi storey property occupier. Second, by reviewing the main principles and basis of rating, this paper endeavors to demonstrate the inequalities on tax payment between the multi storey property owners and the landed property owners. The findings of this empirical analysis demonstrates that despite paying a higher property tax the multi storey property owners benefited less in terms of scope of services provided by the local authority.

Key words: Property tax, local authority, rating, services

INTRODUCTION

The property tax produces a substantial proportion of local government income in a few countries, mainly in the OECD (Muller, 1997). Yet, this tax yield provides only a small, though not insignificant, share of the income available for local governments in most developing and transition countries. Paugam (1999) argued that property tax revenues are low in many developing and transitional economies in part because of the way in which the tax is administered. A number

of reasons contribute to this unfavorable circumstance. For instance, the coverage of the tax is not comprehensive, assessments are low, as are nominal tax rates, and collection rates are also often low. In some cases, low tax rates are imposed by higher-level governments and sometimes by local governments themselves which find rate increases in this most visible of taxes very difficult to sell politically. This form of tax is generally levied on all types of properties. In most countries, the way property tax is calculated demonstrated that different categories of property are treated differently (Youngman *et al.,* 1994). Despite this, there are certain classes of property, or property owner, or uses of property, are exempt (Slack, 1999).

In Malaysia context, property tax is better known as "rating" or "assessment". Dillinger (1992) defined rating as a method by which residents of a particular area contribute money to share the burden of the cost of providing services to themselves within their area year by year. Thus, the sole purpose of rating should be the *collective* raising of money to meet the cost of services rendered to the residents of the particular area. In short, rates are paid by residents who are benefited with the services provided by the local authority, either directly or indirectly. "Directly" means the services by local authority such as the health services, street and drainage, street lighting, rubbish collection and waste disposal that are being used by the residents. Higher rentals or capital appreciations which accrue due to the services provided by the local authority are the examples of indirectly benefited.

Against this background, the first section of this paper seeks to introduce the roles of local authority in Malaysia. It is noteworthy to first comprehend the roles of local authority in Malaysia before further discussion on the issue can be made. A brief discussion on the basis of rating emphasizing on the basis of annual value and review on the principles of rating is then undertaken. Subsequently the paper present the findings of the empirical research drawing upon a case study of two residential areas in Kuala Lumpur comprising about equal number of residential units and with similar market value. The paper then present a critical analysis of the services benefited by the resident in lieu of the property tax paid to the local authority. Finally, a synthesis and conclusion are presented.

LOCAL AUTHORITY

Local authority is the administrative unit of a local government which imposes rating in Malaysia. The Local Government Act 1976 stipulated that local authority refers to city council, municipal council or district council. Local authority and local government represent the same organization which is the lowest in the governmental hierarchy. Phang (1989) asserted that the local authority can only perform those functions enumerated in its statutes and within its gazette area only. Phang (1989) further commented that in general,

the local authority is obliged to fulfill its obligatory functions while discretionary services may only be performed based upon the capability and ability of the local authority concerned.

To perform these functions, local authority depends on a range of sources of revenue. In general, the revenue of a local government is divided into two; external source and internal source. External source is derived from the higher levels of government, namely the Federal and State Grants and fiscal transfers and loans. Internal source is the revenues that are generated by the local authority themselves (Leung and Usilappan, 1997)

Rates collection is the responsibility of the local authority. Rates are payable in two installments on 28th February and 31st August each year. In practice, if the rates are not paid by the stipulated dates, the property owner is held liable to pay the arrears with additional payment of 5% of the outstanding amount. Notice on this additional payment will not be issued separately by the local authority. However, the property owner has instead, been notified in the assessment bill issued.

BASIS OF RATING

In practice, there are two basis of rating implemented in Malaysia, the annual value and the improved value as stipulated in the Local Government Act 1976. Section 130 of this act stipulated that it is the jurisdiction of the State Authority to decide on the basis of rating to be implemented by the local authority. Till to-date, most of the state adopted the annual value as the basis for rating or assessment purpose. It is applicable in all of the states in West Malaysia except for Johor. The State of Johor is the only authority adopting improved valued as the basis of rating.

Section 2 of the Act defined "Annual Value" as the estimated gross annual rent at which the holding might be reasonably be expected to be let from year to year with the landlord paying the expenses of repair, insurance, maintenance or upkeep and all public rates and taxes. In estimating the annual value, any restriction on the tenancy of the holding will not be taken into consideration.

The Local Government Act 1976 provides a separate basis to determine the annual value of vacant land. Section 2 (c) stipulated that the annual value shall be ten per centum of the market value or reduced to a minimum of five per centum with the consent of the state authority. This is also apply to land which is for partially occupied or built upon, vacant, unoccupied or not built upon, and any land with an incomplete building or building which has been certified by the local authority to be abandoned or dilapidated or unfit for human habitation.

SCALES OF RATES

The amount of the payable rates is indeed not the amount of the annual value or the improved value. Rates, in fact, are a percentage of the rate able value of the property. Section 130 (2) and (3) of the Local Government Act 1976 stated that the rates to be levied shall not exceed thirty five percent (35%) from the annual value or five percent (5%) from the improved value.

Section 129 of the Act further stipulated that in levying the rates, local authority may divide its area into different sections and then impose separate rates considered fair and reasonable. Local authority may also levy different rating percentage within such sections in line with actual usage of the holding.

PRINCIPLES OF RATING VALUATION

In deriving at the annual value, there are three (3) key principles to be adhered. First, the tone of list which is usually used when current work need to be carried out (Ahmad and Hasmah, 2001). As stipulated in Section 144 (4) of the Act, where current work is relevant, emphasis is to be given on tone of list. Second, the hypothetical tenancy and third, the concept of *rebus sic stantibus*. Hypothetical tenancy is one of the main principles that are essential for rating purposes (Ahmad and Hasmah, 2001). The property to be assessed is assumed as 'vacant and available to be rented out', regardless whether the property is occupied or not. The rent is determined based on the amount that can be expected if the holding is let on a year to year basis and can be terminated at any time by a notice. Hence, the passing rent is considered as the best evidence in determining the annual value of the holding, provided that the tenancy is recently executed and the rent paid is equivalent to the market rent. Finally, the concept of *rebus sic stantibus* emphasized that the holdings must be valued in existing condition. Potential value of the holding is not to be taken into consideration.

THE CASE STUDY: CITY HALL OF KUALA LUMPUR

City Hall of Kuala Lumpur (CHKL) is the local authority for the Federal Territory of Kuala Lumpur. The CHKL has its own Valuation and Property Management Department to perform a wide range of functions with emphasis on the valuations for rating. The main functions of the CHKL are as listed as follows:

a) To provide the cleaning services and disposal of rubbish
b) To provide public's health services and control on pollution
c) To build and maintain the road, provide public transportations and infrastructure and manage the traffic flow

d) To build and maintain the drainage and piping system
e) To plan and manage the urban development
f) To foresee enforcement and licensing issues
g) To implement social services and development
h) To develop and manage public housing
i) To provide, manage and maintain public amenities

CHKL depends on two major financing sources: internal source and external source. Internal source is the income generated by the CHKL itself, such as rating, return on investment, development tax or development charges, flat rental, license and fines and others (CHKL, 2000). On the other hand, external source derives from contributions and funding from the higher authorities, mostly federal grants. Nevertheless, the major source of finance is through the revenue from rating. For instance, in year 2003 until 2005, the revenues derived from rating represents more than 60% of the total revenue for CHKL in each year. The assessment for all of the rate able properties in the area of CHKL is based on the tone of the list which is implemented as of 1st of January 1992. Table 1 illustrates the scale of rates for year 2006.

Table 1: Scale of Rates According to Area and Types of Property

Area	Types of Property	Percentage of Rates
Within 36 Square Miles	Commercial Buildings	12%
	Vacant Commercial Land	10%
	Residential Building	6%
	Vacant Residential Land	7%
Outside 36 Square Miles	Residential Building	6%
	Commercial Building	10%
	Vacant Residential Land	6%
	Vacant Commercial Land	6%
Within New Villages	Residential Building	3%
	Commercial Building	3%
	Vacant Land	2%
	Kampung Sg. Pencala & Kampung Melayu Segambut Dalam	2%
Kampung Baru	Residential and Commercial	2%
	Vacant Land	2%

Source: CHKL, 2006

The intrinsic case study

a) Taman Desa

Taman Desa falls under Zone Six of CHKL's administrative area and is situated within the Mukim of Kuala Lumpur, District of Kuala Lumpur. It is a large residential estate comprising mainly landed residential buildings dominated by double storey terrace houses. A proportion of this housing estate is chosen for the purpose of this study. The study area consists of 117 units of double storey terraces identified as Lot Nos. 785 to Lot 959. The units are situated along Jalan Desa Bahagia, Jalan Desa Damai, Jalan Desa Ria 1, Jalan Desa Ria 2 and Jalan Desa Setia.

Residences in this locality enjoyed a range of services provided by City Hall of Kuala Lumpur in lieu of assessment tax paid. Among the environmental services that can be found in the boundary of the study area are as describe in Table 2.

Table 2: Services provided by City Hall of Kuala Lumpur

Types of Service	Description
Street lighting	There are 11 street lights provided by the local authority in the study area.
Traffic Management	There is no traffic light in the area and the roads are designed as dual way.
Drainage system	The study area also has a well-planned drainage system. However, drainage cleaning are only carried out when drains are clogged but regularly maintain during rainy seasons
Rubbish Collection	Rubbish bins are positioned in front of each house and refuse is collected from house to house, usually twice a week.
Street Cleaning	The cleaning job is scheduled on a weekly basis
Landscaping	Generally, the landscaping services provided in the area include tree cutting and grass mowing which are only done twice a month.
Mosquito fogging	In certain circumstances where dengue cases are reported, the local authority will also provide mosquito fogging.

Source : Author, 2006

The CHKL only provides one public amenity (public phone) in the study area. As for social services and development in the study area, CHKL only focuses on road and infrastructure maintenance. Nevertheless, since the road linkages are already well-developed, the duty of the CHKL is only on the maintenance works of the roads which is only carried out based on CHKL's schedule or upon received of complaints from the residence.

b) Danau Idaman Condominium

Danau Idaman Condominium is located at Taman Danau Desa, adjacent to Taman Desa. Similar to Taman Desa, Taman Danau Desa is located in Mukim Kuala Lumpur, District of Kuala Lumpur, which falls under Zone Six of the administrative area of CHKL. Danau Idaman Condominium is developed on PT 6221, Mukim and Distirct of Kuala Lumpur comprising an area of 28,328 square

meters. The site is situated at the intersection of Jalan 109F and Jalan 2/109F. The condominium consists of three blocks with a total of 660 residential units. All the units have a standard size of 849 square foot. Block Aman is a 22 storey building and comprised a total of 264 units while Block Bayu which is an 18 storey building has a total of 216 units. Block Cerah is a 15 storey condominium building consisting of 180 units.

Danau Idaman Condominium is currently managed by Faber Facilities Sdn Bhd. The management corporation has yet to be formed. The empirical findings suggested that that the service charges are imposed on the owners for providing the services, facilities and the upkeep and maintenance of the common property within the boundary of the condominium. The basis of apportioning service charges for the condominium is based on the floor area occupied. Since all of the units in the condominium have similar floor area, the service charge is imposed at equal amount. At present, the service charge is at RM 0.17 per square foot. Hence, the total monthly service charge for every unit is RM 144.33.

The services in the study area are generally similar to the other condominiums of the type. The scopes of work are only provided to the area within the boundary of the Condominium and are exclusively for the residents of Danau Idaman only. Table 3 summarized the services provided by the management of the condominium.

Table 3: The Services Provided by the Management of Danau Idaman Condominium

TYPES OF SERVICE	DESCRIPTION
Cleaning of common area	Cleaning operations cover the whole building and exclude the demised area of the tenants. The common area, inclusive of the ground floor and the corridor and stairs of every storey are clean everyday. Drains are also taken care of to avoid stagnant of liquid waste.
Rubbish Collection	No refuse chutes are provided, hence the residents have to literally carry their rubbish to the collection point located on the ground floor of every block. The management is only responsible to transport the refuse to the rubbish house to be collected by the CHKL.
Drainage	The condominium is fitted with normal fixtures connected to the soil and waste plumbing systems and all associated ancillaries. The management is responsible to manage the drainage system of the building. However, the work scope of the management only covers the area in the boundary of the condominium. External sewer drainage is under the responsibility of the CHKL.
Landscaping	Landscaping is carried out twice a week for the upkeep of the garden while plants and trees along the corridor are watered daily
Lighting	Lighting is provided to corridor, staircase, car park and other common areas.
Pest Control	Health issues are among the major concern in a condominium and therefore pest control is also provided.

Maintenance of facilities	All the facilities and services provided are under the responsibility of the management and the maintenance work is funded by the service charges.
Main Distribution Frame	The management has provided audio and video communication, light and power, emergency light and power.
Lifts	There are two lifts allocated for each block. Cleaning and maintenance required as scheduled.
Security and CCTV	The condominium has a good security system where a guard house is located at the entrance as an addition to the automatic barrier. The condominium is surrounded by a brick wall of about two meters high. Moreover, security counters are set up beside the lifts at the ground floor of each block and security guards are to patrol around the condominium, especially in the car park area.

Services Provided by the CHKL

The boundary of the condominium is demarcated by a brick wall. The whole of Taman Danau Desa is under the jurisdiction of CHKL and thus, it is the obligation of the local authority to provide municipality services to the area. The services in the area are similar to the services in the study area of Taman Desa. Table 4 summarized the services provided by the CHKL in this area.

Table 4: Services provided by City Hall of Kuala Lumpur in Taman Danau Desa

Types of Service	**Description**
Street lighting	There is only three (3) street lights allocated on both Jalan 109F and Jalan 2/109F.
Traffic Management	There is no traffic light at the entrance or exit of the condominium
Drainage system	The CHKL is only responsible to clean the drains outside the boundary of the condominium. The drains are noted to be covered with concrete to provide pedestrian walkway and thus, suggests cleaning job are seldom carried out.
Rubbish Collection	There is a marked difference between the way the collection of rubbish are carried out for Taman Desa and Danau Idaman Condominium. CHKL is responsible to collect the rubbish only from the main rubbish house outside the condominium units and not from house to house as in the case of Taman Desa.
Street Cleaning	Street cleaning is carried out on a weekly basis along Jalan 109F and Jalan 2/109F
Landscaping	There are a few trees landscaping the boundary of the condominium along Jalan 2/109F and Jalan 109F. Tree cutting is only done when necessary, i.e. if the branches fell after being struck by lightning and etc
Mosquito fogging	When dengue cases are reported, the local authority will also provide mosquito fogging in the condominium. However, the management of the condominium will usually look after the matter and in most cases, the job are done by the contractor appointed by the management.

Source : Author, 2006

In terms of public amenities, contrast to Taman Desa, there is a bus and taxi stop but no public telephone in the area. The bus and taxi stop is located

along Jalan 2/109F in front of the condominium area. Whilst, the social services provided by the CHKL in the study area is similar to those provided in Taman Desa. Only maintenance works of the roads is carried out by CHKL. However, since the road linkages surrounding the condominium are relatively shorter that the linkages in the study area of Taman Desa, the scope of the maintenance work is thus, smaller compared to Taman Desa.

In sum, there are some distinctions in the scope of work for the services provided in the case studied area. For Taman Desa, CHKL is the only body that provides the services; therefore the scope of services is relatively wider than the Danau Idaman Condominium which has its own management body to render the services within the boundary of the condominium. CHKL only provides its services to the external area (surrounding area) of the condominium. The scope of services for CHKL is noted to be similar to the scope of services of the management. For instance, cleaning services, drainage system, street lighting, rubbish collection, landscaping and mosquito fogging are carried out by both bodies. In addition, the quantity and frequency of services provided in the Taman Desa are higher which also signify that the services rendered by the CHKL in Taman Desa are of better level than in Danau Idaman Condominium.

Having established the scope of services provided by the local authority in the case study, the following section intends to examine whether the residents of these two different local communities are paying a fair tax to fund those services whose collective benefits are enjoyed by them.

Determination of Annual Value in the case study area

The findings of this empirical research demonstrate that the CHKL adopted comparison method to ascertain the annual value of the holdings. The rentals and comparables are adopted directly from the existing Valuation List which is based on the tone of list of the year 1992. Here, the rental evidences for the double storey terrace houses in the study area is analyzed at RM 0.35 per square foot per month. In compliance with the principle of *rebus sic stantibus*, the holdings are valued as residential use and additional built-up areas which are rate able are also taken into consideration.

As practiced by the Valuation and Property Management Department of CHKL, the rate for any extension area is half of the monthly rental per square foot, which is RM 0.18 per square foot. As for the corner unit, the empirical finding illustrates that additional land area for corner units are also taken into consideration in determining the annual value and rating. For the corner units which have an extra land of less than 1,500 square feet, 5% from the monthly rental of the standard built-up area has to be added to derive to the annual value.

As for the lots with more than 1,500 square feet of additional land areas, 10% from the monthly rental is applied.

Based on the above practiced, rates payable for all the 117 units of double storey terraces in Taman Desa is then explored. Analysis on the study area shows that 101 units from the total terrace houses are intermediate units while the remaining 16 units are the corner units. Both the intermediate and corner units have standard built-up area of 1,569 square feet. The findings also demonstrate that a few units have been renovated and result in additional floor areas which are considered as rate able areas. However, for the purpose of determining the rating or assessment tax charged in lieu of the services provided in the area, the rate able area for each unit is taken as the standard built-up area. The rational behind this assumption is that terrace houses have limited land area and thus, in most cases, the additional floor area that can be calculated as rate able area is relatively small and less significant to the amount of rates payable. Analysis on the rate payable by a total of 101 intermediate units is as shown in Figure 1.

As for all of the corner units, the extra land areas are taken into consideration in the calculation of ratings. The analysis indicates that there are16 corner units which have extra land area of more than 1,500 square feet. Figure 2 illustrates the analysis on the rate payable for the corner units.

Figure1: Analysis on the rate payable by a total of 101 intermediate units in Taman Desa

Number of Intermediate Units	:	101
Standard Built-Up Area	:	1569 square feet
Valuation Rate	:	RM 0.35/ square foot

Calculation:

Total Monthly Rent	**=**	**Number of units x Standard Built-Up Area x Valuation Rate**
	=	101 X 1569 ft^2 x RM 0.35 / ft^2
	=	RM 55,464.15
	≈	RM 55,460
Total Annual Value	**=**	**Total Monthly Rent x 12 months**
	=	RM 55,460 x 12 months
	=	RM 665,520
Rating	**=**	**Annual Value x Rate of Assesment**
	=	RM 665,520 x 6%
	=	RM 39,931.20
	≈	**RM 39,930 per year**

Figure 2: The analysis on the rate payable for the corner units.

Monthly Rent	**=**	**(Standard Built-Up Area X Valuation Rate)**
	=	1569 ft^2 X RM 0.35 / ft^2
	=	RM 549
	≈	RM 550
Annual Value	**=**	**Number of Units x [Monthly Rent + 10%] x 12**
	=	16 X [(RM 550 + 10%)] X 12
	=	RM 9,680 X 12
	=	RM 116,160

Finally, the annual value for the total study is of 117 holdings (304,451square feet) is analysed. Figure 3 illustrates the analysis of rate payable per square foot which is imposed in the study area of Taman Desa. This means that in average, the 117 owners are paying only RM 0.15 for every square foot of the services provided in the whole study area.

Figure 3: Rating per square foot payable by residents in Taman Desa

Total Study Area	=	304,451 ft^2
Total of Rating in the Area	=	RM 39,930 + RM 6,970
	=	RM 46,900
Rating	**=**	**Total of Rating / Assessment Fee**
		Total Study Area
	=	RM 46,900
		304,451 ft^2
	=	**RM 0.15 ft^2**

Further analysis of rating per holding in the study area of Taman Desa indicates that rating for each unit is at RM 400 per annum (see figure 4).

Figure 4: Analysis of Rating (Per unit) in the Study Area of Taman Desa

Total number of holdings	=	117
Total rate payable in the area	=	RM 46,900
Rating	=	Total Rate payable
		Total number of holdings
	=	RM 46,900
		117
	=	RM 400 per unit

Similar to the holdings in Taman Desa, all the residential holdings in Danau Idaman Condominium is also assessed using comparison method. A current work which was undertaken in year 2003 illustrates that the rentals and comparables

were also adopted directly from the valuation list of year 1992. The rental evidences for the similar type of condominium were in the range of RM 0.75 per square foot to RM 0.85 per square foot. Figure 5 illustrates the calculation for rating for each holding in this Danau Idaman Condominium.

To determine the property tax paid for the services provided in the whole area covered by the condominium, the total rating are divided by the total area covered by the condominium. The findings from the calculation shows that CHKL charge the residents at RM 1.02 per square foot in lieu of the services provided in the area (see Figure 6). This suggests that all 660 owners of the units are paying an average of RM 1.02 per square foot for the services rendered in an area of 304,920.04 square feet.

Figure 5: The calculation for rating for each holding in Danau Idaman Condominium

Rate able Floor Area for Each Household/Unit	:	849 ft^2
Monthly Rental (ft^2)	:	RM 0.77 ft^2
Annual Value	=	Rate able floor area for each holding x Monthly Rental (ft^2) X 12
	=	849 ft^2 X RM 0.77 ft^2 X 12
	=	RM 7,844.00
Rating	=	Annual Value x Rate of Assessment
	=	RM 7,844.00 X 6%
	=	**RM 470 per year**

Figure 6: Rating per square foot payable by residents in Danau Idaman Condominium

Number of units in Danau Idaman Condominium	:	660 units
Annual Value for Each Unit	:	RM 7,844

Total Annual Value	=	Total Number of Units in Danau Idaman Condominium x Annual Value for Each Unit
	=	660 units X RM 7,844
	=	RM 5,177,040
Total Rate payable	**=**	**Total Annual Value X Rate**
	=	RM 5,177,040 X 6%
	=	RM 310,620 per year
Total Area Covered By the Condominium	:	28,328m^2 or 304,920 ft^2.

$$\textbf{Rating} = \frac{\textbf{Total Rate payable}}{\textbf{Total Study Area Covered by Condominium}}$$

$$= \frac{\text{RM } 310{,}620}{304920\ ft^2}$$

$$= \textbf{RM 1.02 } \textbf{ft}^{\textbf{2}}$$

In sum, the findings show that the two case studies is assessed using similar basis, principles and method of valuation. However, despite the similarities, the study suggested that the residents of Danau Idaman Condominium are paying higher rates at RM 1.02 ft² and RM 470 per holding compared to residents in Taman Desa. The landed property residents paid a lower rates of RM 0.15 ft² and RM 400 per holding (see Table 5).

Table 5: Summary of the analysis of rating in the study areas

Analysis		Taman Desa (Landed Property)		Danau Idaman Condominium (Multistorey)
1. Area	Square feet	304,451		304,920
	Acre	6.99		7.0
2. Number of Units		Intermediate (with standard built up area of 1569 ft²)	Corner (with standard built up area of 1569 ft² and extra land > 1500 ft²)	Standard Unit (with built up area of 849 ft²)
		101	16	660
3. Annual Value		RM 665,520	RM 116,160	RM 5,177,040
4. Total Units		117		660
5. Total Annual Value		RM 781,680		RM 5,177,040
6. Total Rate payable		RM 46,900		RM 310,620
7. Rating per unit		RM 400		RM 470
8. Rating per square foot		**RM 0.15**		**RM 1.02**

Hence, this study concludes that the owners for the multistory property are actually paying more than the owners of the landed properties even though they comparatively benefited less scope of services provided by CHKL. Likewise, the residents of the multistory property have to pay an amount of RM 144.33 a month for the service charge in lieu of the services provided by the management corporation.

CONCLUSION

Providing municipality services to the citizens in its administration area is one of the key functions of the CHKL. The operating expenses incurred are to be financed by the communities who have benefited the services. The empirical study indicates that indeed, the communities were provided with similar scope of services. However, the service rendered is regardless of the total number of units. As a result, a marked difference of level of services prevails. The landed property residences in Taman Desa enjoy a higher standard of services compared to those multi-storey property residents in Danau Idaman Condominium

In addition, the empirical finding also suggested that the management of Danau Idaman Condominium charged the residents for the services of which are a common practice among the management of other condominiums in Malaysia. The rational of service charge can be distinguished as the residents directly enjoy the benefit of services rendered. Hence, the element of double charging on the residents of the Danau Idaman Condominium seems to appear as they are obliged to pay both the rating (assessment tax) and service charge for the services which are of the same scope but carried out by different body.

The findings of this study also revealed that similar basis, principles and method of valuations are used in determining the rating for landed property of Taman Desa and multi-storey property of Danau Idaman Condominium. The annual value basis is used for all residential rate able holdings whereby the main principles are the tone of list; hypothetical tenancy and *rebus sic stantibus*. The rental comparison method is used in the valuation as residential properties are commonly rented out and evidences of rental are vastly available. Nevertheless, the outcome denotes that the property owners of Danau Idaman Condominium are paying higher amount than the property owners in Taman Desa. The same applies to the analysis of rating per household where the condominium is charged at RM470 per household against a figure of RM400 per household for the landed properties.

The key lesson from this case study perhaps opens up further research and warrant attention by the policy maker in this area. It is obvious that the owners of Danau Idaman Condominium are paying higher assessment rates whereby the level of services provided are lower than those in the area of the Taman Desa. This is perceived as unfair to the owners of the multistorey properties as they are not receiving services which are equal to the tax levied. Moreover, the owners are also liable to pay for the service charge imposed by the management corporation. Some of the scope of work such as cleaning and pest control are already covered by the management and the local authority should not disregard the matter and include the works in their list of responsibilities as to justify the reason for imposing rating.

Hence, it is suggested that some allowances to be given for the services which are not carried out by the local authority. Perhaps, CHKL will review on this matter when determining the rating to be imposed on the properties. The tax assessor in the local authority also should not confine their valuation approach rigidly based on the mathematic formula to determine the annual value. Rather, they should verify the actual local services and amenities provided by the local authority to derive to an acceptable and fair rates. Above all, property tax policies, whether established by provincial legislation or by local bylaw, should be transparent and understandable; fair; stable and predictable; and justifiable.

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Mobbing – Legal and Medical Aspects in the Transitional Society (Case of Croatia)

Mario Vinković, Ph.D.
Senior Assistant
Faculty of Law
University of Osijek
Osijek, Croatia
mvinkovi@pravos.hr

Maja Vinković
Postgraduate student
Faculty of Medicine
University of Osijek
Osijek, Croatia
maja.djuranovic@os.t-com.hr

Abstract

By definition, mobbing denounces such work place behaviour in which a person or a group of persons systematically throughout a longer period psychologically harass the other individual by means of jeopardizing integrity, dignity, honour and reputation.

Croatian labour law is characterized by insufficiency of legal definiton and via facti inadequate legal protection of victims involved in the mobbing process. Since 2004 the legal system contains framework for protection from work place harassment and discrimination but without possibility of equalizing the various known mobbing behaviours with those legal definitions.

The aim of this paper is to find the answers to the victims' adequate protection at the time of nomotechnical and substantial under-capacity of legal provisions, to explain the causes of increasing court cases in this area, as well as to determine the possible case manipulations. Improving the existing or creating the new legal framework identifies the numerous unanswered questions from the medical and legal perspective.

Key words: *mobbing, harassment, Croatian legal system, psychosomatic disorders, burn-out syndrome, rights, labour law*

INTRODUCTION REMARKS

Since 1980, Leymann's researches in the area of mobbing have resulted in the revolutionary fragmentation of this problem in the medical literature, multidisciplinary scientific studies and analyses and some decades forth with its identification as the separate institute in the numerous national legislations. Political and economic transition of some European countries has led the way to harmonization and work up of their legal systems, i. e. the substantial legal modification of the national legal provisions. The post communistic transitional countries were mostly not familiar with this legal institution in its current sense, but, like Croatia, have dealt with the problem of emotional and physical violence at work throughout provisions of the civil law and legal definition of "šikana" (harassment). Harmonization of the national legislative in Croatia with the *acquis communautaire* in 2003 have resulted in the introduction of the institution of the harassment and sexual harassment at work place, protection of the employee's dignity and prohibition of the direct and indirect discrimination into labour law,[1] but the term "mobbing" was not introduced in the national legislative. It doesn't *prima facie* mean that it is impossible to give the legal protection to the victims, because this problem substantially interweaves with the aforementioned, but it justifies the question if the existing solutions have nomotechnical and contextual insufficiencies in means of providing adequate legal protection?

ABOUT DEFINITION

The introduction remarks have led to conclusion that there is no generally accepted definition of the mobbing. Moreover, various types of behaviour which constitutes mobbing according to Leymann and the other authors can be attributed to other, existing legal institutes. The literature mentions emotional violence, harassment, sexual harassment, emotional abuse, workplace violence, mobbing, bullying etc. Many of these terms are used as synonyms although the literature mentions their differences. The term mobbing has been established in Germany and Scandinavian countries, whereas in Australia, Ireland and the UK the term bullying is used as synonym.[2] The bullying often denounces individual cases of harassment, while the mobbing encompasses collective form of harassment.[3] Leymann is still more sophisticated in the term description. Analyzing the school behaviour, he points out that in the bullying the strong

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[1] Cf. Articles 2, 3, 4, 5, 6 and 30 Zakon o radu, (eng. Labour Act), Consolidated version, Narodne novine (Official Gazette of the Republic of Croatia), No. 114/03.

[2] Di Martino, V., *A cross-national comparison of workplace violence and response strategies,* in: Bowie, V., Fisher, B. S., Cooper, C. L., (eds.), *Workplace violence-issues, trends, strategies*, Willan Publishing, 2005, p. 21.

[3] Ibid.

elements of the physically aggressive behaviour are pronounced, while in the mobbing repetitive sophisticated behaviour with maltreating and oppression towards the working individual occurs.[4] The bullying should therefore denounce the aggressive school children behaviour and the mobbing undesirable workplace behaviour among adults.[5] Although the sexual harassment is one of the possible manifesting forms of mobbing, some authors suggest the preferable use of the term mobbing in order to make a shift in Europe, especially Germany, from *US Politics of Sexual Harassment*.[6]

The mobbing denounces such workplace behaviour in which a person or a group of persons systematically throughout a longer period of time psychologically harass the other individual in order to jeopardize the human dignity, integrity, reputation and honour.[7]As it encompasses the numerous various types of behaviour, maybe it is advisable to talk of the *mobbing syndrome*[8] which has its specific evolutional dynamics. In the beginning, there is unsolved conflict situation which gradually evolves into aggressive tendencies towards the other person with the intention to assault and punish, the victims become labelled, isolated, the subject of mocking at workplace. By different forms of psychological and sometimes physical harassment the victim becomes marked and presented as the problem in the working environment. With further evolution, it can also be incorrectly assumed, by the management and the employer, because of the systematic stigmatization and slender that the victim itself represents the source of the problem and that the change in behaviour and psychosomatic symptoms are characteristic of a personality instead of the consequences of psychological trauma due to environmental factors. In the final stage, the negative psychosocial connotations (psychosomatic disorders, burn out syndrome, absenteeism, leaving the workplace) take place, unless there is proper intervention from the employer, physician, psychologist, family of the victim, consequently all involved in this complex problem.

Vanderckhove and Conners[9] have differentiated three forms of the mobbing: *descending type* (the types of behaviour which fall down to the mobbing are conducted by the superiors to subordinates), *ascending type* (from the subordinates

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[4] Leymann, H., *Mobbng and Psychological Terror at Workplaces*, Violence and Victims, 1990, Vol. 5, No. 2, p. 119-126.

[5] Leymann, H., The Mobbing Encycloapedia, http://www.leymann.se (25/062007).

[6] Zippel, K. S., *The Politics of Sexual Harassment, A Comparative Study of the United States, the European Union, and Germany*, Cambridge University Press, 2006, p. 190.

[7] Leymann, H. , *Mobbing and Psychological Terror at Workplaces*, op. cit.

[8] Davenport, N. , Schwartz, R. D. , Elliot, G. P. , *Mobbing: Emotional Abuse in the American Workplace*. Ames: Civil Society Publishing, 2002.

[9] Vanderckhove, W., Conners M.S., *Downward Workplace Mobbing: A sign of the Times*, http://www.bullybusters.org (2002.)

to superiors) and *horizontal type* (from the employees towards the co-workers of the same rank). The results of the research differ among the frequencies of the particular types of the mobbing, according to the research data from the European Union, the more frequent is the descending type, whereas according to E. Koić et al.[10], the horizontal type appears to be more frequent.

CROATIAN CONTEXT – CURRENT LEGISLATION, LEGAL AND MEDICAL ASPECTS

In the past year or two in Croatia, there is a gradual increase in the number of mobbing cases in the court procedure. The problem is present in the media but at the same time the justifiable questions arise: Have all the cases been identified? What is the extent of the unreported or not prosecuted (both on courts and employer's level) cases due to fear of the job loss in times of high unemployment? But also what is the *ratio* of the feigned reports and attempts to solve personal frustration against the employer through media pressure and false complaints? In spite of dozens of cases in the procedure at courts, there are hardly any judgements with legal validity in the mobbing cases in Croatia. So it is not only difficult to prove the existance of mobbing, it is also extremely difficult to obtain adequate institutional and legal protection. There are numerous reasons to that, but they are mainly due to lack of procedural provisions, insufficiently informed judges in this area and often incapacity in interpreting the existing legal norms and its implementation in the everyday practice and specific cases.

Constant but gradual increase in number of the mobbing cases at courts undoubtedly mirrors the enforcement of the social and work awareness of mobbing problems and consequences on the workers health, work environment, working efficiency and business, as well on the family and society in whole. The situation is similar in the European perspective. According to the *Fourth European Working Conditions Survey,*[11] about 5% of all working population was the victim of the psychological harassment at work in 2005 but with significant oscillations in the percentage among states.[12] In Finland, the number is around 17% whereas in Italy and Bulgaria it is just 2%.[13] The differences are not due to fact that in some societies the percentage of work place psychological violence is higher than in some others, but because of the differentiation in the social awareness and the level of the sensitivity of the society and working population

[10] Koić, E. , Filaković, P. , Mužinić, L. , Matek, M. , Vondraček, S. , *Mobbing*, Rad i sigurnost, Vol. 7, No. 1, 2003., p. 2.

[11] Parent-Thirion, A., Fernández Macías, E., Hurley, J., Vermeylen, G., *Fourth European Working Conditions Survey*, European Foundation for Improvement of Living and Working Conditions, 2007.

[12] Ibid, p. 36

[13] Ibid.

among the different countries.[14] In Croatia, the percentage is between 15,4% and 53,4%[15] and includes much broader context, i. e. such behaviour which surpasses the framework of pshychological violence. The legal and terminological context but also the paramount role of physician in identifying, diagnosing, medical and legal handling of the problem is crucial for the transitional society searching for its own solutions.

Banning of direct or indirect discrimination, harassment and sexual harassment as well as the protection of the employee's dignity procedure are defined by the provisions of the Croatian Labour Act. However, nomotechnical and contextual structure of the above mentioned provisions of the Labour Act suggests numerous insufficiencies. *Prima facie,* we reflect upon the fact that workers can demand the protection against harassment and sexual harassment only if the undesired behaviour of the perpetrator is caused by some of the legal foundations for the prohibition of discrimination from Article 2. As the legal foundations for discrimination, i. e. harassment and sexual harassment, it can therefore appear only race, colour, sex, sexual orientation, marital status, family responsibilities, age, language, religion, political or other conviction, national or social background, birth, financial status, social status, membership or non membership in the political party or trade union, physical or mental disabilities. Since the legislator has nomotechnically used the system *numerus clausus,* which is closed count list, such behaviour that are not based on some of the aforementioned foundations couldn't be legally sanctioned *prima facie*. Mobbing is not necessarily connected with one of the legal foundations for discrimination prohibition,[16] therefore, the warranted question of providing appropriate legal protection arises in such cases. Constitution of the Republic of Croatia, however, includes the provision which could be used in court as sort of guidance till future modifications or supplementations of the existing definitions or adoption of the new legal rules. It is about open count list of the legal foundations based on which the individual cannot be put in the unfavourable position when it comes to the individual's rights and freedom guaranteed by the Article 14 of the Constitution.[17] In such way, some behaviour which constitutes mobbing[18] and

[14] Ibid.

[15] Koić et al. , op. cit. , p. 6.

[16] Cf. Marinović-Drača, D. , *Odgovornost za neimovinsku štetu zbog povrede dostojanstva kao prava osobnosti u svezi s radom (Mobing), in: Odgovornost za neimovinsku štetu zbog povrede prava osobnosti u vezi s radom – mobing, dostojanstvo, diskriminacija, izloženost štetnim utjecajima, ozljeda na radu, profesionalna oboljenja i dr.* ,Radni materijali, Savjetovanje, Zagreb, 28/09/2007, p. 15.

[17] Ustav Republike Hrvatske, Narodne novine, No. 41/01.

[18] Leymann specifies 45 forms of mobbing manifestations, he speaks of attacks on the ability to express oneself (limiting the ability to speak form the superior or the co-workers, constant interruption of work duties, loud swearing and yelling, constant criticism of the performed work or personal life, phone terror, oral or written threats, refusal to establish contact by disrespectful gestures or avoiding

at the same time cannot be submitted under some of the legal foundation of banning of discrimination, could also be sanctioned, i. e. have court protection through direct connection with the constitutional provisions. The *Framework agreement on harassment and violence at work,*[19] of the European social partners from 26th April 2007, also differentiates between different forms of violence and harassment at work which can be physical, psychological and/or sexual nature and implementing the French doctrine[20] they can represent an isolated incident or systematic, repetitive behaviour among working colleagues, superiors and subordinates or from the third parties, students, buyers, patients, clients etc.[21]Those acts range from minor cases of incompliance to serious acts, even felonies which call for intervention of official state authorities.[22]

The Croatian national legislation provides the protection of the employee's dignity during the work, forcing the employer to ensure such working conditions which would guarantee no harassment or sexual harassment including the steps for the prevention.[23] The protection should be provided in the relation employer – employee, worker to worker, as well as the worker and all other persons whom he contacts during work. It seems however that only a few provisions of a single legal article, without sufficient autonomous sources and appropriate employer's behaviour, cannot result in positive steps forward in practice. The special issue of the employee's protection against workplace harassment are the small firms

communication); attacks on social contacts (not speaking to the victim, inability to express oneself, transfer to remote rooms away from the co-workers, forbidding the other colleagues to speak to the victim, treating a person as if it didn't exist); attacks on the reputation (spreading rumors, mocking the victim, accusing the victim of mental illness, forcing to psychiatric evaluation, making laugh of a person's handicap, mimicking the victim's gestures, voices or moves, attack on political or religious beliefs of the victim, making fun of the private life, national background, forcing the victim to perform duties which undermine self-confidence, questioning the victim's decisions, incorrectly judging on the working abilities of the victim, disrespectfully addressing the victim or swearing, sexual harassment or verbal sexual offers); attacks on the quality of life and working environment (not appointing work tasks, taking away all work tasks, appointing meaningless tasks or those which are below the victims skills and qualification level, permanent appointing the new or offensive tasks) and attacks on the victims health (forcing to do tasks which can endanger health, threats of physical violence, use of light force, physical harassment, causing expenses with the intention to harm the victim, sexual assaults and causing physical damage at home or workplace of the victim). See Leymann, H., Mobbing-Psychoterror am Arbeitsplatz und wie man sich dagegen wehren kann, Rowohlt, Hamburg, 1993; id. Från mobbing til utslaging i arbetslivet, Publica, Stockholm, 1992.

19 *Framework agreement on harassment and violence at work* at http://ec.europaeu/employment_social/news/2007/apr/harassment_violence_at_work_en.pdf (03/07/2007).

20 See Hirigoyen, M. F. , *Stalking the Soul: Emotional Abuse and the Erosion of Identity*, New York, Helen Marx Books, 2000; id. *Malaise dans le travail: Harcèlement moral, démêler le vrai du faux*, Le Découverte et Syros, Paris, 2001.

21 *Framework agreement on harassment and violence at work*

22 Ibid.

23 Cf. Article 30(1) of the Labour Act.

because only the employers who employ more than twenty workers are legally bound to regulate the procedure and the measures for protection of the employee's dignity by collective agreement, book of labour regulations or by the agreement between work council and employer.[24]

Although there are some positive examples in practice, in which the employer was willing to examine the case and remove the causes of harassment, discrimination or mobbing, the workers complaints are often ignored by the employer and they attempt to force the worker to give up the further official procedure by different means of pressure. In such circumstances the only way out is to file an arraignment to the court and to expect proper institutional protection. Crossing under the jurisdiction of the court procedure, protecting the worker against the mobbing opens up the numerous issues and imposes upon the courts, physicians and court experts a very responsible task of establishing the circumstances of a specific case in order to make a righteous and final court verdict. The success of the worker in a court procedure substantially depends on quality set claim completed with gathered medical documentation and physician's expertise of the claimant's psychophysical condition.

The process of mobbing represents difficult assault on the victim's integrity, psychological and physical health and also temporarily or permanently endangers the victim's existence and ability to participate *pro futuro* at the labour market. The existence of the well-determined medical criteria when establishing and evaluating the consequences of mobbing is therefore *condition sine qua non* in building and harmonizing the high standard court practice and providing adequate legal protection accompanied by justly financial compensation.[25] The worker victim of harassment or sexual harassment can initiate the court procedure if the legal procedure within the working institution has been exhausted, i. e. if it is not likely to expect that the employer would protect his dignity.[26] The burden of proof in that case lies upon the employer who must prove that the worker was not the victim of discrimination, harassment or sexual harassment. It is the employee's, i.e. the claimant's obligation to present the facts in its demand supporting the reasonable doubt that he was the victim of harassment, sexual harassment or/and discrimination based on one of the mentioned legal foundations[27] and claim compensation.[28] The employer compensates reparation of the caused damage by

[24] Cf. Ibid. , Article 30(3).
[25] See and Marinković-Drača, op. cit. , p. 19.
[26] Cf. Article 30(7) (8) of the Labour Act.
[27] Cf. Potočnjak, Ž., Grgurev, I., *Odgovornost za neimovnsku štetu zbog diskriminacije na radu in: Odgovornost za neimovinsku štetu zbog povrede prava osobnosti...*op.cit. , p. 38.
[28] Cf. Articles 4, 5 of the Labour Act.

the provisions of the law of obligations,[29] but the crucial would be the existence of the causative relation between damage act and the consequence.

Inseparability of the psycho-social from the working environment of the individual reflects a clear significance of the public - health and socio – economic implications which are immanent to the mobbing problem. Since the victims are, in the beginning, often not aware that mobbing affects them in particular, because of the subtleness typical for the mobbing behaviour and also culturally accepted behaviour which sometimes approve some forms of the harassment at workplace, it stresses out the need for informed medical professionals in this area, since the victims often address them first with various physical symptoms and illnesses as the reaction to initial stress. Such correlation is well known for peptic ulcer, diabetes, arterial hypertension, headache, dermatitis and many other illnesses which only much later can be related with unfavourable situation at workplace. Later in the process the victims involved in the mobbing process start to show various psychological and psychosomatic reactions, by far the most common are reactive anxious- depressive symptoms, burn-out syndrome, chronic posttraumatic stress disorder,[30] reactive psychotic states, even suicide. The appearance of chronic pain syndromes is also related to chronic stress disorder.[31] Mahler and the co-authors[32] directly relate mobbing to allergic dermatitis caused by chemical substances, while Jones connects it with asthma.[33] Also, the occupational problems start to emerge: higher incidence of injuries at work, decreased working efficiency, absenteeism and early retirement.

It is very important to distinguish between *work fatigue* and the *burn-out syndrome* typical for the mobbing victims, which is characterized by the loss of self-confidence, work ethics, emotional and psycho-physical exhaustion and decreased effectiveness at work, accompanied by depersonalization in relations toward others. The change in attitude toward work is atypical for common fatigue. The "solution" at this stage could become different addiction problems. Failure

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[29] Ibid. , Article 109.

[30] See in particulary Mikkelsen, E. G. , Einarsen, S. , *Basic asumptions and symptoms of post-traumatic stress among victims of bullying at work*, European journal of Work and Organizational Psychology, Vol. 11. No. 1, p. 87-111; Schwickerath, J. , *Mobbing am Arbeitsplatz, Aktuelle Konzepte zu Theorie, diagnostik und Verhaltenstherapie,* Psychoterapeut, 3, 2001, p.199-213.

[31] Koić, E., Francisković, T. , Mužinić, L. , Đorđević, V. , Vondraček, S., Prpić, J. , *Chronic pain and secondary traumatisation in wives of Croatian war veterans treated for posttraumatic stress disorder*. Acta clinica Croatica, Vol. 41, No. 4, 2002, p. 295-306.

[32] Mahler, V. , Schmidt, A. , Fartasch, M. , Loew, T. H. , Diepgen, T. L. , *Value of Psychotherapy in expert assessment of skin diseases. Recommendations and indications for additional psychotherapy evaluation in expert assessment from the viewpoint of dermatology*, Hautarzt, Vol. 49, No. 8, 1998, p. 626-633. See and Koić et al. op. cit.

[33] Jones, R. N. , *Occupational asthma*, Clincs in Chest Medicine, Vol. 5, No.4, 1984, p. 619-622. See and Draper, A. , Occupational asthma, Journal of asthma, Vol. 39, No. 1, Februar 2002, p. 1-10.

to recognize the burn-out syndrome as the signalling flag of the over-stretched coping mechanisms with stress can increase the risk of creating psychopathological conditions related to unfavourable situation at workplace.

The negative connotation of the psychiatric diagnoses and symptoms, still socially accepted, can also postpone the visit to the physician and asking for help and further worsen the psychological status. This stage might be the ideal opportunity for the family practitioner to get involved in the healing process of the victim because he is the first to get in touch with the victim. As mentioned before, educating the medical staff is very important, as well as directly causatively relating the psychosomatic symptoms of the patient with the problems at workplace. Thus, making a proper diagnose is one of the crucial moments in resolving the complex situation of the victims. According to the International Classification of the Disease[34] the diagnosis Unspecific Somatic Disorder (F 45) may serve as the guidance to the physician till establishing the definite diagnosis e.g. reactive depressive state (F 32.0), depressive-anxious state (F 41.2), generalized anxious disorder (F 41), panic attacks which are the most common psychopathological manifestations of mobbing. Additional caution is needed because of the possible existence of personality disorder before the mobbing process started so the meticulous socio-occupational and hetero-anamnesis is absolute must. The psychiatrist carries out the final evaluation of the mental status of the mobbing victim and his expertise is invaluable in the case of possible labour disputes.

The Croatian law does not have the elements based on which can be determined whether one incident or repetitive behaviour of the mobber is necessary for legal sanctioning of the harassment or sexual harassment, as the current legal framework against mobbing. Leymann assumes the statistical determination of the repetitive behaviour of at least one insult per week in a period of six months[35], Einarsen does not specifies time frame but asks for the repetitive, constantly aggressive and hostile behaviour, i.e. such behaviour perceived as hostile by the victim.[36] We share the opinion similar to Hirigoyen's, that in the present Croatian legislative the one incident or typical behaviour is sufficient to constitute harassment/mobbing which is a result of discrimination or is related to one of the discrimination prohibition foundations. The act of mobber which in its substrate has only one intense attack/conduct motivated for exemple by the victim's gender or national background or sexual orientation is sufficient

[34] MKB – 10 – Međunarodna klasifikacija bolesti i srodnih zdravstvenih problema, deseta revizija, Medicinska naklada, Zagreb, 1994.

[35] Leymann, H. , *The Definition of Mobbing at Workplaces in: The Mobbing Encyclopaedia*, op. cit.

[36] Einarsen, S. , *Bullying and Harassment at Work: Epidemiological and Psychosocial aspects,* University of Bergen, Bergen, 1996; id. *The nature and cause of bullying at work*,International Journal of Manpower, Vol. 20, No.1/2, 1999, p.18.

cause of the psychosomatic disorders. On the contrary, if there is no connection between legal bases for discrimination and mobbing, the repetitive behaviour will serve as the only direct proof of the connection between *"subjective and objective harassment"* as Brodsky[37] postulated, i.e. subjective impression of the victim and objective proof of the existence of mobbing.

The victim's claim should entail declaratory[38] as well as condemnatory part.[39] The first would describe the behaviour explaining harassment, sexual harassment and discrimination, whereas the latter would encompass the claim for banning further behaviour of the kind. It is about providing *preventive and repressive protection*[40] because declaratory part confirms the facts which disturb the existing employment relationship and has preventive function, whereas condemnatory part has invaluable significance for damage reparation. Croatian law of obligations and civil procedure will enable the damage reparation through natural restitution and reparation of pecuniary or moral damage. The protection of personal rights as the separate institute will be significant for the compensation of moral damage because of the violation of the personal rights to mental health and/or dignity, honour, respect and privacy but only if the court finds that burden of violation and the case circumstances justify the verdict of rightly pecuniary reparation.[41] The role and responsibility of the court expert is therefore upon any terms part of the complex process of determination the consequences of harassment on health and integrity of the victim and prevention of the possible simulations and abuse.

In spite of nomotechnical and contextual deficiencies and pronounced lack of procedural rules in the Croatian Labour Law, the harmonization of the national legislation with the *acquis communautaire* has provided, in this part, at least some kind of legal protection and damage reparation to the victims of mobbing. The court practice has, under the circumstances of substantial insufficiencies, the responsibility of finding solution in careful and wise interpretation of the existing institutes and legal framework. The conservative interpretation of the discourse of individual rights and freedom protection has to take into consideration, until determining the new solutions and respectable court practice, the perception of the human being as the central social value and sacredness of the individual

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37 Brodsky, C. M., *The Harrassed Worker*, Lexingon Books, DC Heath and Company, Toronto, 1976.

38 Bodiroga-Vukobrat, N., *Mobbing – pravni aspekti,* in: Bodiroga-Vukobrat, N. , Frančišković, T. , Pernar, M. , Mobbing, Rijeka, 2006, p. 149.

39 Ibid. See and Crnić, I., *Sudska zaštita individualnih prava radnika*, Novi informator, Zagreb, 2004, p. 13-14.

40 Triva, S., Dika, M., *Građansko parnično procesno pravo*, Narodne novine, Zagreb, 2004, p. 802.

41 Crnić, I., *Odgovornost za štetu iz radnog odnosa i popravljanje štete*, in: Potočnjak, Ž. , (ed.), *Radni odnosi u Republici Hrvatskoj*, Zagreb, 2004, p. 314-315.

characteristics with guaranteed right to human dignity. We are of the opinion that only that way it is possible to find solutions in the *Scylla and Charybda* of the existing legal restrictions and legal customs and lead the way to the wide reception of the general legal principles immanent to common constitutional tradition of the modern democratic societies. This is also the way of lobbing for efficient legal protection of the human dignity through appropriate and obligatory sanctioning of the attacks on the psychophysical integrity of the working individual in the court practice.

DE LEGE FERENDA

The open questions and inadequacies of the labour legislative are pressing up the need for changes and supplementation of the existing legislative. In such manner the Croatian public was presented with Draft bill on Harassment Prevention of the Association Mobbing[42] in April 2007. The draft recognizes procedural insufficiencies and limitations of the Labour Act and present possibility to realize the protection and damage reparation mostly through provisions of the law of obligations and not through the labour law provisions. By adopting the separate law this problem would be unanimously solved for all the employees in the Republic of Croatia, regardless of the size of the firm or employment on the bases of *lex generali or lex specialis* and would provide effective and uniform protection with undoubtedly higher level of the legal security for both workers and employers.[43] Personally, we doubt if the adoption of the separate act should be given the advantage or should the proposed, high standard solutions be integrated in the separate chapter of the Labour Act and at the same time modify[44] the existing legal definitions of harassment and sexual harassment. The inflation of numerous regulations in the Republic of Croatia have, so far, shown as the aggravating condition in establishing higher legal security and harmonization of the court practice, so there is reasonable scepticism for the fate of the above mentioned draft bill. The possible solution would be to promulgate the separate act in the constitutional/organic act but the practical chances for such promulgation seem currently very low.

CONCLUDING REMARKS

Regardless of whether we represent the anglo-saxon concept of mobbing as the form of discrimination of the employee or more dominant, european approach

[42] http://www.mobbing.hr
[43] Cf. Bodiroga-Vukobrat, op. cit. , p. 151-153.
[44] Cf. Potočnjak, Grgurev, op. cit. , p. 37.

of mobbing as the attack to the employee's dignity,[45] it is the aggression toward the victim and not the conflict situation at workplace. The motifs and aims of every mobber are different but are mostly determined by their psychopathology. The education of workers and employers can therefore help in prevention and diminishing the possible aggressive behaviour but in the end cannot do wonders. The prevention and mediation programmes are therefore justly criticized because altering the sociopath mobber behaviour is almost impossible.[46] In the labour law sense the true implementation of autonomous sources; codex of practice and behaviour as well as the prompt reaction to mobbing, harassment and/or discrimination will send strong message of unacceptability of such behaviour at workplace environment.

The Croatian Labour Law legislation needs to carry out necessary modifications of the existing legal provisions with the intention of shifting the efficient protection of the workers from civil to labour judicature. It seems that lack of interpretational skills of the judges combined with a lack of procedural provisions, as the main causes, result in complete absence of final judgements in the cases of harassment, discrimination and/or sexual harassment and protection of the employee's dignity. In the transitional period of establishing appropriate procedural norms and amendments on the current legislation the courts have the great responsibility to interpret the existing legal provisions with high competence.

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Colonialism to Globalisation: The Human Rights and Democratic Deficits in Western Development Policies for Africa

Kwadwo Appiagyei-Atua*
Senior Lecturer
Faculty of Law
University of Ghana
Legon, Ghana
E-mail: appiagyeiatua@yahoo.fr

For by definition, the neo-colonial state has tended, for its own reproduction, to usurp and obliterate the autonomy of civil society and therefore the very foundation of democracy. It is within this formation that rights struggles, like other democratic struggles, have to be waged.

– Issa Shivji.[1]

INTRODUCTION

This paper is devoted to a political economic analysis of post-colonial Western development policies in Africa in the context of the relationship they establish with human rights and democracy in Africa.

In discussing Western development policies in the context of human rights, it is important to note that each development programme is linked to an agenda of globalisation. Four distinct policy eras are identified. The first was the Slave trade which led to the establishment of the Trans-Atlantic trade route.[2] The second was

Dr. Kwadwo Appiagyei-Atua (Senior Lecturer, Faculty of Law, University of Ghana, Legon) wrote this paper in conjunction with two of his students who were then LL.B. students at the Law Faculty, University of Ghana, Legon - Peter Atudiwe Atupare and John Bentil. Kwadwo holds an LL.B (Hons) from the University of Ghana, Legon; Barrister-at-Law degree (BL) from the Ghana School of Law; LL.M from Dalhousie University, Halifax, Canada; and, Doctor of Civil Law (DCL) from McGill University, Montreal, Canada. Peter holds a LL.B (Hons) from the University of Ghana, Legon and an LL.M from University of British Columbia, Vancouver, Canada. John is an LL.B (Hons) degree holder from the University of Ghana and at the time of publication completing his BL degree at the Ghana School of Law, Accra.

[1] Issue Shivji, *The Concept of Human Rights in Africa* (London: CODESRIA, 1989) at 5.

[2] J.D. Anderson, *West and East Africa in the Nineteenth Century* (London: Heinemann, 1972); Walter Rodney, How Europe Underdeveloped Africa (London: Bougle-L'Ouverture Publications, 1978). See the arguments of the colonial apologists who argued that colonialism was for the good of Africa

colonialism[3] which resulted in the incorporation of Africa into the world economy as a periphery to the colonial centre.[4] The third is the neo-colonial era which started after the attainment of political independence in the late 1950s and early 1960s. The fourth is the post-Cold War era which is often referred to as the era of globalisation. It is the most massive and comprehensive globalisation attempt yet.

COLONIALISM AND HUMAN RIGHTS

Colonialism ushered Africa into a forced graduation at a time when most of the traditional African communities were at a stage of metamorphosis that were different from that of the West. The consequences and shocks of this development are still felt in the lives of the people on the continent today.[5]

Colonialism had the goal of attaining development principally for the colonial power.[6] Thus, the appendages of the colonial power determined the development agenda and what role the colonized community had to play to realize these goals. These included the production and acquisition of commodities such as cocoa,[7] gold, diamond, etc which were deemed essential for the industries of the North. Duties that were imposed on the colonial peoples to meet these needs were at times in the form of forced labour. No environment conducive to the performance of their duties imposed on them by colonialism was put in place. The enjoyment of rights was thus at its lowest ebb. In fact, human rights was considered to be too "luxurious" and "foreign" for African peoples to enjoy. As a result, Africans lost their very sense of being and *Africanness*.[8]

To ensure total compliance with the duties inflicted on African peoples in the absence of rights, duties could only be performed in the Austinian way, as

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and the results too were positive, eg., L.H. Gann and P. Duignan, Burden of Empire: An Appraisal of Western Colonialism in African South of the Sahara (London: Pall Mall, 1968); and, David K. Fieldhouse, "The Economic Exploitation of Africa: Some British and French Comparisons," in P. Gifford and W. Lewis, eds., France and Britain in Africa: Imperial Rivalry and Colonial Rule (New Haven, Conn.: Yale University Press, 1971) 593.

3 Semankula Kiwanuka, *From Colonialism to Independence: A Reappraisal of Colonialist Policies and African Reactions; 1870-1960* (Nairobi: East African Literature Bureau, 1973).

4 A periphery state occupies a subservient position on the world economic structure as producer of raw materials and purchaser of manufactured goods from the centre or metropolis. The latter buys the raw materials and manufactures them for sale to the periphery. This analysis represents a key component of the Dependency school's economic theory of exploitation. See eg., Andre Gunder Frank, *Dependent Accumulation and Underdevelopment* (New York: Monthly Review Press, 1979).

5 See references in *supra* note 2.

6 W. Rodney, *supra* note 2.

7 Eg., the colonial government decided to promote the production of cocoa in Ghana and thereby made Ghana a monocultural cocoa economy.

8 Frantz Fanon, *Wretched of the Earth* (New York: Grove Press, Inc., 1963); W. Rodney *supra* note 2.

the "command of the sovereign."[9] Thus, Ake argues that since the colonial state was for its subjects only an absolutist and arbitrary power, it could not engender legitimacy (in the language of natural law) though "it made rules and laws profusely and propagated values."[10]

Due to flagrant and egregious denial of rights to local peoples, their capacity to contribute to developmental needs of the colonial elite could not be maintained for long. Consequently, as unfulfilled needs continued to accumulate, tension began to rise which sparked the nationalist flame and agitation for independence. At this point, it was felt that colonialism was becoming an expensive economic enterprise for the post-war needs of imperialism.[11] According to Babu, it was thought expedient to grant independence to the colonies and pass on the financial burdens the colonial powers would have incurred to the newly independent colonies in the form of loans.[12] This analysis lends support to the contention that decolonialisation was not granted on the moral charitable grounds but was negotiated and granted to colonized people as it was in the economic interest of the colonial authorities to do so.

ANTI-COLONIALISM AND HUMAN RIGHTS

With the support and co-operation of the mass anti-colonial coalition force behind them, African nationalist leaders adopted different strategies in their fight for independence. The strategies were embodied in the concepts of African nationalism and Pan-Africanism.[13] The former is identified as representing the political revolt against colonialism and the latter, the aspiration for continental

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[9] R. W. M. Dias, *Jurisprudence* (London: Butterworths, 1985); and, H.L.A. Hart, D*efinition and Theory of Jurisprudence* (London: Oxford University Press, 1953).

[10] Ake, *Democracy and Development in Africa* (Washington, DC: The Brookings Institution, 1996) at 3.

[11] The same reason accounts for the abolition of the Slave trade. See Adam Smith's ethnocentric perspective in support of the slave trade in A. Smith, *Lectures on Jurisprudence* (Oxford: Clarendon Press, 1978).

[12] A.M. Babu, *African Socialism or Socialist Africa?* (Dar es Salaam: Tanzania Publishing House, 1981) at 48. In support of this claim one can refer to the delay in the introduction of social welfarism by British colonial powers in West Africa and the reluctance displayed in implementing them with British funds but rather money belonging to the colony. See Adelaide Hill, "The Administrative Structure for Social Welfare in West Africa," in St. Clair Drake and T. Peter Omari, *Social Work in West Africa* (Report of The Seminar on Social Work in West Africa) (Accra: Ghana Publishing, 1962). See details below.

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solidarity and African equality.[14] Concerning the practical aspects of the nationalist struggle, Nkrumah summed it up when he declared:

I described Positive Action as the adoption of all legitimate and constitutional means by which we could attack the forces of imperialism in this country. The weapons were legitimate political agitation, newspaper and educational campaigns and, as a last resort, the constitutional application of strikes, boycotts, noncooperation based on the principle of absolute nonviolence, as used by Gandhi in India.[15]

One realises that embedded in these approaches was an appeal to the colonial authorities and the international community to respect the rights of colonised peoples. It was also to tell the colonised peoples that they, as human beings like anyone else, were endowed with rights which should be respected. At their Pan-African Congress held in Manchester in 1945, for instance, part of the Declaration of the Pan-Africanists[16] read as follows:

We are determined to be free. We want education. We want the right to earn a decent living; the right to express our thoughts and emotions, to adopt and create forms of beauty. We will fight in every way we can for freedom, democracy, and social betterment.[17]

Thus, both under nationalism and Pan-Africanism, African nationalists used the rights debate as an important basis of their struggle for independence. They harped on civil and political rights abuses, such as the denial of representation in the colonial legislative assemblies, brutal suppression of resistance, the introduction of preventive detention, the killing of the development of a buoyant traditional "civil society" elements within most of African political systems, etc.[18] Rights abuses in the economic sphere were also high. These included forced labour, suppression of trade unionist activities, the eviction of African peasants from their land and prohibition from engaging in profitable cash production, particularly in East Africa.[19] In all of these arguments, African nationalists, though not involved in its formulation, appealed to the Universal Declaration of

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[14] See Margaret Roberts, "A Socialist Looks at African Socialism," in Friedland and Rosberg, supra note 13, 80 at 80, 81 and 85.

[15] K. Nkrumah, *Ghana: The Autobiography of Kwame Nkrumah* (London: Thomas Nelson, 1957) at 122. For detailed analysis of the nationalist struggle see Sithole, *Roots of a Revolution: Scenes from Zimbabwe's Struggle* (Oxford: Oxford University Press, 1977).

[16] This is used to refer to both African nationalist leaders and militant African-American leaders interested in forging and maintaining links with their African roots.

[17] G.B.N. Ayittey, *Africa Betrayed* (New York: St. Martin's Press, 1992) at 99.

[18] *Ibid.* For an account of French repression see Kéba M'baye and Birame Ndiaye, "The Organisation of African Unity (OAU)," in Karel Vasak, general ed., The International Dimensions of Human Rights Vol. 2 (Westport: Greenwood Press, 1982), 583.

[19] R. Howard, *Colonialism and Underdevelopment* (London: Croom Helm, 1978) at 9,10.

Human Rights to support their claims for an end to colonial rule and the rights abuse that went with it.

INDEPENDENCE AND HUMAN RIGHTS

The provision of detailed fundamental rights principles was not agreeable to the departing colonialists. At least in the case of Ghana such an attempt was thwarted by the British. According to Geoffrey Bing,[20] in September and October of 1956 the Gold Coast government under Kwame Nkrumah drafted a Constitution based on that of the older Commonwealth countries for adoption as the independence constitution. The British, however, in reply "made it clear that it was not agreeable to the Gold Coast becoming independent on the basis of this proposed Constitution."[21]

Part II of this proposed Constitution[22] was devoted to provisions on fundamental rights for ensuring personal liberty, inviolability of dwellings, freedom of religion and of opinion and assembly. There were also provisions against appropriation of property without compensation, retrospective laws, double punishment, prohibition against self-incrimination, as well as provisions against discrimination of any type. The revised constitution which finally came out as the Independence (Monarchical) Constitution of Ghana, 1957[23] did not contain a Bill of Rights, but only trifling provisions guaranteeing freedom of conscience and protection on racial grounds. One major provision on rights was section 34 which provided for compensation in the event of compulsory acquisition of property and granting "any person claiming such compensation a right of access for the determination of his rights (if any), including the amount of compensation, to the Supreme Court of Ghana." According to Ebenezer Appreku, this situation is explained by the fact that "Ghana, like many other newly independent countries, had to forgo a bill of rights as a condition for independence."[24] The fact that it was mainly the Bill of Rights provisions that were more adversely revised in the new constitutional text goes to confirm this point.

It is interesting to observe that African leaders began to divorce human rights rhetoric from their ruling style, both in practice and in the constitutional texts.

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20 G. Bing, *Reap the Whirlwind: An Account of Kwame Nkrumah's Ghana from 1950 to 1966* (London: Macgibbon & Kee Ltd, 1968).

21 Ibid, the Appendix.

22 Articles 7-13 thereof.

23 Promulgated by the Ghana (Constitution) Order-in-Council, 1957 (LN 47/1957) on 22 February, 1957.

24 E. Appreku, The African Charter on Human and Peoples' Rights: Prospects of Implementation in Ghana, at 1. A paper presented at the Seminar on the Implementation of the African Charter on Human and Peoples' Rights in the internal Legal Systems, Banjul, The Gambia, from 26-30 October, 1992. (Ref: SEM/002/6).

Suppression of rights became the order of the day. Whether, for instance, in the case of Ghana, the human rights situation would have been better protected had the proposed bill of rights been maintained is hard to say.

At this juncture, it becomes important to relate this trend to the development plans and goals set up for implementation in post-independence Africa. The general assessment of scholars on the implementation of the development agenda of Western states in Africa is that it has been a total failure.[25] Yet, one writer has put forward a radically different assessment of the situation. In his *Democracy and Development in Africa*, Claude Ake argues that "the problem is not so much that development has failed as that it was never really on the agenda in the first place."[26] According to Ake, the following issues became the principal preoccupations of African leaders at the dawn of political independence: the struggle over which of the nationalist groups that had joined forces to negotiate an end to colonialism should take over the colossal power structure left by the colonial power;[27] increased competition and conflict among elements of "civil society" and nationalities and ethnic groups at independence; the tendency to use state power for accumulation of profit by individuals and groups; and, alienation of leaders from followers in the post-colonial era.[28] As a result:

Besieged by a multitude of hostile forces that their authoritarianism and exploitative practices had engendered, those in power were so involved in the struggle for survival that they could not address the problem of development. Nor could they abandon it. For one thing, development was an attractive idea for forging a sense of common cause and for bringing some coherence to the fragmented political

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[25] Fantu Cheru, *The Silent Revolution in Africa: Debt, Development and Democracy* (London: Zed Books Ltd., 1989); E.A. Brett, "State Power and Inefficiency: Explaining Political Failure in Africa," (1986) Vol. 17 No. 1 *IDS Bulletin* 22; Richard Sandbrook, *The Politics of Africa's Economic Stagnation* (London: CUP, 1985); Rosenblum and Williamson, *The Squandering of Eden: Africa at the Edge* (New York: Harcourt Brace Jovanovich, 1981); James S. Wunsch and Dele Olowu, eds., *The Failure of the Centralized State: Institutions and Self-Governance in Africa* (Boulder: Westview Press, Inc., 1990); Ozay Mehmet, *Westernizing the Third World: The Eurocentricity of Economic Development Theories* (London: Routledge, 1995. World Bank, *Sub-Saharan Africa: From Crisis to Sustainable Growth* (Washington: The World Bank, 1989); and Chazan *et al, Politics and Society in Contemporary Africa* (Boulder: Lynne Rienner, 1988). Eg., Chazan *et al* argue at p. 15 that if application of the modernisation theory in African failed then the shortcomings could be attributed "either to poor judgment, to mistaken ideologies, to the conflict between competing goals, or to an inability to overcome cultural impediments deeply rooted in African societies."

[26] C. Ake, supra note 10 at 1. The "agenda" refers to the one African leaders set for their various countries at the time of independence. But not that of the former colonialists for their former colonies.

[27] Which struggle resulted in mutual alienation of the anti-colonialist coalition partners. In this regard, it is pertinent to refer to Dunduzu K. Chisiza, *Africa – What Lies Ahead* (Indian Council for Africa, 1961) at 1. cf. J. Ayodele Langley, *Ideologies of Liberation in Black Africa 1856-1970: Documents on Modern African Political Thought from Colonial Times to the Present* (London: Rex Collings, 1979) 572 at 572, 573.

[28] *Ibid*, 4-6.

system. More important, it could not be abandoned because it was the ideology by which the political elite hoped to survive and to reproduce its domination. Since development was the justification for rallying behind the current leadership, for criminalizing political dissent, and for institutionalizing the single-party structure, to abandon it would undermine the power strategy of the elite.[29]

Faced with this dilemma, African leaders responded by making perfunctory attempts to promote development. But, in fact, they sought to pass that responsibility on to foreign patrons. Thus while African leaders talked about the frailty of political independence and the need to buttress it by self-reliant development, they eagerly embraced economic dependence.[30] This analysis represents a usefully radical assessment of the development environment that African peoples confronted. Ake's work is important in two major respects. First, he makes us aware that in the absence of a development agenda, one cannot talk about development having commenced. Secondly, of all the numerous factors that have been identified as being responsible for Africa's problems – poor management, unfavourable terms of trade, lack of entrepreneurial skills, etc[31] -- Ake isolates the political as the key factor.

However, I offer a critique of Ake's analysis in the context of a colonial/post-colonial analysis of the Gramscian notion of civil and political societies.[32] In the post-independence era in Africa, political independence did not result in the total replacement of one ruling group by another but a sharing of that space with the former colonial powers, and with the foreign counterpart still holding dominant power. The subordinate position of the local ruling elite is attributed to the fact that it was relatively weak and dependent, financially. Also the economy over which it was to preside had equally been placed in such a weakened and dependent position. Thus, African leaders thought it expedient to ally themselves with the foreign ruling elite structure.

One can place this analysis in the context of internationalising Gramsci's concept of civil and political societies in order to establish the missing link between colonialism and neo-colonialism, something that is not well-established in Ake's work. In the assessment of the goal of colonialism and how it came to establish itself, two forces are identified: the intellectual community, especially from the philosophical, economic and anthropological traditions. The main role of this

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29 *Ibid*, 7.

30 *Ibid*, 7,8.

31 Ake, supra note 10 at 1.

32 According to Gramsci, civil society is represented by the captive intellectual elite who formulate policies for governments in order to help the latter maintain its hegemonic influences. Political society, on the other hand, is the coercive arm of the government whose role is to complement that of the intellectuals. See Antonio Gramsci, (Quintin Hoare, ed., and Geoffrey Smith, trans.,) *Selections from the Prison Notebooks of Antonio Gramsci* (London: Lawrence and Wishart, 1971).

intellectual class is "to provide authority with their labor while gaining great profit."[33] These intellectuals helped lay the foundation, and provided the justification, for colonial adventurism. In the post-independence era their role shifted to formulating development policies for Africa. Their task therefore corresponded with Gramsci's civil society.[34] The other force is the political society, which during colonialism was represented by the arbitrary and absolute colonial political machinery run by the Colonial Administrators, Governors-General, the Provincial Commissioners, the District Commissioners, etc. In the post-colonial era, it was African leaders who took over this role, deeming it fit to perpetuate these structures to perpetrate abuse on their citizenry in the name of development.

But it is not only African leaders who failed to create a development agenda for Africa. Western states were equally disinclined to formulate a development agenda for Africa. In fact, the phrase "Western development agenda" is in reference to an agenda for the development of the West itself, not Africa. In this regard, it is not that development failed for Africa. Rather, it is the case that the West did not, and still does not, have a development agenda for Africa, but for itself. This assertion is supported by the fact that the economic/political policy advisers and scholars on Africa did not see the need to change their stance in the face of glaring "failures" of their approaches.[35] In fact, there has been nothing new under the sun[36] with regard

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[33] Thus, "the problem for the intellectual is … the insiders, experts, coteries, professionals who … mold public opinion, make it conformist, encourage a reliance on a superior little band of all-knowing men in power." Edward Said, *Representations of the Intellectuals* (New York: Pantheon Books, 1994) at xv and xiii.

[34] Incidentally, this includes Hegel himself from whom Gramsci borrowed his concept of civil society. But by turning Hegel's notion of civil society on its head, Gramsci's civil society in the context of colonial theory of civil society places Hegel in the category of those who use their intellectual influence to foment and justify hegemony. See Hegel, *Philosophy of Right* (Oxford: Clarendon Press, 1957); A. Gramsci, *supra* note 32.

[35] Mehmet argues that he does not suspect conspiracy on the part of the theorists. In other words, they do not belong to Gramsci's civil society. Among others, he cites Kaldor and Rosenstein-Rodan who realised the inadequacies in their theories and "confessed" and abandoned their earlier stances. There were also those who dissented. But the mainstream stuck to its guns and prevailed. Mehmet continues: "Accordingly, no amount of good intent can hide the failure of Western theories…When these idealized (i.e. stylized) theories failed in the Third World, the typical reaction of the mainstream economist was to simply rearrange the underlying assumptions of the theory, always preserving its Western rationalist roots, never conceiving the possibility of culture-specific conceptions of rationality." See Mehmet, *supra* note 25 at 3. With this conclusion reached, I find it difficult that Mehmet should still cling to the "good intent" theory. Those who "repented" and dissented had the good intent but those who stuck to their stance are the "organic intellectuals" whom Gramsci saw as directly connected to classes or enterprises that used intellectuals to organize interests, gain more power, get more control." (Said, *supra* note at 4). Compare eg., Samuel Huntington, *Political Order in Changing Societies* (Yale: Yale University Press, 1968) with Samuel Huntington, "Democracy for the Long Haul," (1996) Vol. 7 No. 2 *Journal of Democracy* 3. This class of intellectuals composes the international civil society of capitalism.

[36] This is in fulfilment of the saying of the wise King Solomon, the Preacher: "What has been is what will be, and what has been done is what will be done; and there is nothing new under the sun.

to the Western development agenda for Africa from the time of implementation of the first "globalisation" effort, the Slave trade, to date. Therefore, perhaps we need not talk of "failure" of the development agenda but rather its "success," for the results attained from the various development programmes are what were actually being pursued, development for the West. Any development that was attained for Africa was only incidental or facilitative. In other words, it was not planned but only a means to promote development for Western capitalist states.

Another critique on Ake is that his work seems to limit itself more to economic development. My contention is that respect for human rights and democracy is also part of development and, in fact, the foundation to development. Other significant elements towards an analysis of a holistic concept of development are the physical, moral, spiritual, aesthetic, social, cultural, etc. So the real question is whether or not a holistic development that is sustainable ever started in Africa. I suggest that it is yet to begin. If human rights were given the maximum respect it deserved, it would have addressed the woes of mismanagement, expose and reduce corruption, and provide people with skills to enable them to attain their self-development. Political conditions and human rights should also be considered in the context of Gramsci's civil and political societies. They are the key in promoting, popularising and defending rights exercise.

According to Gramsci, civil society is expected to take advantage of any expanded set of parameters granted as a concession by the ruling elite in order to appease a demoralized, disenfranchised and oppressed people. They are to utilise the space to take over political society (the coercive arm of the state) and thereby create a stateless society where civil society would reign.[37] It is my contention that the idea of the withering of the state was utopian in its application to internal national politics.[38] But Gramsci's concept was applicable to both the colonial and post-colonial context in Africa. It was up to post-independence African leaders to cause the "withering away" of the old colonial state and its appendages by breaking up the colossal colonial political apparatus which the departing colonialists expected the new African leaders to use to set up new *political societies*.

Post-independence African governments were supposed to utilise the space granted under decolonisation to transform themselves, share power with the

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Is there a thing of which it is said, "See, this is new? It has been already, in the ages before us." Ecclesiastes 1.9-10 (RSV). See also, Peter Uvin and Isabelle Biagiotti, "Global Governance and the "New" Political Conditionality," (Sept-Dec.1996) Vol. 2 No. 3 *Global Governance* 377.

37 A. Gramsci, *supra* note 34; also, Norberto Bobbio, "Gramsci and the Concept of Civil Society," in John Keane, *Civil Society and the State: New European Perspectives* (London: Verso, 1988), 73.

38 Or when it is "successful" at all, such as in the case of Poland when the Solidarity Movement seized power, it brings chaos. See K. Kumar, "Civil Society: an inquiry into the usefulness of an historical term," (Sept 1993) Vol. 44 No. 3 *British Journal of Sociology* 375 at 386.

elements of "civil society"[39] to flourish and thereby automatically destroy the colonial political apparatus. However, they preferred to fight among themselves in order to capture total political power, and rather share this power with the foreign ruling class.[40]

So African nationalist leaders fell to the bait of fighting to capture political power for themselves. In the end, they had to share power with Western and Western-trained intellectuals. This is the intellectual group (Gramsci's concept of civil society) which formulated economic policies for African governments, under the guidance of the broad principles of, among others, modernisation theory and Keynesian theory of economics. While they did so, African governments busied themselves consolidating political power. African leaders also took part in formulating the concept of African socialism which they used to camouflage the Euro-Yanqui-centric[41] approach to development as something African.

African socialism was one of the principal post-colonial ideologies developed by African leaders. Although it was short-lived, the impact it had on the human rights situation in Africa cannot be overlooked. The anti-human rights principles and strategies formulated under African socialism were used to legitimise and excuse rights repression; and to facilitate the implementation of the neo-colonialist development policies carved in the name of Keynesianism and modernisation theory. These Western concepts could only thrive in Africa under a coercive, state-centred, dictatorial government.

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[39] As existed in the traditional political systems and which were co-opted into the nationalist struggle.

[40] Thus, except in a few instances, colonialism was not attained through the mustering of "all legitimate and constitutional means" as Nkrumah suggested: Nkrumah, supra note 15 at 112), but through a negotiation and handing over of the reins of government to Africans who could be trusted "to share their values and be attentive to their interests." It is also significant to note the acceptance speech made by the new President of Congo (Kinshasa) on the attainment of independence from Belgium where, after praising the Belgian administrators, and promising future co-operation, he added that Belgium had given "an example unprecedented in the history of peaceful decolonization – leading our people directly, without transition, from foreign rule to independence under full national sovereignty." G.B.N. Ayittey, supra note 17 at 98. Contrast the President's speech with the fiery one delivered by the then Premier, Patrice Lumumba also quoted in Ayittey above. Nkrumah also could not hide his admiration and positive overtures towards capitalist states in his *Autobiography*. In this regard, Ake argues that "On the whole, political independence in Africa was rarely the heroic achievement it was made out to be; it was often a convenience of deradicalization by accommodation, a mere racial integration of the political elite." Ake, supra note 10 at 4.

[41] Term borrowed from Richard Devlin, "On the Road to Radical Reform: A Critical Review of Unger's Politics," (1990) Vol. 28 No. 3 *Osgoode Hall Law Journal* 641 at 645.

WESTERN DEVELOPMENT POLICIES: KEYNESIANISM AND MODERNISATION THEORY

Keynesianism has had a strong relationship with the modernisation theory, *inter alia*, in the context of both concepts following the negative relationship approach between human rights and development in Africa. Keynesianism is first and foremost an economic concept, though its proponent, John Maynard Keynes, is also considered a political activist.[42] John Keynes formulated the concept in the heat of the Depression.[43] It is important to note that it was meant for application in the capitalist world only to redress the crisis that plagued capitalism at the time,[44] principally unemployment and the endemic social ills of capitalism such as rising inequality, individualism, etc. Keynes' contention was that the crisis in capitalism, which he called one of the "greatest economic evils of our time" were attributed to "the fruits of risk, uncertainty and ignorance:"

It is because particular individuals, fortunate in situation or in abilities, are able to take advantage of uncertainty and ignorance, and also because for the same reason big business is often a lottery, that great inequalities of wealth come about; and these same factors are also the cause of unemployment or labour, or the disappointment of reasonable business expectations, and of the impairment of efficiency and production.[45]

Keynes grounded his thesis on economic reforms of capitalism on three concepts: economic efficiency, social justice and individual liberty.[46] He repudiated the notion of the "invisible hand" and endogenous market forces and blamed them for the ills of capitalism. In their place he advocated state intervention in the economy to co-ordinate a kind of collective planning that would involve active government spending. The idea was to spawn artificial demand which would in turn help create jobs and end the vicious cycle of unemployment.[47]

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[42] He was a member of the Liberal party of his time though his political views which one comes across in his writings have socialist trappings which deviated from the classical liberal stance. See Hyman Minsky, *John Maynard Keynes* (New York: Columbia University Press, 1975), 146ff. See also Keynes, "Am I a Liberal?" in Keynes, *Essays in Persuasion* (Vol. 9 of *The Collected Writings of John Maynard Keynes*) (New York: Norton, 1963), 295ff.

[43] Though he started his writings in the pre-Depression period. The views he expressed, eg. in *The End of Laissez-faire* (London: Hogarth Press, 1926) were those that were re-echoed in later works.

[44] Claus Offe argues: "the KWS [Keynesian Welfare State] has been adopted as the basic conception of the state and state practice in almost all Western countries." Claus Offe, *Contradictions of the Welfare State* (Cambridge, Mass.: MIT Press, 1984) at 193; Mehmet also argues that Keynesianism was directed, "as with other Western theories, to solving Western problems." Mehmet, *supra* note 25 at 59.

[45] Keynes,, *Laissez-faire and Communism* (New York: New Republic, Inc., 1926), 68.

[46] Keynes, *General Theory of Employment, Interest and Money* (16th ed.) (London: Macmillan Press, 1977), especially Chapter 24.

[47] Allan Meltzer, *Keynes's Monetary Theory: A Different Interpretation* (Cambridge: Cambridge University Press, 1988) at 252-253.

Western governments were also to engage in the provision of social services to mitigate the harsh effect of unemployment.[48] Keynes' goal was to create a more benign, equitable and egalitarian capitalism. The state's role in this regard was to help tap and harness the potential inherent in capitalism and direct it towards the attainment of more appropriate social welfare goals.[49]

Situating the Keynesian theory in the context of civil society, one realises that it repudiates the Lockean idea of civil society which was responsible for engendering the neo-classical economy of the invisible hand. Keynesianism rather supports the Montesqueiean model of civil society which supports some form of governmental intervention and control.[50] But more significantly, Keynesianism is a reflection of the Hegelian notion of civil society. The difference between them Keynes and Hegel seems to be that Hegel concentrates his work on social reform leading to political and economic reforms,[51] while Keynes centres on economic reform as the foundation to social reform. Thus, for example, Keynes admitted that state interventionist measures would infringe on some personal freedoms that are deemed "untouchable."[52] Also the state-organised process of decommodification was to have a dramatic reduction effect on the nature of civil society which had been structured by the market.[53] Keynes might, or ought, to have anticipated this as well. Yet, he did not offer a re-theorising of the concept of rights in a "positive" context commensurate with the "positive" role he assigned the state. He only offered an economic prosperity solution: the benefits accruing from state planning would compensate for any abuse of power by the state.[54]

Another solution Keynes suggested, which perhaps displays the extent of his "political naiveté," or lack of concern for the political aspect of his theory, was the fact that he could rely on altruistic "judges" (elected officials), public opinion

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48 However, Keynes was cautious about the negative impact of social spending on the poor. According to him, it would increase consumption and reduce savings.

49 J. Keane, "Introduction," in Claus Offe, *supra* note 44 at 15. He argues: "The Keynesian welfare state is to "positively subordinate" itself to the capitalist economy. It is required to both *intervene* in this subsystem and create, through non-market or *decommodified* means, the pre-conditions of its successful functioning." The influence of Keynesianism is probably reflected in the various social charters that is found in the constitutions of Western European states, including the European Social Charter.

50 See Taylor, Charles, "Modes of Civil Society," in (1990) Vol. 3 No. 1 *Political Culture*, 95.

51 Hegel *supra* note 344.

52 Keynes, *supra* note 46 at 380. He contends: "Whilst, therefore, the enlargement of the functions of government, involved in the task of adjusting to one another the propensity to consume and the inducement to invest, would seem to a nineteenth century publicist or to a contemporary American financier to be a terrific encroachment on individualism, I defend it, on the contrary, both as the only practicable means of avoiding the destruction of existing economic forms in their entirety and as the condition of the successful functioning of individual initiative."

53 Keane, ed., *Civil Society and the State: New European Perspectives* (London: Verso, 1988) at 7.

54 Meltzer, *supra* note 45.

and the ballot box to check abuses of the state.[55] He therefore did not see the need for political reform to allow his economic concept to work.[56]

In terms of similarity, both Hegel and Keynes advocated for the rights of workers or the underclass generally.[57] This was an attempt to resolve looming class conflicts, not through a revolutionary control of the means of production, but through the volume of distribution and growth and greater access to political power through the trades union and its corporatisation into the state apparatus. Bowles describes the compromise reached between capital and labour as follows:

[The accord] represented, on the part of labour, the acceptance of the logic of profitability and markets as the guiding principles of resource allocation, international exchange, technological change, product development, and industrial location, in return for an assurance that minimal living standards, trade union rights, and liberal democratic rights would be protected, massive unemployment avoided, and real incomes would rise approximately in line with labour productivity, all through the intervention of the state, if necessary.[58]

There is no denying the fact that the adoption of Keynesianism did accrue to the benefit of capitalism. Offe writes that "most observers agree that its effect has been, first, an unprecedented and extended economic boom (at least until the 1980s) favouring all advanced capitalist economies."[59] But Offe fails to analyse the international political effects of the creation of this profit margin for capitalism.[60]

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55 *Ibid*.

56 See Claus Offe who argues that the continued compatibility of capitalism and democracy was deemed inconceivable and unworkable in the eyes of both classical liberalists and classical Marxists. But the ability of Keynesianism (which he describes as a mediating principle) to survive was due to the development of "a *specific version* of democracy, one with political equality and mass participation that is compatible with the capitalist market economy. He therefore refers to Keynesianism and the mass political participation as two mediating principles that ensured compatibility between the two forces. See Offe *supra* note 44 182ff. See also Keane on "negative and positive subordination" of the state to capitalism: Keane, *supra* note 49 at 14, 15.

57 Although these are feeble attempts to rectify the task-definition/task-execution model of capitalism that Roberto Unger repudiates. See, R. Unger, *Social Theory: Its Situation and its Task* (Cambridge: Cambridge University Press, 1987) at 3.

58 S. Bowles, "The Keynesian Welfare State and the Post-Keynesian Political Containment of the Working Class," unpublished manuscript (Paris, 1981) at 12. cf. C. Offe, *supra* note 44 at 193.

59 Offe, *supra* note 44 at 193.

60 Keane critiques Offe's lack of international perspective in his analysis of the influence of transnational migration of industrial production to the peripheral capitalist countries and the fiscal crisis facing capitalism in relation to the growth of armament production. He relates the second factor to Offe's "general failure to analyse the external ordering of welfare states within the global-system of nation-state power and conflict." Keane's criticism, however, still does not go far enough since he did not specifically mention the role of the peripheral states in contributing largely to

One can draw a link between the practice of the concept of Keynesianism and the introduction of modernisation theory by reference to two factors. First, the urge to provide a solution to the burgeoning unemployment rate in the Western world which, for example, led the United States to develop a large military-industrial complex that employed millions of workers. The production and sale of armaments for the US government (and other Western allies) reaped a huge profit for Western economies that in turn created a fiscal crisis in the form of inflation.[61] Babu maintains that America was able to transfer its inflation to Europe which could not absorb the excess liquidity thereby creating "the unwanted Eurodollars."[62] This in turn spawned the Euromarket which has become one of the largest international markets for short-term funds[63] for "needy" economies such as Africa's.

In addition, the proliferation of the arms race led to what Keane describes as "the external ordering of welfare states within the global system of nation-state power and conflict."[64] An effect of this external ordering on African development is the proliferation of arms which was used, among others, as a means to promote compliance with Western foreign policy by African states. Another was that the proliferation of arms and the fear of centrifugal forces overcoming the absolutism of state power led to African governments channelling large portions of their budget into the purchase of arms to suppress dissent. This policy has had a negative effect on African economies in two respects: first, the money which should have been used to meet the socio-economic needs of the people was used to stock-pile arms. Secondly, the arms were most often used as a tool to suppress the people's exercise of their "freedom rights" in order to cow them into further submission.

Yet another form of external ordering was the effect Keynesianism has had on the imposition of modernisation theory, as an independence model of development, on Africa. The relationship lies in the fact that the post-colonial economic agenda for African states was – in the name of modernisation theory – to be attained through a restructuring of the socio-economic framework inherited from colonialism, but not the political. This is related to Keynes'

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the success of Keynesianism. See Keane, supra note 49 at 17 and 19. A criticial analysis of the failures of Keynesianism which gave way to the emergence of neo-classical economics and the "new international order" is discussed below.

61 Babu, *supra* note 12 at 85. In fact, one major failure of Keynesianism which has prompted unabashed criticism is inflation. See C. Offe at 149,150,199; also, Frederich von Hayek, *New Studies in Philosophy, Politics, Economics and the History of Ideas* (Chicago: University of Chicago Press, 1985).

62 Babu, *supra* note 12 at 86.

63 F. Cheru, *supra* note 255.

64 Keane, *supra* note 49 at 19.

lack of emphasis on re-theorising the political and human rights frameworks of capitalist states. The emphasis was on the end (prosperity) to justify the means (reliance on the inherited colonial political structure). This way, Keynesianism became the shadow of the "trickle down" concept inherent in modernisation theory. This latter concept optimistically assumed that increased economic capacity would "trickle down" to the masses and thereby alleviate poverty and improve the material conditions of the poor in the less industrialised world.

Modernisation theory had both economic and political aspects to it, each expected to function together in a parallel fashion.[65] In general, it borrowed not only from Keynesianism but also the deterministic, social darwinistic framework or path to modernity and civility. The unilinear "march to progress" was to result in the non-industrialised world evolving to become industrialised states.[66] Modernisation therefore came to mean "westernisation," "industrialisation,"[67] and later "development."[68]

Modernisation theory is summarised by a UNDP discussion paper as follows:

The conventional perspective on development is linear. It assumes that there is a single track that all countries follow. The challenge of those who are behind on this track is to "catch up" with other others. It follows that the most expedient approach to development is to imitate those that are further ahead. Transfers of technology are the means to achieve that goal. Because all eyes are on the experience of others, developing countries are encouraged to abandon their tradition. The latter is a hurdle to overcome. Finally, it is investment in physical capital that is basic to progress. The structures that such capital investments give rise to produce development. The human factor is generally relegated to a peripheral position; the perspective on change is typically short-term.[69]

The emphasis on physical capital, in the form of aid and loans and technology transfer, explains the lack of attention to the human factor and the consequent unconcern for human rights which emerges in the form of human or social capital. Thus, instead of investing in people by creating conditions for pre-developed African peoples to exercise their rights, the ordinary citizenry were only expected to work for the new ruling group. They have worked with their bare hands to

65 Mehmet, *supra* note 25 at 58.

66 W.W. Rostow, *The Stages of Economic Growth: A Non-Communist Manifesto* (Cambridge: Cambridge University Press, 1960); also, Rostow, *Politics and the Stages of Economic Growth* (Cambridge: Cambridge University Press, 1971).

67 Ake, *supra* note 10 at 11; Mehmet, *supra* note 25.

68 Gustavo Esteva, "Development," in Wolfgang Sachs, ed., *The Development Dictionary: A Guide to Knowledge as Power* (London: Zed Books Ltd., 1992).

69 UNDP, *Sustainable Human Development. From Concept to Operation: A Guide for the Practitioner*. A UNDP Discussion Paper, August, 1994.

the extent of becoming "so exploited and mystified that they make themselves active accomplices of their executioners."[70] The means to attain this goal was the centralisation of power in the state. Thus, Mehmet maintains that

Rostow's *Non-Communist Manifesto* was not *laissez-faire* capitalism with reliance on the invisible hand of the market. In fact the Rostowian prescription favoured state capitalism. By strategic decisions affecting resource allocation designed to stimulate investment in leading sectors, a society (i.e. government) could engineer economic growth and accelerate the growth rate. Thus, quite paradoxically, Rostow, the prophet of capitalism, far from advocating reliance on market forces ended in legitimizing state intervention in Third World development, based on planning and foreign intervention.[71]

The elaboration and implementation of the economic centralisation aspect of modernisation theory found expression in its political counterpart. Political modernisation was propounded by American political scientists in the 1950s to facilitate attempts by the US government to promote America's emerging influence in world politics.[72] Thus, exponents of the concept,[73] can be placed in the category of Gramsci's civil society whose goal is to promote international hegemony for capitalism. In their view, a country could not strive for democratic form of government simultaneously with economic modernization. Economic development should therefore take precedence over political development for "in the long run, social and economic modernization [would] produce broadened participation."[74] This stance is related to the intellectual foundation African governments built to contend that the exercise of civil and political rights was a luxury that had to wait till economic development was attained.[75] The task of politics was to create the conditions for economic growth by ensuring social peace and political stability.

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[70] P. Hountondji, *African Philosophy: Myth and Reality* (Bloomington: Indiana University Press, 1996) 2nd ed., at 170.

[71] Mehmet, *supra* note 25 at 69.

[72] Vicky Randal and Robin Theobald, *Political Change and Underdevelopment: A Critical Introduction to Third World Politics* (London: Macmillan, 1985) at 12, ff. In support of this contention, one can refer to the preface to Huntington and Nelson, *No Easy Choice: Political Participation in Developing Countries* (Cambridge: Harvard University Press, 1976) where it is stated, *inter alia*, that "this study grows out of a research program conducted from 1969 to 1973 at the Centre for International Affairs of Harvard University…The present essay was originally a substantive report to the Agency for International Development, which provided the bulk of the funding for the research program." Huntington and Nelson, above at 1,2.

[73] See, eg. Samuel Huntington, *supra* note 35. Also *ibid*; David Apter, "Some Economic Factors in the Political Development of the Gold Coast," in (1954) *The Journal of Economic History*; Apter, *The Politics of Modernization* (Chicago: University of Chicago Press, 1965); A. Organski, *The Stages of Political Development* (New York: Alfred A. Knopf, 1965).

[74] Huntington and Nelson, *supra* note 72 at 1.

[75] See details below.

This view is vividly represented by Huntington and Nelson's analysis of the two phases in the historical evolution of overall levels of political participation. In the first phase, two models are represented and referred to as the "bourgeois" and "autocratic." In second phase, the models are the technocratic and the populist.[76] The technocratic model usually takes place at the first phase and, in fact, it is what modernisation theory is all about: "low levels of participation, high levels of investment (particularly foreign investment) and economic growth, and increasing income inequalities."[77] On the other hand, in the populist model of development at phase II the reverse is true. That is, "high and increasing levels of political participation go with expanding governmental benefits and welfare policies, increasing economic equality, and if necessary, relatively low rates of economic growth. The logic of this pattern of evolution leads toward increasing social conflict and the polarization of society, as more groups become more participant and attempt to share in a stagnant, or only slowly growing, economic pie."[78] Of the two, Huntington and Nelson seem to favour the technocratic model as the lesser evil since they believed that the populist model would lead to a total breakdown of society through civil war or cause a "participation implosion" occasioned by a military take-over.[79] While they claimed that these models were not perfect in themselves, their overall analysis lent support to the principal ideas enunciated in the models presented above. And in reality, it is the technocratic model that has been implemented in Africa.

Against this background, the contention that African leaders were abusive by nature, or that the African culture did not have space for rights exercise[80] (which is why attempts to introduce human rights failed)[81] is wrong. In reality, it would not have been possible to implement modernisation and Keynesian theories (which had been packaged and waiting for execution in post-colonial Africa)[82] in an ambiance of effective human rights exercise and political participation, as formulated according to the tenets of the theory of community emancipation. Thus, the conditions for rights abuse were laid open for African leaders to exploit. This is where we have to locate the source of rights abuse in Africa.

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76 Huntington and Nelson, *supra* note 72 22ff.

77 *Ibid* 23.

78 *Ibid*.

79 *Ibid*, 24.

80 Eg., R. Howard, *Human Rights in Commonwealth Africa* (Totowa: Rowman and Littlefield, 1987).

81 Eg., S. Huntington, "Will more countries become democratic?," (1984) Vol. 99 No.2 *Political Science Quarterly* 193.

82 Mehmet, *supra* note 25 at 60.

GLOBALISATION AND HUMAN RIGHTS

The pattern of promoting development through limited or no respect for human rights is repeating itself, albeit in a much more indirect fashion under the post-Cold War globalisation era. This situation has largely been dictated by the nature of the democracy that the Western donor community has prescribed for Africa, which is the nominal or "formal" type of democracy. This type of democracy gives room for respect for a limited number of rights relating to voting rights. As Larry Diamond puts it, for Africa, even the democracy bar has been lowered further down.[83] True exercise of civil and political rights are related to the concepts of accountability, openness and transparency whose realisation are constrained to reform of the judiciary, governmental bureaucratic structures, parliamentary procedures, etc as the means to generate and promote enjoyment of civil and political rights. Economic, social and cultural rights are also seen as mere provision of social services which on the one hand are taken away through imposition of IMF and World Bank policies and on the other, given in piece-meal fashion through the operations of development-oriented NGOs.

The practical application of this concept of rights and democracy has always privileged the interests of the well-to-do over the marginalised and deprived members of the community when it comes to making maximum utilisation of rights for the sake of attaining development. Against this background, the importation and application of the Western liberal notion of rights and democracy in the context of Western development policies have not helped promote *sustainable holistic* development for Africa since independence and the reforms introduced in the post-Cold War era are not radically different from the previous development policies to trigger positive change in development in Africa.

The political situation in Africa is such that, as a result of the mistrust the colonial system in the "civic" or artificial public, the original public, the primordial, remains largely in tact. People will transfer their trust from their ethnic loyalty to the state and only if they get assurances from the state that it will take care of their interests. This trust will facilitate the creation of social groups that cut across ethnic and primordial lines in the civil society. However, with the failure of the colonial state to achieve that, and the perpetuation of the colonial state by the African elite, the 2 publics remain and above all, viable functioning civil society remains non-existent. For example in Ghana, according to a 1998 survey, it was noted that majority of the people's involvement in civil society is religious, as opposed to about 30% in the political realm.[84] Thus, the idea of

[83] Larry Diamond, "Is the Third Wave Over?" (1996) Vol 7. No. 3 *Journal of Democracy*, 20.

[84] E. Gyimah-Boadi (ed), *Democratic Reform in Africa: The Quality of Progress* Boulder, CO: Lynne Rienner, 2004).

social capital, which the World Development Report hails as a significant tool for poverty reduction is largely non-existent in the first place. In that respect, the MDGs become severely compromised, considering that the Millennium Development Compact (MDC) lays strong emphasis on civil society acting as the pressure group and watch-dog on governments to make them fulfil their commitments to the MDGs.[85]

In a recent survey conducted by Ghana Association of Private Voluntary Organisations in Development (GAPVOD), the umbrella organisation for non-governmental organisations (NGOs) in Ghana it identified "overall weak structure in civil society organisations."[86] Civil society organizations (CSOs) scored a mere 1.4 per cent on the Civil Society Index (CSI). The first dimension of the project measured the breath and depth of people's participation and the proportion of citizens' engagement in civil society activities. It was discovered that "Ghanaian CSOs had not been very active in non-partisan political action, and that only 15 per cent of CSOs members had engaged in some form of non-partisan political action."[87]

Also, a discouraging picture emerges when one takes a bird's eye-view of the continent's political landscape. It is noted that in 2004, of the 5 elections that were held in Africa, all were won by the incumbents. According to a BBC report,

It is seemingly almost impossible to dislodge a ruling party, or its heavyweight leader, from their iron grip on power. Often, ruling parties dictate the terms of election campaigns: banning opposition candidates, buying them off, vetting manifestos, and sometimes - as in Tunisia's 24 October elections - choosing the size of election posters and then, for good measure, ripping them down if they do not approve of them.[88]

The phenomenon of "third term", whereby constitutions are doctored to let incumbents who have run their constitutional two-term mandates to run for a third, or in the case of Togo unlimited terms, is continuing with Nigeria as the latest to indicate so. In the Nairobi Declaration issued by delegates at the Regional Conference on the Human Rights Dimensions of Corruption organised by the Kenya National Commission on Human Rights in March 2006, paragraph 14 made specific reference to this emerging problem and called on all and sundry:

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85 UNDP, Human Development Report 2003: Millennium Development Goals: A compact among nations to end human poverty (New York, Oxford: Oxford University Press, 2003).

86 The theme for the research was "Civil Society in a Changing Socio-Economic and Political Context." See, www.ghanaweb.com: General News of Thursday, 20 April 2006, "Ghana Marches On 13yrs Of Freedom".

87 *Ibid*.

88 BBC Focus on Africa, "Africa's Election Turn-Off," http:// news.bbc.co.uk/2/hi/africa/4079125.stm.

To resist fraudulent and illegitimate constitutional changes witnessed recently within the continent, meant to extend the terms in office of incumbent Presidents and other political office bearers popularly known as the *"the third term phenomenon"*, and all attempts to cling on to power beyond constitutional terms, which perpetuates corrupt administrations who are afraid to relinquish control and privilege.

These practices certainly show serious deficits in the democratic process that Africa is embarking on. The practices are rooted in colonialism and manifesting themselves in the era of globalisation.

In talking about the roadmap towards poverty reduction, the emphasis on reform by a poor country to be followed by more donor assistance – an approach strongly re-emphasised in the Millennium Development Compact – seems to be a biased, and therefore ineffective diagnosis. The reforms that are being suggested have been implemented since the imposition of the SAP in the 1980s, the principal addition being the democraticisation process from the 1990s. But the majority of the citizens of African states continue to grow poorer, less healthy, less educated, more disenfranchised, etc:

Between 1990 and 1998, the number of people living in poverty actually **increased** in Sub-Saharan Africa, from 242 to 291 million people. And while the number of people living on less than a dollar a day—in absolute poverty—declined in this period by five percentage points the world over, in Africa the change was barely discernible. Even with faster economic growth, the number of people living on less than a dollar a day will increase from nearly 291 million in 1998 to nearly 330 million in 2008. Under conditions of slower growth and rising inequality, that number could be as high as 406 million. In 17 of the 48 countries in Sub-Saharan Africa, life expectancy **declined** between 1990 and 1998, while it went up from age 63 to age 65 in all developing countries. Africa is home to 70 percent of the adults, and 80 percent of the children, living with HIV in the world. Of the nearly 22 million people who have died from AIDS and AIDS-related diseases, 17 million have been Africans. It is estimated that by the year 2014, the population of the world will be 7 billion. Of the increase, nearly a quarter—240 million—will be in Sub-Saharan Africa. [89]

In an unprecedented fashion, according to the HDR 2003, 21 countries, most of whom from Africa, actually experienced declines in the last decade, making the 1990s a decade of human development crisis.

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[89] Foreword by James D. Wolfensohn, The World Bank President in Shantayanan Devarajan, *et al*, eds *Aid and Reform in Africa: Lessons from Ten Case Studies* 2001 The International Bank for Reconstruction and Development / the world bank Washington.

Yet, the perception remains that massive injection of donor assistance is the solution. But the conditionalities attached to aid and loan disbursement remain. Foreign development aid as a Western development policy to boost the economic, political and self-interested ambitions of the Western donor community has not been questioned and reforms suggested. But it remains a reality that more aid ends up benefiting the donor, rather than the recipient community.[90]

Whichever way one looks at it, donor assistance needs to be structurally reformed or be done away with. Indeed, aid has a limited role to play in the global effort to reduce poverty. It is time aid is transformed into a system of global taxation and redistribution so that the poor will have a right to redistribution, not as recipients of paternalistic charity. Other measures also need to be explored and undertaken to reduce poverty, without a necessary resort to aid.

So is foreign investment. The quest of foreign investment has led to African leaders globe-trotting and setting up "favourable investment climates" which only end up in lowering standards for the protection of workers' rights, environmental protection, closing of local industries due to inability to compete with dumped goods, etc. At the same time, little or no effort is done to promote local entrepreneurship.

CONCLUSION

The paper set out to analyse the various development policies that Western states have sought to implement in Africa and their impact on the evolution and development of a culture of democracy and human rights in Africa.

It was observed that the neo-liberal development pattern, premised on the Keynesian and modernisation theories, is to maintain a centre-periphery relationship which creates barriers in the way of African states to attain higher levels of economic development. Moreover, the political framework for the operationalisation of the economic model is highly deficient in meeting the minimum threshold requirements for a democratic order based on the respect for human rights and fundamental freedoms.

True democracy is supposed to be empowering when people are able to transcend their personal interests and meet as a group to articulate needs, assess capacities, impose duties and make rights claims or assert the same in order to deal with their needs. It in turn involves finding through this interaction, the

[90] John Hendra, "Only Fit to be Tied": A Comparison of the Canadian Tied Aid Policy with the Tied Aid Policies of Sweden, Norway and Denmark." (1987) Vol. 8 *Canadian Journal of Development Studies*, 261. See also, Graham Hancock, *Lords of Poverty: The Power, Prestige, and Corruption of the International Aid Business* (New York: Atlantic Monthly Press, 1992); and, Teresa Hayter, *Aid as Imperialism* (Hammondsworth: Penguin, 1971).

means to interpret their experiences, the injustices and stumbling blocks to their development and realise self-hood and contribute to community development. The activity involved through the exercise of the ensemble of right to freedoms of association, movement, assembly, etc helps people to acquire agency, recover selfhood and earn self-confidence.

For democracy to thrive, it has to establish the proper relationship with human rights and development. It has to be in tune with the needs and circumstances of the people. It has to be owned by them, be identified with their aspirations and daily experiences and its practice should likely lead to the attainment of sustainable, holistic development. It should have a functioning civil society.

To turn this tide around, it is recommended that African citizens should be given the opportunity to design effective, workable and practical grassroots democracy. The solution to the building of effective democratic structures lies in adopting traditional African approaches to establishing indigenous civil societies which link the urban to the rural communities, and expressed in town/village improvement associations. Such associations have proved effective in supporting community-based projects in rural communities, keeping the rural communities informed about developments in the city, etc. What was not included in their programme was human rights education, largely due to the wave of suppression of human rights and civil society activism in the past.

It is also recommended that democracy should be based on broad-based, inclusive national governments represented by all ethnic groups in the country, no matter how large and diverse. This may include automatic reservation of certain parliamentary seats to disenfranchised and margnisalised minority groups. National leadership could also be organised on rotational basis where the major political parties who obtain a certain percentage of the votes will have the opportunity to serve as Presidents in turn and the rest as Vice-Presidents with responsibilities over certain cabinet portfolios. Presidential elections should be held over a period longer than the conventional 4-year time frame to enable various party representatives to take their turn as leaders. However, parliamentary elections could be held on a more frequent basis.

The solution to the problems of "failed" development lies not in change in terminology, but in the unfettered exercise of rights, and rights broadly conceived; and particularly applied in the African context.

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Minority Rights in Finland - The Case of Åland

Mira Lulić
Assistant Professor
Law Faculty
University J. J. Strossmayer
Osijek, Croatia
E-mail: miral@pravos.hr

Danijela Bačić
Undergraduate
Law Faculty
University J. J. Strossmayer
Osijek, Croatia
E-mail: danijela.bacic@gmail.com

Abstract

In this paper the authors analyze historical development and today's legal status of Åland and also some specific aspects of Åland autonomy. The authors write about important historical facts that led to the special status of Åland. After the World War I, Ålanders have posed the irredentist demands asking for the separation from Finland and accession to their mother country Sweden. However, Finland has effectively and successfully hampered it by giving Ålanders unusually high degree of autonomy. In this way, Finland has hold its sovereignty and protected territorial integrity and Åland has received adequately rights and freedom in areas of education, language, media, regional citizenship and restrictions on land alienation which enable them to keep separate identity. Finland has kept such a practice towards Ålanders until now. It seems that granting a very high level of autonomy to Åland did not in any way endangered sovereignty or territorial integrity of Finland. It did in fact even strengthen Finland like one of the most democratic countries in the world. It is most possible that respecting the human rights in general with special attention for respecting minority rights is the best guarantee to preserve the territorial integrity of the states. Finally, one poses a question can this Finnish model - to peacefully solve the problems and conflicts related to the rebellious minorities - be applied in other states with identical issues and in the cases of other ethnic tenses and conflicts.

Key words: *Finland, Åland, minority rights, human rights, autonomy, constitution.*

FOREWORD

Åland is located in Baltic Sea and is approximately on the same distance from Sweden and Finland. It is an autonomous, demilitarised, Swedish-speaking region of Finland. It is demilitarised which means that there may be no military presence there and it may not be fortified. It is also neutralised, and must therefore be kept outside the war conflict or any military activities. Åland consists of more than 6,500 islands of which 6,400 are larger than 3,000 m^2. The largest island is the main island of Åland, which makes up 70 per cent of the Island`s total land area and is home to 90 per cent of the population. The longest distance from north to south is 50 km and from east to west 45 km. Despite its relatively small size, there are 912 km of public roads in Åland. The population of Åland is currently at an all-time high. According to a travel memoir written by F.W. Radloff in the 18th century there were 11,000 people in the Islands at this time, spread across 80 different islands[1]. Over 40 per cent live in the only town - Mariehamn[2]. 95 per cent of population are Swedes and religion is Protestantism[3]. In 1905 the number had grown to 22,000, living on 150 islands. The current population of 26,200 live on only 65 islands.

On the world scene, minorities were marginalized for decades, especially after the Second World War. Special status which minorities had in period of League of Nations was lost. They became a part of the new system of "general protection of human rights". It seams like International Law ignored them in the period of the Cold War. Unfortunately, United Nations in the Cold War period did not put on efforts regarding protection of minority rights ad League of Nations did. Those are that minorities had rights at least to use mother-tongue or that they had specific level of autonomy[4]. Unfortunately from that period there are a lot of worrying cases of denial of basic human rights in the most serious ways (discrimination, marginalization, ethnical cleaning, expelling, forced assimilation, racism, genocide, etc.).

Dealing with conflicts between majority and minority in multiethnic societies is pressing issue in contemporary world since those conflicts arise very often in armed conflicts. Unfortunately, countries in which minority rights and freedoms are respected and in accordance with International Law norms and standards are very rare today (for example: Austria, Finland, Canada and Sweden). Therefore

[1] Official Internet site of Åland, Åland in Brief, World Wide Web URL http://www.Åland.ax/Ålandinbrief/fakta.htm/.

[2] Ibidem.

[3] World Directory of Minorities, Minority Rights Group, Longman Group, St. James Press, Chicago, 1991, p. 66.

[4] Jackson Preece, Jennifer: Minority rights in Europe: From Westphalia to Helsinki, RIS, 1997, 23, 75 92, p. 87.

in this work the authors will set forth one of the most known cases with quality solution of minority status and protection of minority as well, and that is the case of Swedish minority on Åland. The authors would also try to give an answer could this example of Åland serve like an example for preventing secession and like an alternative for secession in other states where such tensions or conflicts occur.

HISTORICAL BACKGROUND TO THE ÅLAND ISLAND

After the last ice age, 11 000 years ago, different immigrations from many directions brought inhabitants to the huge areas in the Nordic countries. Oldest evidences of colonization in Finland date back from 7000 year before Christ. From that period it is known almost nothing about the language of the inhabitants. From the middle of the 12 century country had a population that spoke Finnish. In that period began an influence from central Sweden. Colonization was supported by Romanian Catholic church and Swedish Kingdom as well. Swedish immigrants migrated to the Åland and Finish coast which were uninhabited. This vale of immigration collapsed in the beginning of the 14 century. Even from those times Finnish and Swedish people lived together[5]. As the consequence of Swedish domination, Swedish legal and social systems routed in Finland very early. In 1362 year Finns were given the right to send representatives to the election of the king in Sweden[6]. War period from 1808–1809 separated political union of Sweden and Finland so Finland became a part of Russian empire like a Grand Duchy. Sweden was forced to relinquish Finland to Russia, and Åland was included in that deal. Finnish became a language of the government, Swedish was dominant one in education[7].

The movement for Finnish independence became more focused on language as a factor of national identity. In 1863, Finns was given an equal position with Swedish as the official language of Finland. A legislative reform in 1906 gave Finns a position in practice which corresponded to the dominant numbers of Finnish speakers in the country's population. Opposition between Finns and Swedish in Finland grew more pronounced during the 1870s and 1880s. During this time, there was also a counter-reaction among Swedish speakers in Finland. In the 1860s and 1870s, a movement promoting Swedish emerged, fronted

[5] Official Internet site of Finnish – Swedish organization Scandinavica; World Wide Web URL http://scandinavica.com/.

[6] Arvo Peltonen: The population in Finland, Ministry for Foreign Affairs, Helsinki, 2003, p. 3.

[7] See more Seppo Zetteberg: Main outlines of Finnish history, Ministry for Foreign Affairs, Helsinki, 2005.

by Axel Olof Freudenthal and others[8]. At the same time, the educated strata of Swedish speakers were mobilised around the ideals of a bilingual state and Swedish cultural traditions[9]. As a result of these movements, Swedish was now perceived for the first time as a uniting factor for all Swedish speakers, irrespective of social standing and heritage[10].

The fall of the Russian Empire in 1917 enabled Finland to gain its independence from Russia. The period from 1917 to 1923 was crucial for the formation of Finnish society as we know it today. The 1919 Constitution of Finland enshrined Swedish and Finnish as the two national languages of Finland. Swedish speakers were given an education system of their own and a Swedish diocese as cornerstones for their cultural autonomy. A Swedish-speaking unit in the Defence Forces was also established. At the same time, a separate solution was created for the Province of Åland, a solution with international support and which rests on autonomous rule and a single language, Swedish, for the entire province[11].

THE ÅLAND ISLANDS CASE: ITS SETTLEMENT BY THE LEAGUE OF NATIONS

Åland was under the Swedish sovereignty from 1157 up to 1809 when all Finland including Åland was occupied from Russia[12]. Finland gained independent on 6 December 1917 and Åland becomes part of the country. Åland was demilitarized since 1858 in accordance with treaty which was concluded between Great Britain, France and Russia although Russia has confirmed it in military sense again in the period of the First World War[13]. As a result of "threatening position" *vis-à-vis* Stockholm and because of strategic importance in Baltic Sea, all states came to a conclusion that Åland has to be demilitarised and neutralised[14]. For the first time in history, Åland became the question of International Law[15].

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[8] Anna Jungner, Public relations secretary, The Swedish Assembly of Finland, World Wide Web URL http://virtual.finland.fi/netcomm/news/showarticle.asp?intNWSAID=26218/.

[9] Ibidem.

[10] Ibidem.

[11] Ibidem.

[12] John Loughlin and Daftary Farimah: Insular Regions and European Integration: Corsica and the Alland Islands Compared, European Centre for Minority Issues Reports, November 1999, p. 19. See also AÅland Island, in Encyclopedia of Public International Law, 12, North-Holland - Amsterdam - New York - Oxford - Tokyo, 1990, pp. 1-3.

[13] See Hannum, Hurst: Documents on Autonomy and Minority Rights, Martinus Nijhoff Publishers, Dordrecht/Boston/London, 1993, p. 370

[14] Ibidem.

[15] Ibidem.

More than 95 per cent of Åland´s population, during the conflict considering islands, were Swedish ancestry, talked Swedish and cared of Swedish culture[16]. The controversy of Åland occurred when Sweden, in accordance with the Wilson´s right of self-determination, appointed claim for returning Åland to Swedish sovereignty. That claim was grounded on unofficial plebiscites of Åland´s population with claim to secede from Finland and to unite with Sweden. Presenters of Åland´s communes gathered August 20, 1917 in collectively Assembly of Communes (Landsting) in Finstrom and accepted the Resolution in which it was stated that Swedish government and Parliament needed to notice the wish of Åland´s population to join the Kingdom of Sweden[17]. After that special Committee was established with a purpose to organize referendum. Anticipated referendum was maintained 31 December in progress of which 7000 people signed petition for for a reunion of Åland with Sweden [18].

Swedish authorities interpreted the situation in a way that after Finland had become independent Åland did not directly came under Finnish sovereignty and that the status of Åland had to be negotiated separately. In contribution to this thesis that Åland should be rejoined with Sweden, Swedish authorities stated that Province had geographical unity, borders could be defined without any difficulties, economic importance for Finland was not significant and that they had strong historical connection with Sweden[19]. Finland, naturally, rejected these arguments and ruled out possibility that Åland could become part of Sweden. Finnish authorities believed that right on succession is possible only in case of oppression or grave breaches of International Law norms. In accordance to that, Finnish authorities declared that they will respect all rights of population on Åland like a Swedish minority in Finland. Finland declared that not just that there is no oppression on Swedish minority but Finnish authorities are willing to grant all special rights to Åland´s population as members of minority[20].

Since two states could not come to a solution while they negotiated, proceeding started in Council of League of Nations in 1919. First thing was to decide if Council had the jurisdiction in dealing with this matter or was this the question of exclusively internal matter of Finland. In the case it was defined that the case of Åland was of international concern, did Åland´s population have indeed right

[16] See official web site of the Åland Island, World Wide Web URL http://www.Åland.fi and World Directory of Minorities, Minority Rights Group, Longman Group, St. James Press, Chicago, 1991, p. 66.

[17] See Bulajić, Milan: Pravo na samoopredjeljenje u Društvu naroda i Ujedinjenim nacijama (1917.-1962.), Beograd, 1963, pp. 39.-41. and Hannum, Hurst: Rethinking Self-Determination, Virginia Journal of International Law, vol. 34, Fall 1993, pp. 8-11.

[18] Ibidem.

[19] Ibidem.

[20] Ibidem, pp. 40-41.

of self-determination and secession from Finland? League of Nations formed two groups of experts who had a task to analyze matter of Åland. In conclusion two resolutions were adopted.

International Commission of Jurist consigned report on September 5, 1920[21]. They defined that the quesiton of Åland was not in the exclusive jurisdiction of Finland. The question of Åland was one of international in scope. Council of League of Nations had right to discuss in this question. Based on this notice Council of League of Nations established new five members of the Commission of Rapporteus. Duty of the Commission of Rapporteus was to analyse in details questions and legal status of Åland as well as to propose conclusion for solution of the problems. Commission of Rapporteus analysed geographical, economic and strategic position of Åland. In the end, Commission brought these conclusions: Finland was sovereign country, Åland was an integral part of Finland and secession from Finland would be violation of the territorial integrity of the state[22]. In fact, Finnish authorities believed that minority group would eventually had right on secession from one and reunification to another state only in case if there was oppression agains that minority group. But Finish government had power and will to achieve and apply effective guaranties for religious, language and social rights and freedoms for Åland minority[23]. If central government did respect minority rights, there were no legal possibilities for secession from the state (Finish thesis). Åland´s population, according to notice of Commission of Rapporteus did not have a right to secede since they were not oppressed by Finish authorities but contrary, Finland was willing to ensure specific guarantees for Åland therefore to their specificities could be maintained

Receiving recommendation from the Commission of Rapporteurs, Council of League of Nations accepted on June 25, 1921 Recommendation by which sovereignty over the Åland belongs to Finland[24]. It was decided that Åland has a right on special autonomous status and appropriated level of self-government. Åland was demilitarised and neutralized. Finland was obliged to give special guarantees for protection of language, culture and local customs of Swedish minority on Åland Islands[25]. Thereby request from representatives in Åland for reunification with Sweden, which was based on the principle of self-

[21] Report of the International Committee of Jurists, entrusted by the Council of the League of Nations with the task of giving an advisory opinion upon the legal aspects of the Åland Islands question, League of Nations Official Journal, Spec. Suppl. No 3, Oct. 1920, p. 5.

[22] Report presented to the Council of the League of Nations by the Commission of Rapporteurs, League of Nations Doc. B. 7.21/68/106 (1921), p. 27.

[23] Ibidem. See also Musgrave, Thomas, D.: Self-determination and national minorities, Oxford monographs in international law, Oxford University press, 2000, p. 171.

[24] Bulajić, op. cit., p. 43.

[25] Vukas, Budislav: Etničke manjine i međunarodni odnosi, Školska knjiga, Zagreb, 1978, p. 68. See also League of Nations Official Journal, January - February 1921, p. 64-78.

determination, was denied[26]. It is important to notice that the Commission also stated that the "right of self-determination" was not enshrined in the Convenant of the League of Nations nor was it a rule of International Law at that time. Commission of Rapporteurs notified that in accordance to International Law neither one national group had any right to secede from state grounded just on unilateral declaration of will of the people. That kind of claim could not set neither other state, in this case Sweden. Self-determination was not inscribed in the Convenant of the League of Nations and inclusion of that principles in certain number of international treaties was not enough to be accepted as a contemporary norms of the International Law[27]. Therefore right of self-determination of people was denied not just to minorities but to many nations as well. Right on self-determination in that period was just a simple political concept[28].

Sweden and Finland accepted the decision of League of Nations that Åland remain by the Finnish sovereignty accompanied by full international guarantee for Swedish minority. That agreement is still on force. On May 6, 1920 came into force Guarantee Law of Finnish Parliament which approved the Council of the League of Nations by Resolution July 27, 1921[29]. That was also accepted by both Finland and Sweden[30]. Finland agreed to guarantee to the Ålanders "the preservation of their language, of their culture, and of their local Swedish tradition"[31]. Hannum pointed out that this agreement was "one of the most radical form of international guarantee for a national minority ever to have been drawn up"[32].

ÅLAND´S PARLIAMENT AND GOVERNMENT

First sitting of Åland´s Parliament was kept on June 9, 1922, and this day is now celebrated in commemoration of Åland´s autonomy. Guarantee Law (1922) was revised several times. First of all on December 28, 1951 and on August 16, 1991. The latter, Act on the Autonomy of Åland, entered into force on January

[26] Cassese, Antonio: Self-Determination of Peoples – A Legal Reappraisal, Cambridge University Press, Cambridge, 1995, pp. 31-32.

[27] Bulajić, loc. cit.

[28] See Cassese, op. cit., p. 30 and Shaw, Malcolm N.: International Law, A Grotius Publication, Cambridge University Press, 1997, p. 177.

[29] Hannum, Hurst: Autonomy, Sovereignty, and Self-Determination, University of Pennsylvania Press, Philadelphia, 1996, p. 371.

[30] Agreement between Finland and Sweden, Relating to the Guarantees in the Law of May 7, 1920 on the Autonomy of the Åland Island, League of Nations Official Journal, Supp. 5.

[31] Resolutions adopted by the Council of the League of Nations at its Thirteenth Session (1921), League of Nations Official Journal, Supp. 5, p. 24.

[32] Hannum: Autonomy, Sovereignty, and Self-Determination, op. cit., str. 371.

1, 1993 and it was revised several times since then[33]. It has 79 Sections divided in 11 Chapters. Åland has a right to vote for it's own laws and their rights are established by the Finnish Constitution. The most important rights are related to the education, culture, health system, social welfare, post services, radio, television and local affairs and industry. Amendments that regulate relations and obligations between Åland and Finnish authorities have to be approved by the qualified majority in the Parliament of Finland and in legislative parliament of Åland[34].

Right of domicile is acquired at birth if it is possessed by either parent. Immigrants who have lived in Åland for five years and have an adequate knowledge of Swedish may apply for the status, provided that they are Finnish citizens[35]. Right of domicile in Åland is a requirement for the right to a) vote and stand for election in elections to the Parliament; b) own and or be in possession of real property in Åland and c) conduct a trade in Åland[36]. The limitation in the right to own or be in possession of real property was introduced to ensure that the land would remain in the hands of the local population. It does not prevent people from settling in the Åland Islands.

According to the Section 3 of the Act on the Autonomy of Åland, the Åland Parliament represent the people of the Åland Island in all matters relating to its autonomy. The administration system is vested in the Government of Åland. Government of Finland will be represented by the special Governor in Åland[37]. Governor´s special obligation is opening and closing of Parliament[38]. The Parliament ("Lagtinget") apoints the regional Åland Government ("Landskapsregeringen"). Any amendment of the Act on the Autonomy of Åland must follow the same legislative procedure as constitutional amendment and requires the consent of the Parliament of Åland. The division of power between Åland and Finland can be changed on a consensual basis of the both parties. Åland shall have legislative powers in respect of, for instance, education, culture and the preservation of ancient monuments; health and medical care, the environment; promotion of industry; internal transports; local government; building and planning, social welfare; hunting and fishing; postal communications; radio

[33] Act on the Autonomy of Åland (August 16, 1991/1144) see in Hannum, Hurst: Documents on Autonomy and Minority Rights, Martinus Nijhoff Publishers, Dordrecht/Boston/London, 1993, p. 115-144. See also official web site of the Legislative Assembly of Åland, World Wide Web URL http://www.lagtinget.Åland.fi/eng/act.html/.

[34] Act on the Autonomy of Åland; Chapter 4, section 17, 18 and 19.

[35] Act on the Autonomy of Åland, Chapter 2, Section 6 and 7.

[36] Ibidem, Section 9, 10 and 11.

[37] Act on the Autonomy of Åland; Chapter 1, Section 4.

[38] Act on the Autonomy of Åland; Chapter 3, Section 14.

and television, municipial boundaries, public order and security, etc[39]. In these areas Åland functions practically like an independent state with its own laws and administration[40]. Parliament includes 30 members who are elected every 4 years by the covert voices of persons over age of 18 and those who have regional citizenship[41]. In those areas where the Åland Parliament does not have law-making powers, Finnish laws apply in the same way as in other parts of the state. To ensure that Åland's interests are taken into account also in these areas, Åland has a representative in the Finnish Parliament[42]. The laws adopted by the Åland Parliament are referred to the Finnish President. The President has a right of veto in two cases: if the Parliament has exceeded its legislative authority or if the bill would affect Finland's internal or external security[43]. The jurisdiction of Åland's Parliament also encompasses decision making related to the state budget. Additionally, it is in Finland's jurisdiction to collect fees on Åland as well. In accordance to the Section 5 of the Autonomy of Åland, a special joint organ of Åland and the State – Åland Delegation has been established[44].

The Government of Åland has up to eight members which are selected by the Åland's Parliament and the government is led by the Chairman. Its jurisdiction covers all issues related to the Act on the Autonomy of Åland. Åland is divided into 16 municipalities. As local government is a regional concern, the rules relating to municipality self-government are contained in an Ålandic law, and one passed by the Parliament[45]. The municipalities' decision-making power is exercised by the local council, which is elected by public ballot for a period of four years[46]. Right to vote and stand for election have those who have right of domicile or have lived in Åland for three years are entitled[47].

Foreign affairs are not transferred to Åland under the Act on the Autonomy of Åland, but remains under the control of the Finnish Government. The

39 Act on the Autonomy of Åland; Chapter 4, Section 18.

40 Act on the Autonomy of Åland; Chapter 4, Section 18.

41 Act on the Autonomy of Åland; Chapter 3, Section 13. See also official Web Site of the Åland Parliament, World Wide Web URL http://www.lagtinget.ax/eng/index.htm/.

42 Constitution of Finland, Chapter 3, Section 25.

43 Act on the Autonomy of Åland, Chapter 4, Section 19.

44 Its composition, duties and expenses are as provided by sections 19, 32, 55–57 and 59b of the Act on the Autonomy of Åland.

45 Åland's largest municipality is its only town, Mariehamn, which is home to over 40 per cent of the Islands' population. Mariehamn was founded in 1861 and is the centre of political and economic life in Åland. Out of the other municipalities on the main island, Jomala, Mariehamn's neighbour, is the largest, with about 3,400 inhabitants. The smallest municipality in Åland, and all of Finland, is Sottunga in the archipelago, which has a population of 130. See more on the Worl Wide Web URL http://www.Åland.ax/.

46 Ibidem.

47 Act on the Autonomy of Åland, Chapter 2, Section 9.

Government of Åland may propose negotiations on a treaty or another international obligation to the appropriate State Officials[48]. The government of Ålanda will be informed on negotiations related to the international treaties if the matter is subject to the comptence of Åland. Also, the Government of Åland shall be reserved the opportunity to participate in those negotiations if there is "a special reason for the same"[49]. The Act on the Autonomy of Åland states that an international treaty of this kind entered into by Finland requires the consent of the Parliament of Åland to become valid also in Åland[50]. Finland became a member of the European Union in 1995[51] and Åland's accession to it was dependent on the consent of the Parliament. After the population voted in two separate referendums, it was decided that Åland's relationship to the EU would be regulated with a special Protocol. The Parliament of Åland expressed its consent to that. That Protocol contains special provisions relating to the purchase of real property and the right to conduct a business in Åland, and confirms Åland's special status under International Law[52]. This document is also part of the Finland's treaty of accession.

CULTURE, EDUCATION, MEDIA AND LANGUAGE

Åland has very lively cultural life which is led at various levels. A whole range of associations and societies have been established which assignment is to promote and strengthen the Åland's culture locally. Goals of Åland´s cultural policy includes a) stimulating and creating conditions for worldwide cultural life without consideration on economic, communal and geographic factors; b) to ensure continuity of origins Åland´s culture and c) to make Åland´s identity stronger[53]. An important aspect of this policy is also the inducement of the co-operation with other Nordic countries. Važan je dio i poticanje suradnje s drugim nordijskim zemljama. Choirs and cultural organizations are very popular[54]. There are six permanent Swedish theatres in Helsinki, Espoo, Turku and in Vaasa. Tove Jansson is now the best known Finnish author internationally[55]. The Swedish

[48] Ibidem, Chapter 9, Section 58.
[49] Ibidem.
[50] Ibidem, Section 59.
[51] See comment of David Rennie: Tiny island that's ready to stop Europe in its tracks, British Telegraph, World Wide Web URL http://www.telegraph.co.uk/news/main.jhtml?xml=/news/2006/02/15/waland15.xml&sSheet=/news/2006/02/15/ixnewstop.html/.
[52] Åland in Brief, World Wide Web URL http://www.Åland.ax/Ålandinbrief/Åland%20_i_varlden.htm/.
[53] See Åland in Brief, World Wide Web URL http://www.Åland.ax/Ålandinbrief/kultur_idrott.htm/.
[54] World Wide Web URL http://Scandinavica.com/culture/language/finswede.htm/.
[55] Ibidem.

Assembly of Finland, or "Folktinget", protects the interests of the Swedish-speaking Finns and is a special forum for political discussion[56].

Since the education is solely within the autonomy of Åland, teaching is carried out in Swedesih language as stipulated by the Act on the Autonomy of Åland. English is obligatory, while Finnish, French and German are optional. Åland provides college/upper secondary-level education in shipping, commerce, tourism, medical care, domestic economy, technology and farming, all of which are important to the local economy[57]. Most local youths who go on to pursue university-level studies leave Åland for a while to attend a university in Sweden or Finland[58]. Today Åland also has its own college of higher education. University level education is provided in both Swedish and Finnish. Academic degrees may be taken in Swedish at Åbo Akademi University in Turku, Vaasa and Pietarsaari, at the Swedish School of Economics and Business in Helsinki and Vaasa, and at the Swedish School of Social Work and Local Administration[59].

Åland has a very active media There are two local newspapers, Tidningen Åland, which was founded in 1891, and Nya Åland, founded in 1981[60]. The number of daily newspapers for the Swedish minority is probably higher in Swedish-speaking Finland than for any other language minority in the world[61]. There are also two commercial radio channels and local cable television companies producing Swedish programmes Radio Vega and Radio Extrem[62]. There are numerous local stations with Swedish programmes from 15 minutes till 3 clocks per day[63].

In accordance to the Act on the Autonomy of Åland, the official language on Åland is Swedish[64]. Swedish language is used by the State administration, Island

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56 The Assembly participates in the law drafting process and issues statements on topics involving the Swedish-speaking population in Finland. Folktinget distributes brochures on linguistic rights, and disseminates information on Swedish culture in Finland. It regularly compiles statistical reports on the Swedish-speaking Finns. They actively work on promotion of positive attitudes towards bilingualism. Members of Åland´s parliament counts 5 members. It also works with a bringing information of minority to public. See Official Web Site World Wide Web URL http://folktinget.fi/om_folktinget.htm/.

57 Åland in Brief, World Wide Web URL http://www.Åland.ax/Ålandinbrief/utbildning.htm/.

58 Ibidem.

59 Eurolang, Language Data - Swedish (Finland), World Wide Web URL http://www.eurolang.net/index.php?option=com_content&task=view&id=92&Itemid=52&lang=en/.

60 Both newspapers are published five times a week. Åland in Brief, Worl Wide Web URL http://Åland.ax/Ålandinbrief/massmedia.htm/.

61 Scandinavica, Swedish language in Finland, World Wide Web URL http://www.scandinavica.com/culture/language/finswede.htm/.

62 Åland in Brief, World Wide Web URL http://www.Åland.ax/Ålandinbrief/massmedia.htm.

63 Scandinavica, World Wide Web URL http://www.scandinavica.com/culture/language/finswede.htm/.

64 Act on the Autonomy of Åland, Chapter 6, Section 36.

administration and municipal administration[65]. However, a citizen of Finland, in accordance with Act on the Autonomy of Åland, Chapter 6, Section 37, shall have the right to use Finnish before a court and with other State officials in Åland. Letters, documentation and other corresponedence between Åland officials and state officials will be carried out in Swedish language[66]. All teaching in schools is also done in Swedish except if it is not otherwise determined by the Act on the Autonomy of Åland[67]. It is interesting to point out that a graduate in any educational institution on Åland can be enrolled in the state educational institution (Swedish or bilingual) even if "he does not have the proficiency in Finnish required for admittance and graduation"[68].

Under old Swedish rule, many ethnic Finns changed their language and started speaking Swedish, but most of them reverted to Finnish in the late 1800s[69]. When in 1917 Finland declared itself independent, Finnish became the official language of the State. But in 1919 Constitution of Finland, Finnish and Swedish became the national languages of the Republic of Finland. Today, according to the Finnish Constitution (2000), Section 17 stipulates: "(1) The national languages of Finland are Finnish and Swedish. (2) The right of everyone to use his or her own language, either Finnish or Swedish, before courts of law and other authorities, and to receive official documents in that language, shall be guaranteed by an Act. The public authorities shall provide for the cultural and societal needs of the Finnish-speaking and Swedish-speaking populations of the country on an equal basis". Communes are classified as a bilingual or one linguistically what depends on proportion population which speak Swedish[70].

CONCLUSION

While process of solving problem about sovereignty of Åland Islands question aroused: was self-determination after Versailles Peace Conference (1919) became part of International Law or was it only a simple principle of politics. Discursively about status of Åland in front of the Legue of Nations we can say that for the first time in history was kept controversy about self-determination on international level at some international organization. Special status for Swedish minority on Åland was ensured by Finnish law as well as by the international organization.

65 Ibidem.
66 Ibidem, Section 38.
67 Ibidem, Section 40.
68 Ibidem, Section 41.
69 Peltonen, Arvo: The population in Finland, Ministry for Foreign Affairs, Helsinki, 2003, p. 4.
70 Communes are bilingual if there minority that speak Swedish counts at least 3000 people or 8 per cent. If commune was classify as a bilingual, the part that speak Swedish must go down under the 6 per cent to be classify as a one linguistically. Scandinavica, World Wide Web URL http://scandinavica.com/culture/language/finswede.htm/.

For any change about Island's legal status, acceptance is essential from Finnish and Åland´s Parliaments. Specific status manifests in a fact that Åland has even rights on representing on international level (for example in Nordic Council and in EU). Besides that, all international treaties that Finland ratifies and are in connections with Åland must be adopted by Åland´s Parliament. Swedish-speakers occupy a position of equalitiy within Finland, despite the fact that they constitute less than 10% of the population[71]. They "see themsleves not as a cultural minority but as co-founders of the Finnish state[72]. This leaves question, how much are other governments willing to respect International Law norms, treaties, customs and standards in human rights/minority rights protection and how much are they ready to show good will to solve problematic multiethnic relations on its territory.

In that way Åland´s minority is ensured to keep their language, culture, customs and identity. Their economy is strong, population live in prosperity. Åland is a peaceable region without violation and conflicts and enjoys all benefits of high level of democracy. This Island's region with developed economy and high life standard is an example for excellently solved question about status, rights and protection of minority in multiethnic society. Precisely here is an answer on question in what way can secession be prevented with respect for minority rights in multiethnic state. Finnish sovereignty in combination with autonomy of Swedish minority on Åland is good solution for both sides. Accordingly for Finnish sovereignty, Finnish authorities accepted readily international guarantees that all specific rights will be respected. Probably this model with solution for Swedish minority in Finland could be applied at least in some part in some other multiethnic societies in the rest of the World.

Although minorities are not subject of International Law, their influence on International Law and relations has been huge[73]. Quarrels and conflicts that arise from self-determination, frustrated and dissatisfied minority in multinational and multiethnic societies became one of the most important global questions of essential importance for international peace and security. States and international organizations can not find appropriate methods for dealing with questions, problems and conflicts associated with this issue of self-determination of peoples. Therefore it is a loss that states do not learn and accept the Finish model of solving minority issues. Naturally, we are aware that this model can not apply easily on some other countries, societies or systems, but some solutions can be applied certainly. Democratization of society is not easy process and it was built for

[71] Hannum: Autonomy, Sovereignty, and Self-determination, op. cit., p. 374.

[72] Antony Alcock: The Swedish Community in Finland, in Co-existence in some plurar European societies, London: Minority Rights Gruop Report No. 72, 1986, p. 10.

[73] See Vukas Budislav: States, Peoples and Minorities, RCADI, 1991, VI, Tome 231 de la collection, Martinus Nijhoff Publishers, The Hague/Boston/London, 1999, pp. 20-21.

many decades before it reached today's high level. Relations between Finns and Swedish minority, democratic high developed society, respect for international and internal legal norms, strong economy and peacefull climate serve for quality solution for minority rights.

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Are Investment Banks needed in Romania

Cristina Ioana Curutiu
Faculty of Economical Sciences and
Business Administration
Babes-Bolyai University
Cluj – Napoca, Romania
E-mail: ccrista2000@yahoo.com

Abstract

Are investment banks needed in Romania? In order to answer this question, the paper was structured in three parts, as following: the first one presents general information regarding investment banks, concentrating on their definition, the activities provided, their history, development and recent trends and their evolution on the Romanian market. The second part will discuss the issue of the Romanian brokerage companies, including the Romanian regulation governing those companies, the present situation and the services they offer; it includes, also, an analysis of Romanian market for brokerage companies and investment banks. Finally, the third part presents the research made and its results, drawing several conclusions.

Key words*: investment banks, brokerage companies, public offerings*

1. GENERAL INFORMATION REGARDING INVESTMENT BANKS

1.1. The definition of an investment bank

The term *investment banking* represents an individual or institution which acts as an underwriter or agent for corporations and municipalities issuing securities.

Investment banking involves raising money (capital) for companies and governments, usually by issuing **securities**. Securities or financial instruments include equity or ownership instruments such as **stocks** where investors own a share of the issuing concern and therefore are entitled to profits. They also include **debt** instruments such as **bonds**, where the issuing concern borrows money from investors and promises to repay it at a certain date with interest. Companies typically issue stock when they first go public through initial **public offerings**

(IPO's), and they may issue stock and bonds periodically to fund such enterprises as research, new product development, and expansion. Companies seeking to go public must register with the **Securities and Exchange Commission** and pay registration fees, which cover accountant and lawyer expenses for the preparation of registration statements. A registration statement describes a company's business and its plans for using the money raised, and it includes a company's **financial statements**. (Heil K., 1999)

Unlike traditional banks, *investment banks* do not accept deposits from and provide loans to individuals.

1.2. The investment banks activities

Borrowers prefer the services of the *investment banks* as the risk of not having all the required amount of capital raised may be transferred to the bank.

The main roles of the *investment banks* include **pricing, structuring** and **underwriting** of the bond issues as well as their **syndication** and **distribution** to investors. They also include **corporate financial advisory services** such as mergers, acquisitions, break-ups and leveraged transactions, **brokerage** and **secondary market trading** as well as **investment management**. (Milea C., 1999)

The *investment banks* also perform the following functions (Pop C, 2003): **the brokerage activity, the underwriting activity, the distribution activity and the advisory activity.**

Before stocks and bonds are issued, *investment banks* perform **due diligence** examinations, which entail carefully evaluating a company's worth in terms of money and equipment (assets) and debt (**liabilities).** This examination requires the full disclosure of a company's strengths and weaknesses.

Investment banks aid companies and governments in selling securities as well as investors in purchasing securities, managing investments, and trading securities. *Investment banks* take the form of brokers or agents who purchase and sell securities for their clients; dealers or principals who buy and sell securities for their personal interest in turning a profit; and broker-dealers who do both. (Heil K, 1999)

The primary service provided by *investment banks* is **underwriting,** which refers to guaranteeing a company a set price for the securities it plans to issue. If the securities fail to sell for the set price, the *investment banks* pay the company the difference. In addition, *investment banks* provide a plethora of other services including financial advising, acquisition advising, divestiture advising, buying and selling securities, interest-rate swapping, and debt-for-stock swapping.

When companies need to raise large amounts of capital, a group of *investment banks* often participate, which are referred to as syndicates. Syndicates are

hierarchically structured and the members of syndicates are grouped according to three functions: managing, underwriting, and selling. All major *investment banks* have a syndicate department, which concentrates on recruiting members for syndicates managed by their firms and responding to recruitments from other firms. (Heil K, 1999)

1.3. The history and development of an investment bank (Heil K, 1999)

Investment banking began in the United States around the middle of the 19th century. Prior to this period, auctioneers and merchants—particularly those of Europe—provided the majority of the financial services. The mid-1800s were marked by the country's greatest economic growth. To fund this growth, U.S. companies looked to Europe and U.S. banks became the intermediaries that secured capital from European investors for U.S. companies. Up until World War I, the United States was a debtor nation and U.S. *investment bankers* had to rely on European *investment bankers* and investors to share risk and underwrite U.S. securities. During this period, U.S. *investment banks* were linked to European banks. These connections included J.P. Morgan & Co. and George Peabody & Co. (based in London); Kidder, Peabody & Co. and Barling Brothers (based in London); and Kuhn, Loeb, & Co. and the Warburgs (based in Germany).

Beginning about the time World War I broke out, the United States became a creditor nation and the roles of Europe and the United States switched to some extent. Companies in other countries now turned to the United States for *investment banking*. Prior to World War 1, securities issues peaked at about $ 1 million, but afterwards issues of more than $20 million were frequent.

The **stock market** crashed on October 29, 1929, and commercial and *investment banks* lost $30 billion by mid-November. After exposing the corrupt practices of commercial and *investment banks*, the investigation led to the establishment of the Securities and Exchange Commission (SEC) as well as to the signing of the **Banking Act of 1933,** also known as the Glass-Steagall Act, which mandated the separation of commercial and *investment banking*.

The **Securities Act of 1933** and the **Securities Exchange Act of 1934** required *investment banks* to make full disclosures of securities offerings in investment prospectuses and charged the SEC with reviewing them. This legislation also required companies to regularly file financial statements in order to make known changes in their financial position.

1.4. Recent trends in investment banking

In the 1980s and 1990s, the *investment banking* industry continued to consolidate. As a result, a few *investment banks* with large amounts of capital dominated the industry and offered a wide array of services, earning the name "financial supermarkets."

Since the passage in 1933 of the Glass-Steagall Act, the U.S. banking industry has been closely regulated. This act requires the separation of commercial banking, investment banking, and insurance. In contrast to *investment banks*, commercial banks focus on taking deposits and lending. Consequently, *investment banks* and insurers support the latest round of activity to overturn the act. (Pop C., 2003)

The rapid expansion of the **Internet** in the mid-to-late 1990s provided an impetus for stockbrokers to begin offering trading services through the Internet. Because of the popularity of online trading, brokers began offering *investment banking* services.

Another trend in *investment banking* at the dawn of the 21st century has been the vertical integration of debt securitization. Previously, *investment banks* had assisted lenders in raising more lending funds and having the ability to offer longer term fixed interest rates by converting the lenders' outstanding loans into bonds. However, lenders have begun to securitize loans themselves. Because of this, and because of the fear that this will continue, many *investment banks* have focused on becoming lenders themselves, making loans with the goal of securitizing them. (Wikipedia, 2006)

1.5 The evolution of the Romanian market (Pop C., 2003)

From the point of view of the brokers, who operate on the capital market, on the capital market there are three different models. These models are the following ones: **the separation model, the universal bank model and the Anglo-Saxon model.**

From this three models mentioned above only two of them represent a major interest for this paper: the separation model and the Anglo-Saxon model.

The main idea of the separation model is that only the specialized societies, meaning the brokerage companies and the *investment banks* are authorized to mediate transactions. The Anglo-Saxon model requires the coexistence between the commercial bank and the financial investment companies**.**

On the Romanian market, the bank system evolution was influenced by the legislative and political system, regarding the bank management. In addition, between 1990 and 1995 the legislation regarding the Romanian National Bank supervision and bank's bankruptcy were added.

If on the Romanian market until 1998, the banking law was following the separation model, after this year when a new Banking Law (no. 58/1998) was adopted the model changed to an Anglo-Saxon one. This modification was followed by a stand-by period and this happened because no more methodological norms were issued. A step forward was made in 2002, when the legislation continued to sustain the Anglo-Saxon model.

Therefore, an *investment bank* won't find its niche on the Romanian market, and its place was taken by a Brokerage Company, and more precisely by a specialized Brokerage Company.

2. ROMANIAN BROKERAGE COMPANIES

2.1. The Romanian legislation regarding the brokerage companies (Law 297/2004)

According to the Law no. 297/ 2004 (chapter 3, article no.6), the brokerage companies, also called *S.S.I.F.,* represent legal entities, made up like a joint-stock company, which issue nominative shares. These companies are constituted according Act no. 31/1990, whose exclusive activities are those of financial investment services. Also the brokerages companies function only if the are authorized by the Romanian National Securities Commission (C.N.V.M.).

The regulation in which are presented all the activities that the SSIFs are allowed to do is the Law no. 297/2004. The main roles of these companies include the financial investment services. They also include:

1. main services:

a) the taking over and the remittance of the order received from the investors regarding one or more financial instruments;
b) the demands' execution regarding one or more financial instruments, otherwise than on its own;
c) the self trading of the financial instruments;
d) the administration of investor's portfolio, on a discrete base, but respecting the given mandate; these portfolios can include one or more financial instruments;
e) the financial instruments subscription according a firm engagement and/or the financial instrument placing;
f) investment consultancy;
g) the placing of the financial instrument, without a pre-arrangement;
h) the administration of an alternative trading system.

2. interfacing services:

a) the safety keep and the administration of financial instruments in their client's accounts, including custodies and the services like funds and undertakings administration.
b) the number of credits and loans given to investors, in order for this one to afford the possibility of trading with one or more financial instruments, but only if the brokerage company is involved in the trade;

c) the consultancy given to the entity regarding the capital structure, the strategy and the interfacing aspects, but also consultancy and services regarding the mergers and the acquisitions of those entities;
d) the trade exchange services regarding the registered investment services;
e) the consultancy regarding the financial instruments, and by this activity one must understand research for investment and financial analyses or any other type of general recommendation regarding the financial instruments trading;
f) services connected to the financial instruments subscription, based on a pre-arrangement.

Other information regarding the SSIFs are referring to: the organizational demands, the starting capital, the financial investment services, the operational demands, the financial instruments, the costs and other associated tariffs.

2.2. Investment banking in Romania – the present situation

Until now, in Romania, the *investment banking* activity was explored by the foreign banks which came for commercial banking. These types of banks are: Raiffeisen, ING or CAIB (this is a member of the HVB group, which was undertaken by Unicredito). Niels Schnecker, the senior manager at Schnecker van Wyk & Pearson, is a little more radical and he affirms that "in Romania does not exist *investment banking*". (Ancutescu I., 2006)

For example (Vranceanu C., 2006), in an interview for Wall Street, Bogdan Baltazar, the one who tried to develop the concept of *investment banking* inside the Romanian Development Bank, says that Romania is not ready yet for an *investment bank,* but it will be necessary for this country to develop also this sector. He also considers that this thing will register progress only with help from the foreign companies, like Goldman Sachs or Merrill Lynch.

From 1994, on the Romanian market appeared no *investment banking* houses, exception making the banking institutions. At the beginning of the year 2006, the first "backlighting" was registered. Together with two other partners, Doru Lionachescu – ex-banker at Bancpost, Citibank and ING, created the Capital Partners Company, which was considered the first *investment banking* house. This company represents a link between the client and the bank, or between the client and others investors (private investors, for example). (Vranceanu C., 2007)

Another possibility of developing an *investment bank* regards the conversion of a company into an *investment bank.* The mentioned company could be a brokerage one, just like SSIF Broker.

2.3. The Romanian market analysis

In this part, it will be presented the evolution of the number of companies and of the public offers registered during 1997-2006, both on the shares market and the bonds market.

2.3.1. The evolution of the brokerage companies

The Romanian National Securities Society Association was constituted on January 1995, with 25 founding members, as professional associations, which purpose was to represent the brokerage company's interests, to raise the company's professional standards, to promote the capital's market general interest and to help of the company's institutions development.

The evolution of the number of companies is shown in table no. 1.

Table no.1

Year	The number of companies
1995	25
1996	85
1997	168
1998	202
1999	167
2000	136
2001	105
2002	75
2003	72
2004	65
2005	71

Source: www.cnvmr.ro

The important number of brokerage companies between 1997 and 2001 is due to the privatization process and to the large number of shares that could be traded. Unfortunately the trading of shares resulted from the privatization process were situated, during that period, at the legality limit, thing that lead to a negative perception of the Romanian capital market.

2.3.2. The evolution of public offers on the shares market

In the table below (table no. 2) it will be presented the public offers value, and the number of days on which were traded shares on Bucharest Stock Exchange.

Table no. 2

Year	Number of days on which were traded shares	Value (million RON)
1997	43	9,63
1998	69	18,20
1999	23	28,85
2000	17	13,10
2001	8	43,81
2002	6	82,16
2003	11	177,36
2004	5	15,58
2005	2	62,44
2006	2	259,83
Total	-	710,95

Source: www.bvb.ro

It can be observed that in 1998 were registered the far greater number of days in which public offers were traded. This year is also the one in which the number of companies registered was the greater. The most important value can be observed in 2006, because of the two following companies which registered a large number of trades and a large number of shares issued:

- Sicomed Bucharest – a number of 99.771.169 shares and 58 trades registered;
- Romanian Power Grid Company – a number of 7.329.787 shares and 4.860 trades registered.

Along with the research made for the brokerage companies, another one regarding the number of public offers on the shares market was registered. The result is the following one (table no. 3):

Table no. 3

	Value (million RON)	Percent (%)
First Category	18259,95	79,35
Specifications	94,57	0,41
Public offers	710,95	3,09
Second Category	3944,21	17,15
Total	23009,68	100%

Source: www.bvb.ro

2.3.3. The evolution of public offers on the bonds market

Unlike the shares market, on the bonds market the first public offers were registered in 2003. In order to present the value of the public offers and the number of days on which these were traded, it will be observed separately the corporate bonds, the municipal bonds and the international ones. This information is presented in table no. 4.

Table no. 4

	Municipal bonds		Corporate bonds		International bonds	
	Number of days	Value (million RON)	Number of days	Value (million RON)	Number of days	Value (million RON)
2003	2	15,80	-	-	-	-
2004	2	7,5	2	229	-	-
2005	1	20	-	-	-	-
2006	0	-	2	279,63	1	526,57
Total	-	43,30	-	508,63		526,57

Source: www.bvb.ro

It can be noticed the fact that the number of days in which were registered trades with public offers is relatively low, and also exist years in which there were registered no trades. Even so the values are relatively high and the greater value registered could be observed on the international bond's market. It was issued by the International Bank for Reconstruction and Development, with a number of 525.000 bonds and 38 trades registered. For the other bonds the maximal values were due to:

- the public offer made by Timisoara city with a number of 200.000 bonds and 61 trades – for the municipal bonds;
- the public offer made by Romanian Commercial Bank with a number of 2.428.278 bonds and a number of 170 trades – for the corporate bonds;

Another research made on the bonds market was regarding the percent owned by the public offers in the bonds total amount (table no. 5).

Table no. 5

	Value (million RON)	Percent (%)
Shares	21654,53	93,79
Municipal bonds	17,15	0,07
Public offers	1078,50	4,67
Corporate bonds	246,67	1,06
International bonds	88,95	0,38
Rights	3,41	0,01
Total	23089,21	100%

Source: www.bvb.ro

4. CONCLUSIONS

According to the research made, but also to its results, it can be observed both a decrease of the number of brokerage companies and of the number of public offers. The decrease of the last ones was progressive, so that on the shares market in 2006 were registered only two issues, and their number on the bonds market were about the same.

Also, the percents of the public offers were very small (3.09% for the shares and 4.67% for the bonds) and unimportant for the development of a company based on *investment banking*.

Nevertheless, on a local plan, the *investment banking* activity was explored by the foreign banks which came in Romanian for commercial banking. Niels Schnecker, the senior manager at Schnecker van Wyk & Pearson, is a little more radical and he affirms that "in Romania does not exist *investment banking*".

One of the motives for this could be because of the fact that the market is small and not attractive for this sector. In addition, on the Romanian market does not exist either a specified brokerage company.

In conclusion, the *investment banks* will appear on the Romanian market, only when in Romania will came important financial foreign groups, for which the *investment banking* activity doesn't necessarily represent their basic activity.

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Institutional Economics Of Co–Operation And The Political Economy Of Trust

José G. Vargas-Hernández, Ph.D.
Instituto Tecnológico de Cd. Guzmán
Cd. Guzmán, Jalisco, México
E-mail: jvargas2006@gmail.com

Yukie Rochín-Angulo
Vinculación Universitaria
Cd. Guzmán, Jalisco, México
E-mail: vinvulacionuniversitariauniver@gmail.com

Abstract

The aim of this paper is to analyze the institutional economics of co-operation and the political economy of trust. It is reviewed the transactions costs, the principal – agent theory, market power, increasing-returns theory and value creation, strategic management: competitive forces, resource-based theory, organizational knowledge and learning, strategic choice theory and the collective efficiency theory. Finally, it is explained the political economy of trust.

Key words: *Co-operation, institutional economics, political economy, trust.*

INTRODUCTION

In recent years, a great amount of scholarly attention has been devoted to the political, social, and economic consequences of cooperation. A new instrument for value production in the global economy is the cooperative mode of organization characterized as interdependent, long-term relations among autonomous organizations.

Productive and creative cooperation considered as a potential incentive-related coordination in many spheres and activities among governments and their agencies, firms of the industrial and commercial sectors, cooperation and conflict between firms, between workers and management, and between firms and functions must contribute to a major economic project.

1. INSTITUTIONAL ECONOMICS OF CO-OPERATION

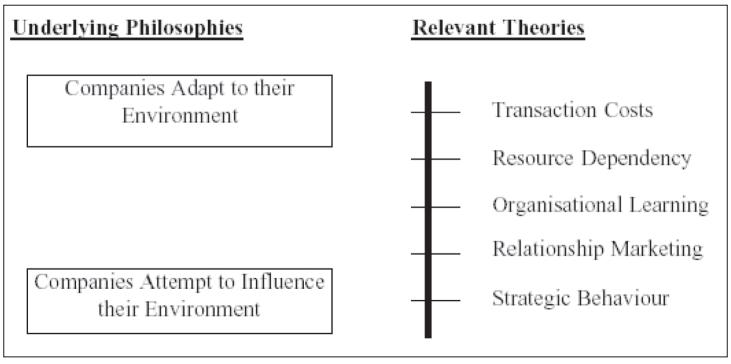
Institutions have an important influence on individuals' expectations of the future, locking in the system to a stable long-run structure. Cooperative structures can emerge as an 'institution' defined as an observed regularity in the behavior and/or actions of individuals or groups when they encounter a similar set of circumstances. (Witt, 1987, p. 87). Social institutions are sets of rules that structure social interactions in particular ways. These rules provide information about how people are expected to act in particular situations, can be recognized by those who are members of the relevant group as the rules to which others conform in these situations, and structure the strategic choices of actors in such a way as to produce equilibrium outcomes. (Knight, 1968:54)

The self-organizational perspective sustains that institutionalisation of competitive or cooperative behaviors results from micro-macro interactions more than coordination costs and asset specificity. The new organizational economics explains theoretically the different modes of vertical relations between firms, suppliers and customers.

Trust may be sustained by appropriate institutions.(Levi, 1998: 77-101; Hardin, forthcoming). An institutional account of trust is done by Farrell and Knight, (2004). Institutions may exert an independent effect on trustworthiness. The evolution of institutions may be expected to have an impact on trustworthiness, and cooperation among individuals.

Transaction costs, the principal-agent theory, market power, increasing returns theory, strategic management (competitive forces, RBV, organizational knowledge and learning), strategy choice theory and resource dependency theory, offer complementary explanations of cooperative arrangements. Transaction cost theory focuses on cost minimization; relationship marketing on providing superior customer value; organizational learning on knowledge; and strategic behavior theory on profit maximization, and resource dependency theory on obtaining resources.

Figure 1. Positioning the underlying philosophies and theories relevant to strategic alliance formation



Source: Hynes, Niki and Mollenkopf, Diane A., 1998.

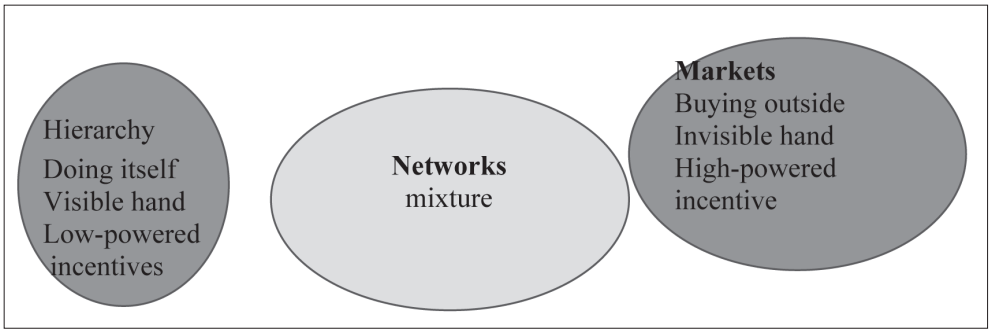
a. Transaction costs

Transaction cost theory rests on the assumption that markets are most efficient for minimizing transaction costs. Transactions are defined as the goods or services being transferred across some boundary. (Williamson, 1981). Transaction costs include the planning, monitoring and adapting of transfers under the various governance structure choices available (Mosakowski, 1991).

Firms internalize transaction costs through ownrship when exceed the benefits of non ownership (Williamson, 1991). Transaction costs deals with environmental factors: Asset specificity, technological uncertainty and small numbers bargaining, which may lead to more control and to provide incentives to look for other arrangements such as.quasihierarchies or vertical integration to internalize the transaction (Hennart, 1988; Osborn & Baughn, 1990; Pisano, 1990; Williamson, 1987). There is a positive correlation between level of integration and degree of control.

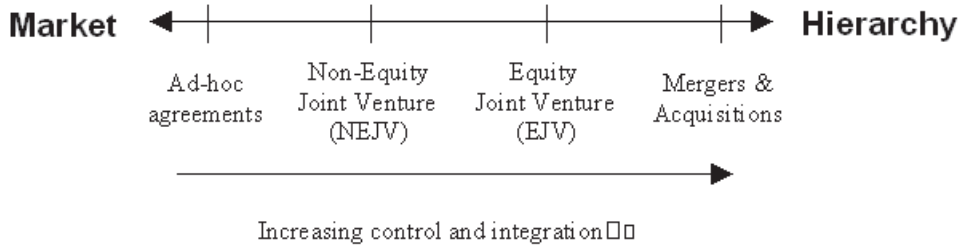
Transaction costs economics explains the economic rationale behind the choice of different modes of cooperation or transaction coordination mechanisms. The three basic mechanisms are markets, hierarchies or firms and hybrid modes, including interfirm cooperation agreements. The minimization of transaction costs is the basic principle in selecting institutional forms for different kinds of activities.

Figure 2. Modes of cooperation or transaction coordination mechanisms



A strategic integration continuum (Sparling and Cook, 1999) of organizational forms ranging from market through network to vertically integrated firms (Williamson, 1985; Powell & DiMaggio, 1991) is shown below

Figure 3. Strategic Integration Continuum



The task of transaction cost economics is to give theoretical support to make decisions on vertical integration, cooperation or collaboration, use the market or a combination of them. Each one can be efficient, depending on the expected amount of transaction costs involved. Hennart (1988) has identified a competition/cooperation tension from the transaction cost perspective. When assets are highly specific, transaction theory predicts instability of alliances, while resource-based theory predicts that an alliance can be stable if the benefits are evenly divided between members.

Mutual trust reduces transactional costs of risky social interactions. (Coleman, 1990: 306-310) "Norms such as those that under gird social trust evolve because they lower transaction costs and facilitate cooperation.". (Putnam, 1993:172). The social capital investments embodied in the construction of inter-firm learning by cooperating gives rise to economies of scales and scopes, although the effects may not be non-linear over time. Social capital benefits in the form of new relationships of trust and cooperation can extend a nonprofits limited resources. Cooperation becomes less attractive with the depletion of opportunities Transaction costs involves different forms of learning by interacting, such us technology transfer.

Transactions cost economists have examined the "temporal specificity" or the importance of timing in receipt of goods or services, which are related to coordination costs (Masten, Meehan, and Snyder, 1991). Cooperative agreements are combinations of internalization and market exchanges and the best one is when transaction costs are intermediate and not high enough to justify vertical integration

b. Principal –agent theory

Cooperation arrangements such us strategic alliance, involve principal-agent-problems. Agency theory explains how to best organize relationships in which the principal determines the work, which the agent undertakes (Eisenhardt, 1985). Agency theory underpins the relationship between the principal and the agent.

Agency theory explains the economic rationality of voluntarily providing costly information to partners in cooperative situations (Fleisher 1991). The

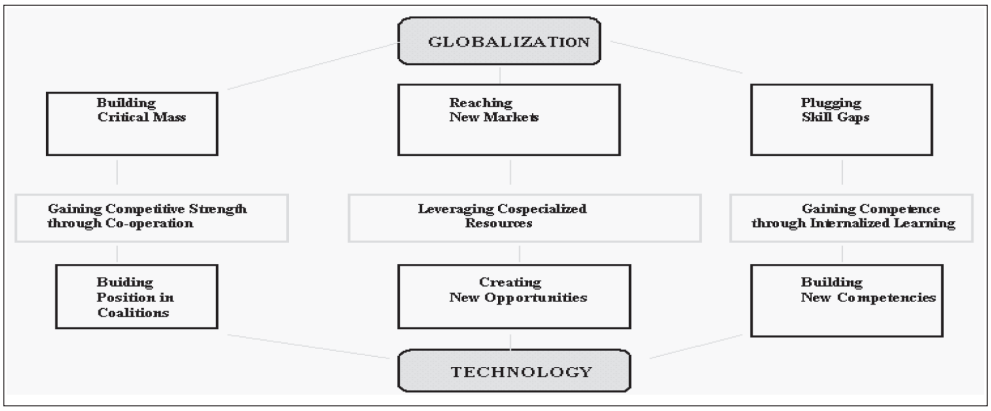
theory argues that under conditions of incomplete information and uncertainty, which characterize most business settings, two agency problems arise: adverse selection and moral hazard. Adverse selection is the condition under which the principal cannot ascertain if the agent accurately represents his ability to do the work for which he is being paid. Any cooperation agreement between legally independent entities often creates a moral hazard problem. Moral hazard is the condition under which the principal cannot be sure if the agent has put forth maximal effort (Eisenhardt, 1989).

c. Market power

A cooperative strategy may enable collaborating firms to increase their position within market.

d. Increasing-returns theory and value creation

Figure 4. The logic of alliance value creation



Source: Doz and Hamel, 1998.

Figure 5. Some factors shaping a firm's claim on value created by its constellation.

Value-Added Perspective: What is the bargaining power of the firm within the group?
The firm controls scarce, valued, and well-protected assets
Competition among the firm's suppliers of complements
Lack of competition between the firm and its partners
Structural Perspective: What is the position of the firm within the network of allies?
Centrality of the firm's position
The firm occupies structural holes
The firm participates in multiple constellations.

Source: adapted from Gomes-Casseres (2003).

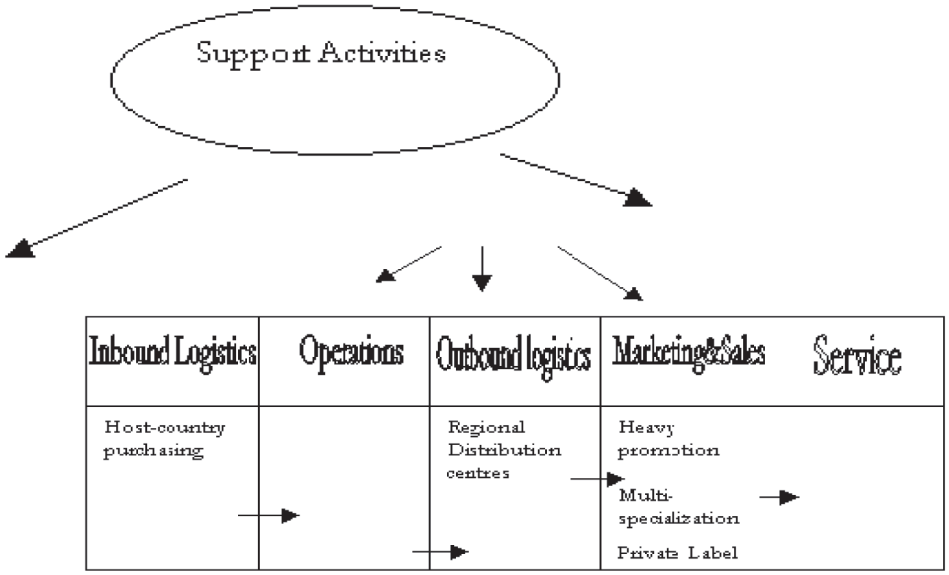
To sustain successful co-operation, partners need to learn in five key areas: the environment in which the alliance will operate, the tasks to be performed, the process of collaboration, the partners' skills, and their intended and emerging goals. Thus, the strategic, operational and economic scope plays a very important role in the alliance management and value creation logics. (Molevicius, Algis)

Figure 6. The relationship of scope to value creation logic

Strategic Scope	Differences in strategic market scope and similarities in skill sets and required capabilities facilitate co-operation
Economic Scope	There must be careful separation of value creation performance from value appropriation costs
Operational Scope	Must provide enough of window for learning from other partner or from a joint learning ground

Source: Molevicius, Algis.

Figure 7. Value Chain Analysis Outline (Carefour)



Collaboration is bound to be difficult if partner fail to understand the goals of each other.. A joint effort at learning about the competitive, technological and market environment develop mutual trust, share understanding and reduces the risks

Figure 8. Value creation logic's and alliance management

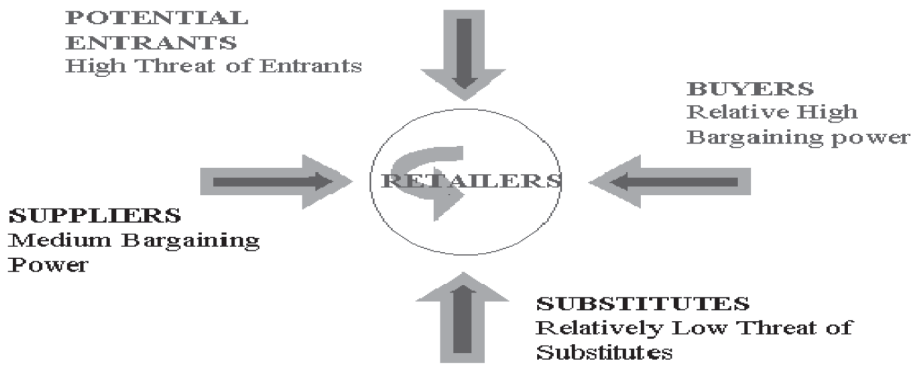
ELEMENTS OF VALUE CREATION LOGICS	LEARNING/INTERNALISATION
Assessing Contribution	• Recent skill leadership • Pace of skill improvement • Access to copractice of key skills
Agreeing on Alliance Scope	• Focus on operational scope as learning ground
Understanding Joint Task Demands	• Ability to copractice:" apprentice to master" relationship • Codiscovery and development of new skill
Defining and Measuring Process	• New or enhanced skills • Leveraging opportunities of using the skills
Keeping Time	• Learning cycle of the "apprentice partner(s)" with regard to the skills contributed by other partners, and renewal rate of the skills contributed to the alliance by each partner
Anticipating Points of Tension	• Symmetry and balance in learning • Potential versus actual learning • Competence replenishment versus competence transfer

Source: Molevicius, Algis

e. Strategic management: competitive forces, resource-based theory, organizational knowledge and learning.

Competitive forces intend to maximize profits through improving a firm's competitive position against rivals.

Figure 9. Five Forces Analysis (Porter, 1979)



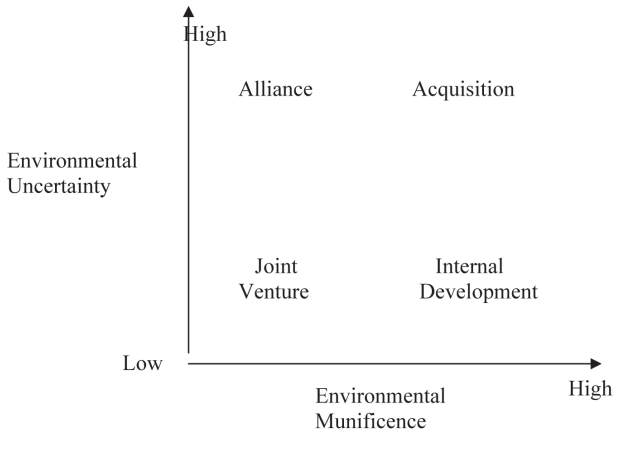
A few authors have shown the way forward in the search for a theory of regulation of interfirm cooperation. The emergence of resource-based approaches to strategy has provided broader bases upon which to build a theory of inter firm cooperation. Resource-based view (RBV) seeks to bridge the gap between theories of internal organizational capabilities and external competitive strategy theories.

The RBV suggests that differences in firms' performance are related to the variances in firms' resources. Firms are bundles of resources and that inter firm relationships provide access to obtain or retain resources and enable exploitation of learning capabilities that will allow reduce risks to enter into new competence areas. Performance risk is attributable to the alliance's interaction with its environment. The RBV suggests that a company with strong internal capabilities can enjoy an enduring competitive advantage and achieve superior performance (Dierickx & Cool, 1989).

Resource dependency theory (Pfeffer & Salancik, 1978) suggests that in order to survive, organizations must constantly interact with its environment either to exchange resources and its products. Organizations seek to gain control over the uncertainty of their external environment through cooperative arrangements to guarantee stable flows of resources (Pfeffer & Salancik, 1978; Galaskiewicz, 1985; Miner, Amburgey & Stearns, 1990; Stearns, Hoffman & Heide, 1987). Complexity and dynamism are closely related to environment uncertainty

Dess and Beard (1984) identified three dimensions of task environments: munificence, complexity, and dynamism. Since complexity and dynamism are usually thought of as determinants of environmental uncertainty (Thompson, 1967). Co-operation is seen as a mechanism to understand and cope with uncertainty (Spekman et al., 1998). Environment can be conceptualized by two categories: uncertainty and munificence (Beydoun, Abdul and Yang, Haibin, 2003.

Figure 10. A Conceptual Framework of Resource Development and Environment



Source: Beydoun, Abdul and Yang, Haibin (2003).

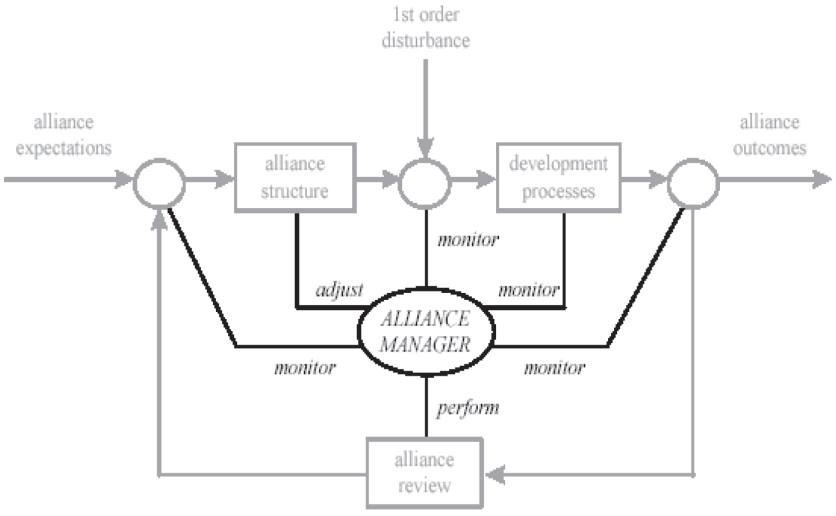
Organizational knowledge and learning explains that tacit knowledge can be transferred under cooperative strategies. The transfer of know-how, product of complex organizational routines can be severely impaired unless the organization is itself replicated (Kogut 1988, 323).

The management of a portfolio of multiple cooperative agreements raises new questions about the cooperative capabilities of firms. In managing a portfolio of alliances, there may be systematic differences in the cooperative capabilities that firms build up. Having more experience and learning with alliances may affect the relative success of those firms with alliances (Lyles, 1988).

Research has 'neglected concepts/measures that focus on alliance management' (Spekman et al.1998) as an explanatory variable for alliance success. Challenges of increasing complexity and conflicting objectives from different alliance partners confronts the management experience of a firm who seeks out ties with partners who could help them manage such strategic interdependencies. Firms have to focus on a series of organizational and strategic issues when is at the center of an alliance network. "Networks can be thought of as a higher stage of alliances, for in the strategic center there is a conscious desire to influence and shape the strategies of the partners, and to obtain from partners ideas and influences in return" (Lorenzoni and Baden-Fuller, 1995: 157). The critical dimensions of a center are to create value for its partners, to act as a leader, rule setter and capability builder, to structure and set up the network strategy.

Callahan,(1999)outlines the components of the role of the alliance manager in the first order control model.

Figure 11. The role of the alliance manager



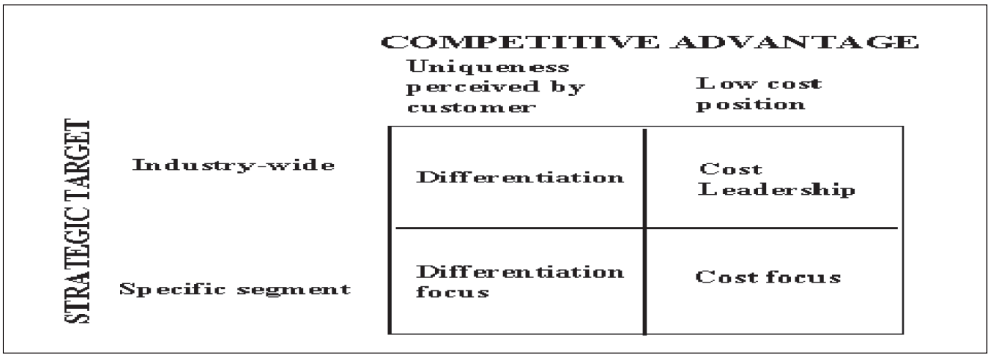
Source: Callahan,1999.

f. Strategy choice theory

Strategic choice theory support alliances as complementary to the new core competence allowing organizations for a strategy of choice for a governance structure to capitalize on functional expertise and contract for other needed functions (Fagre & Wells, 1982; Kogut, 1988; Porter, 1980). Specifying performance and control is required and taking into consideration flexibility of non-equity contractual arrangements in such a way that the closer the alliance is to the strategy of the new venture, the more likely that it would choose an equity structure.

McGee, Dowling and Megginson (1994) support the strategic choice theory by finding a relationship between business strategy and use of alliances. Strategy for cooperative arrangements between firms is an important variable in the effectiveness of a strategic alliance. The use of cooperative arrangements is growing and have a positive impact on firm performance when the alliance was chosen in a functional area that the firm's management team had prior experience (McGee, Dowling, & Megginson, 1995; Wisnieski & Dowling, (1997). Organizations have to choose the right cooperative strategy to realize their objectives through cooperation with other organizations rather than in competition with them (Child and Faulkner, 1998).

Figure 12. Strategic target and competitive advantage



Source: www.quickmba.com/strategy/generic.shtml

g. Collective efficiency

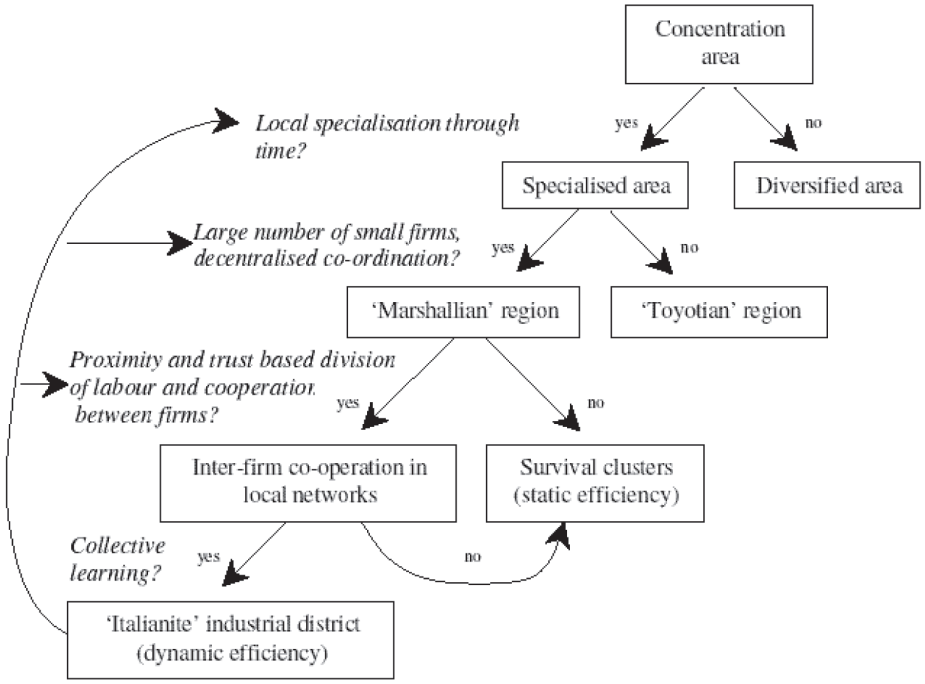
Collective efficiency has two aspects to it: external economies (the passive dimension) that clustered agents accrue by virtue of their location, and joint action (the active dimension) benefits that arise from deliberate and active cooperation between local agents to obtain external gains. For example, under the allocate efficiency principle, some allied nations cooperate to integrate collectives of highly mobile peacekeeping forces to maintain security with diminished resources

A cluster is a concentrated grouping together of firms and institutions, which have horizontal and vertical relationships, and linkages based on cooperation to achieve synergy. Marshall used the term "constructive cooperation" to describe the economies of scale and scope gained from cooperation.

Partnerships must be inclusive and involve the active participation of many members, which involve a balancing of the power differentials that exist within the partnership (Sampson et al, 1989, p.491). Regard therefore has to be given to group dynamics, to the symbolic importance of including and excluding particular interests and individuals and to showing proper respect for the joint activity and all the partners involved in it, e.g. by avoiding an 'inner core' of the 'senior' parties. (Webb, 1991, p.239).

In horizontal partnerships firms endowed with specific skills, typically compete in the market, linked with another company of complementary core competencies, cooperate in product development, basic research, cross-transfer of new technologies and manufacturing capabilities. Horizontal partnerships enable firms to serve new markets, sharing risks and learning.

Figure 13. Regional cluster prototypes



Source: Capello 1999; Visser and Boschma, 2002.

However, there are some 'externalities of joint action'» (Nadvi, 1999) such as the reputation basis created by local standard regulation. An example of environmental externality occurs when cooperation between firms in one line of activity affects other lines of activity, such as the case when R&D affects pricing.

Collective efficiency involves social and technological innovation. Social innovation transforms a non-cooperative behavior into a cooperative minded setting increases the propensity to cooperate in technological innovation.

Minimizing transaction costs and reducing principal-agent problems can be achieved through arrangements of relational contracting and long-term networks based on mutual trust. Cooperative behavior is further enhanced by direct communication between actors and agents and stabilized through the mechanisms of rules and trust, which can overcome opportunistic behaviors and rivalry.

2. THE POLITICAL ECONOMY OF TRUST

Farrell and Knight (2004: 8) define trust as "a set of expectations held by one party that another party or parties will behave in an appropriate manner with regard to a specific issue.

Promoting trust and cooperation between firms, institutions and local government can achieve economic gains. "What is needed is sufficient trust to initiate cooperation and a sufficiently successful outcome to reinforce trusting attitudes and underpin more substantial, and risky, collaborative behavior . . . . Virtuous spirals of trust and effective collaboration need to be established." (Webb, 1991, p.237).

Harmonious relationships between firms, communities and government are built upon trust and mutuality "Social trust in complex modern settings can arise from two related sources - norms of reciprocity and networks of civic engagement." (Putnam 2003; 171). Reciprocity characteristics of networks enhances cooperation because: (1) it increases the costs of defection, (2) it fosters robust norms of reciprocity, (3) it facilitates communication and improve information flows, and (4) it embodies past success at collaboration and provides a blueprint for future cooperation.(Putnam, 2003: 172). Empirical studies on the evolution of cooperative network relationships that focus on the inter-organizational relationships (Human and Provan, 2000).

Economic cooperation is impacted by trust. Trust is a key element and decisive factor in the cooperation relationship, which allows real commitment and confidence among the partners to develop a vision for the long run. A seriously flawed cooperative working relationship will doom any agreement to failure, although a flawed written

agreement can always be modified.. Interdependent decisions to cooperate are influenced by the degree of cooperation already present in the organizations and may lead to an equilibrium in which cooperative alliances prevail.

In the more socialized version of trust, it has been observed that norms of fairness may enter into transactions between parties and firms. Often in relational contracting, norms of conflict resolution within the relation develop (Macneil, 1978). Trust is an interdependent action of social cooperation for mutual benefit. (Coleman, 1990: 306-310)

Rational choice theory explains that trust is a factor in social interactions characterized by risk, as Coleman (1990: 91) has put it "They are situations in which the risk one takes depends on the performance of the other actor." There is a positive relationship between trust and social capital, on the one hand, and political and economic success. researchers attempt to document the various ways in which trust and social capital can improve the performance of political and economic systems. Putnam (1993, 2000) pretends to demonstrate that the political and economic success of large social communities is linked to generalized trust and cooperation, through.

Luhmann (2000) distinguishes between person- and system-trust according to the recipient of trust. Person-trust is aimed at individuals and system-trust refers to the trust in abstract systems of relationships (Krause 1996) such as organizations. Thus, trust can exist towards the representative and at the same time towards the partner organization.

Rational choice theory of institutions explains why individual actors come to trust each other and provides explanation of the forms of cooperation and to understand the differences in cooperation. The encapsulated interest account of trust combined with institutional theory provides the basis for comparative analysis of trust in explaining cooperation. (Farell, 2000). The "encapsulated interest" account of trust specifies the relationship between institutions and trust predicated as trustworthiness in a three party relationship (Hardin, forthcoming) which goes personal and their own self interest among the involved

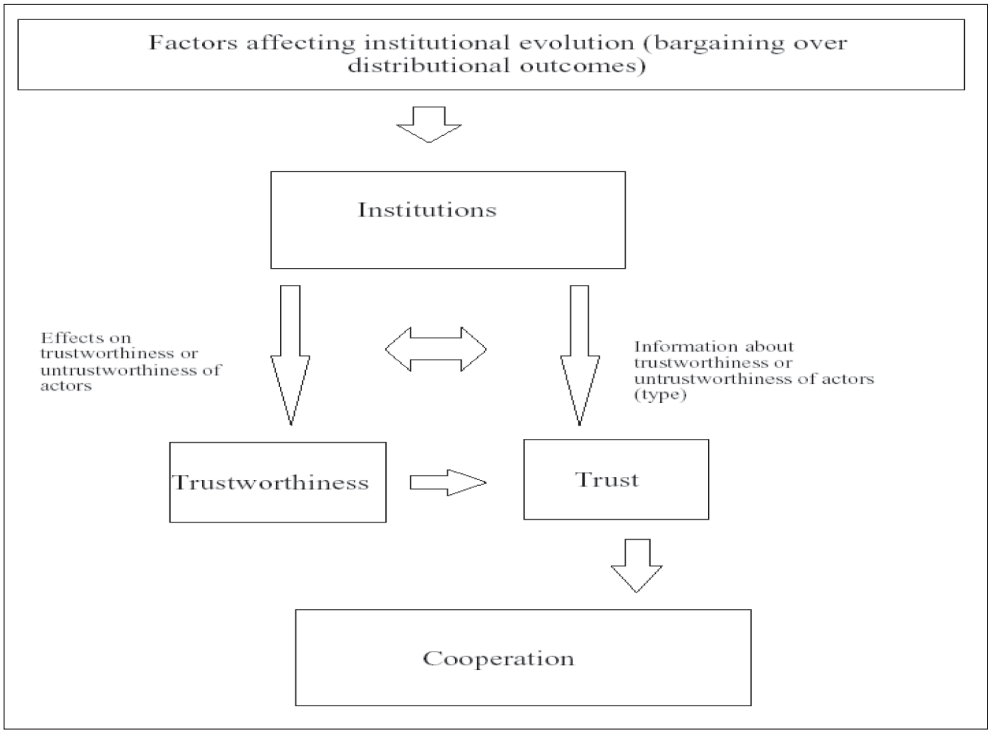
Farrell and Knight specify this relationship between trust and social institutions, in a middle ground between Hardin (Forthcoming) and the broader conception of social trust (Putnam, 1993). On the account of Farrell and Knight (2004: 8) "the existence of institutions in common social settings can affect the trustworthiness of the actors in those situations in such a way as to create ongoing relationships of trust among those actors." The authors suggest a model of the relationship between institutions and trust among actors. Insofar as institutions give actors an incentive to behave in a trustworthy or untrustworthy manner and/or affect

social beliefs about the trustworthiness or untrustworthiness of actors thorough their dissemination of information about the expected behavior of others.

Trust and trustworthiness become relevant when the social cooperation cannot be reduced to simple institutional compliance Cooperation inherent in institutional compliance is different that cooperation through the use of the concepts of trust and trustworthiness. Thus, in any relationship among institutions, trust and social cooperation are relevant. "Cooperation through compliance with institutional rules in particular social settings affects an actor's beliefs about the propensity of others to cooperate (their level of trustworthiness) in similar settings which affects that actor's willingness to cooperate at some subsequent point in time in that same social setting." (Farrell and Knight, 2004: 10-11). Changes in trustworthiness and in trust between actors lead to changes in the extent and form of cooperation. The model the authors set out specifies a set of causal relationships, which may plausibly affect trust and cooperation between actors (Farrell and Knight, 2004: 15).

The model of trust, trustworthiness and cooperation appears "to provide a good account both of cooperation between actors, and the evolution of this cooperation over time, in relations between economic actors" (Farrell and Knight, 2004:38).

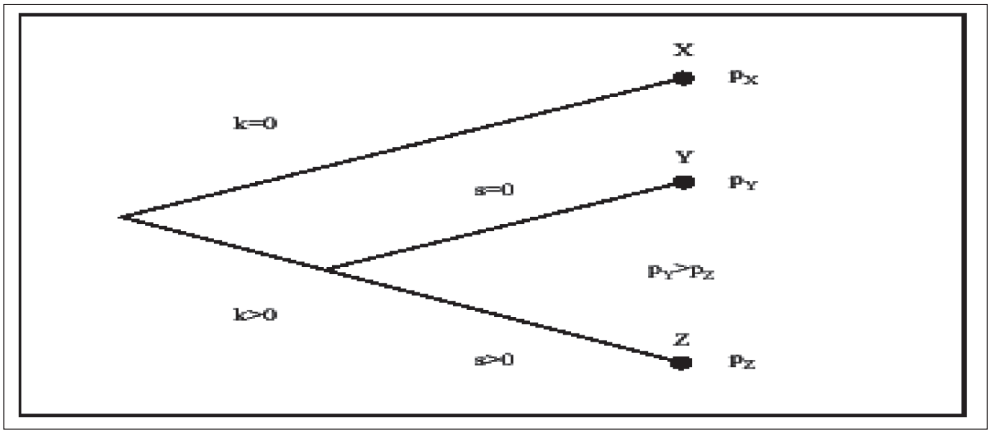
Figure 14. Model of trust, trustworthiness and cooperation



Source: Farrell and Knight (2004).

Trust and confidence in the partner can rise unrealistically during the partner search and selection stages only to drop as difficulties arise (Doz,1996) A simple contracting scheme in order to differentiate transactions and corresponding governance structures can be shown

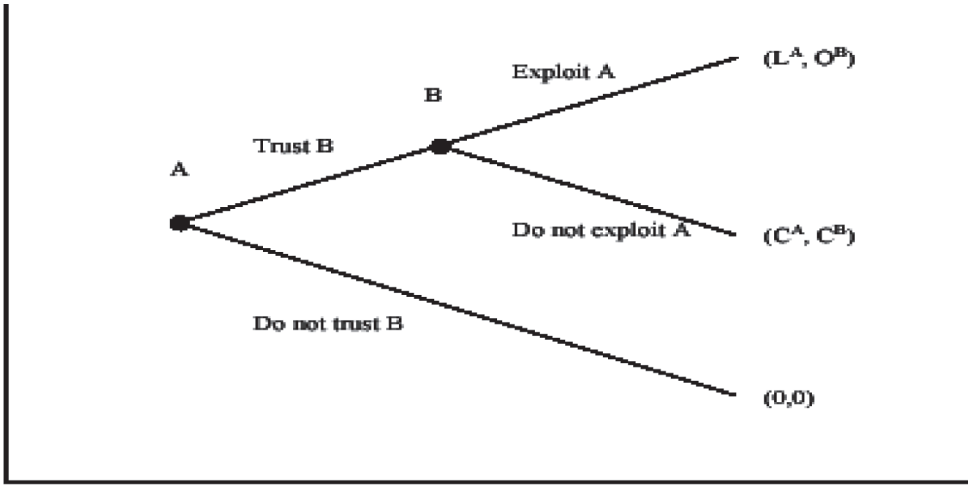
Figure 15. Classification of transaction types by using Williamson's contracting scheme



Source: Hirsch and Meyer ().

Hirsch and Meyer explain the scheme in the following terms: Good or a service can be supplied either (1) by a general-purpose technology or (2) by a special purpose technology. The latter has the advantage that it is more efficient for servicing steady-state demands (e.g. for a cooperation partner), but it requires greater investments in transaction specific durable assets. The variable k is used to measure the extent of transaction-specific assets. An investment in the general-purpose technology can be described by k=0 and respectively k>0 when there have been transaction-specific investments. According to Williamson (1989/1999: 62-63), classical market contracting suffices for the first kind, while for the latter type, unassisted market governance poses hazards. The question is whether individuals should trust each other. The authors call this the trust problem in co-operations. Game theory, and more specifically, the prisoner's dilemma models this kind of trust decisions as shown below

Figure 16. A stylized trust problem based on the one-sided prisoner's dilemma.



Source: (Hirsch and Meyer).

The trust engendered in the partner will result in behavior, which is of benefit to the firm in the alliance. The political economy of trust in clusters of small firms geographically concentrated relay on cooperation to prosper.

Power has distribution aspects (Knight 1992). Power affects cooperation based on trustworthiness as a relational concept. Any agreement puts in place relationships of power and prescribes roles of action for the partners. Relationships of partnerships include the distribution of power and may not be based on equality and equity. In the case of indigenous groups real partnership must involve equitable cooperation. Power over relevant decisions can be shared but not necessarily equal power. No always there is consensus on decisions and the degree of influence exerted by partners may not be equal. Thus, any asymmetries in power affect the trusting relationship of cooperation. There is a widespread perception of alliances as "weapons of power" instead of being "tools of management"(Schroeder, 1976).

Firms frequently exercise their power over other firms to solicit compliance. Schroeder (1976) argues that alliances work, to a certain extent, as pacta de contrahendo, constraining and controlling the actions of the allies. To achieve a genuine relationships based on trust it is necessary to establish an appropriate culture linked to reputation sanctions (Kreps, 1990) or to subject behaviors to external organizational forms or institutions which provide actors with a technology to limit abilities to use power (Levi, 1998). Cultural and legal backgrounds of partners give rise to communication and coordination information asymmetry.

Explaining the relationship between trust, distrust and power in subcontracting relations among firms, Farrell and Knight (forthcoming), Farrell (2001) and

Farrell (2004) have suggested that asymmetries of power are incompatible with trust up to a certain level, and even when trust and its outcomes are asymmetric, trust may be possible. Disparities of power prevent trust of arising and distrust is the likely outcome. Firms may prefer to exploit their power instead of nurturing complex relationships of cooperation (Helper, 1993).

The level of confidence required by a partner is not static. To increase the level of trust not necessarily lead to a reduction in control exerted by partners "the trust level and the control level jointly and independently contribute to the level of confidence in partner cooperation" (Das and Teng, 1998: 496). These authors negate any relationship between trust and control suggesting that both high level of control and trust are necessary in international joint ventures compared to other forms of inter organizational cooperation. In a joint venture, a new corporate entity is formed. Thus, trust and control seem to be independent, but other contingencies should be included in the analyses of the relationship between trust and control in different forms of inter organizational cooperation, such as the impact that cultural factors have on these variables.

As a means of both enhancing cooperative behavior and mitigating competitive conflicts, relational capital based on mutual trust and interaction at the individual level between alliance partners creates a basis for learning and know-how transfer across the exchange interfaces. (Kale, Singh and Perlmutter, 2000).

Canadian companies currently in Mexico concur and overwhelmingly view establishing trust as very important to doing business with Mexicans (Dennis and Beamish, 1993)

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Reinsurance necessity and forms of application

Bențe Corneliu
Lecturer
The Faculty of Economics
University of Oradea
Oradea, România
E-mail: corneliubente@yahoo.com

Andor Adrian
The Faculty of Economics
University of Oradea
Oradea, România
E-mail: andiadi@gmail.com

Abstract

Reinsurance is one of the major risk and capital management tools available to primary insurance companies.

Reinsurance is insurance for insurers. Insurers buy reinsurance for risks they cannot or do not wish to retain fully themselves. Reinsurers help the industry to provide protection for a wide range of risks including the largest and most complex risks covered by the insurance system. Insurers also benefit for the capital relief that the reinsurance provides and from the reinsurers' product development skills and risk expertise. As such, reinsurance is an indispensable part of the insurance system that makes insurance more secure and less expensive. This is ultimately for the benefit of policyholders who get more protection at a lower cost.

As with insurance, reinsurance is fundamentally a promise to pay possible future claims against a premium today. Reinsurers apply sophisticated risk management processes to ensure that this promise can be honoured. These processes – including risk monitoring and modeling – guarantee that the capital base and the risks assumed are aligned.

Reinsurance is, by its nature, a global business which deploys capital across geographic and boundaries lines of business. To work effectively, it requires a reliable legal system which is secure and honours the freedom of contract. In addition, reinsurance needs a regulatory framework, which gives reinsurers market access to provide their services, allows free movement of capital and relies on capital requirements which recognize reinsurers' broad diversification across lines of business and geographies and their superior risk management capabilities.

Key words: *premium, risk, claims, protection*

1. BENEFITS OF REINSURANCE

Reinsurance has important benefits for primary insurers. It provides:

] reduced volatility of underwriting results;

] capital relief and flexible financing;

] access to reinsurers' expertise and services, especially in the field of product development, pricing and underwriting, and claims management.

These benefits apply to both life and non-life insurance. However, due to the different focus, the importance of the different benefits varies for the respective sectors.

1.1. Non-life insurance: less volatile underwriting results and enlarged capacity

One of the foremost reasons for non-life insurers to buy reinsurance is to protect their capital base against large deviations from expected losses. This is most important in the event of major catastrophes.

Another important benefit of reinsurance is that it allows non-life insurers to accept more business with the same amount of capital: by buying reinsurance coverage, insurers transfer risks to the reinsurers and consequently do not need to allocate capital for these risks. The ability to assume more risks, at the same level of capital, means that primary insurers can spread their overheads – the cost of distribution networks, administration and claims handling – over a broader base of business and thereby benefit from economies of scale.

Reinsurers' also assist insurers' efforts to handle claims efficiently by bringing in their international and long-term experience. The involvement of reinsurers in claims handling can substantially contribute to mitigating and adjusting claims efficiently, to the benefit of insurers and policyholders.

1.2. Benefits for life insurers: accumulation control, expertise and business financing

Life insurers buy reinsurance to minimize the potentially negative impact of large risks: for example, life insurers often want to limit their exposure to high sums assured for individual risks or to avoid an accumulation of mortality risks, particularly in the case of the group cover schemes, which provide protection as part of many employee benefit packages throughout the world.

Life reinsurance arrangements are also frequently entered into in order to gain access to reinsurers' expertise on underwriting and claims management as well as pricing and product development.

Reinsurers typically operate on a global basis and therefore have a broad and deep understanding of markets and their products, as well as data from a wide range of the insured populations. This allows reinsurers to assist primary insurers

with superior underwriting tools, training for insurers' underwriters and other capabilities. The same applies to managing claims: guidelines on claims assessment and training are important benefits for insurers and ultimate for policy holders.

Reinsurers' broad expertise also help insurers to develop and price new products, for example to design products with more refined risk classes – smoker and non-smoker differentials are an example of this. This allows for innovation, while at the same time helping primary insurers to minimize possible risks arising from novel products.

As in non-life business, the transfer of risk and the ability to benefit from reinsurers' expertise allows life insurers to reduce their capital requirements and to use the freed –up capital to achieve other targets - for instance the expansion of business into new lines or geographical areas. Life insurance business places considerable demands on capital. Initial statutory reserves, solvency capital and commission can amount to several times the first year's premium, particularly in the case of protection business. Reinsurance can help to ease this capital strain.

Ultimately, insurance allows primary insurers to mange their risk and capital in the most efficient way, making insurance more secure and less expensive.

Reinsurance enhances the stability of the primary insurance industry as it allows insurers to protect their balance sheets against unexpected adverse losses, understand assumed risks better and ensure correct risk assessment and pricing. As a consequence, insurers' results become less volatile, reducing significantly the likelihood of a loss event depleting an insurer's capital.

Because reinsurance allows insurers to take advantage of economies of scale, insurers can use their capital more efficiently, allowing them to offer their policyholders the same level of security at a better price. In addition, without reinsurance, many large and complex risks would not be insurable.

The ultimate benefits of reinsurance are not confined to the single primary insurer or the policy holder. By enabling innovation and ensuring that risk is held in the most efficient way among the different players in the economy, reinsurance forms an integral part of the insurance industry's contribution to economic growth and social welfare.

2. THE CONCEPT OF RISK MANAGEMENT

When insurers cede part of their business to reinsurers, they reduce their underwriting risk. In exchange, they assume counterparty credit risk – which is the risk that the reinsurer cannot honour its financial obligations. For the insurer it is, therefore, crucial that its reinsurers are financially secure.

Reinsurers have implemented sophisticated risk management processes to ensure their ability to honour financial obligations. The overarching goal of risk management is to guarantee the long-term survival of the reinsurance company. The role of risk management is to identify, monitor and model the risks and their interdependencies and to ensure that risks are in line with what the company can bear[1]. To meet its tasks, close cooperation with the underwriting units, asset management and capital management is key.

3. UNDERWRITING – ASSESSMENT, CAPACITY ALLOCATION AND PRICING

Underwriting is the process of examining, classifying and pricing risks, for example a book of motor business, or a single risk that is submitted by the primary insurer for reinsurance, as well as concluding the contract for those risks which are accepted.

The main task of the underwriting process is to ensure that:

- ⇨ risks are assessed properly, and terms and conditions are adequate;
- ⇨ the limits of assigned capacity are respected;
- ⇨ there are controls for accumulation and peak risks;
- ⇨ pricing and wording are appropriate.

3.1. Risk assessment and terms and conditions

Risk assessment starts with assessing the data provided by the primary insurer and determining whether additional information about the characteristic of the insured objects or persons is required. In non-life reinsurance, risk assessment will consider information that helps to determine the risk of death or illness, such as age, gender, smoker status, medical and lifestyle factors.

Only risks which meet the general conditions of insurability can be (re)insured.

Terms and conditions under which the risks are insured have an important function in making risks insurable, as they limit the cover provided in such a way that the principles of insurability are met.

3.2. Capacity allocation, accumulation control and peak risks

Reinsurers only accept risks if these are in line with the capacity limit they have set. Capacity is the maximum amount of coverage that can be offered by a reinsurer over a given period. In the case of risks with a low accumulation potential, such as a portfolio of different fire policies, underwriters are generally

[1] Swiss Re : Additional research: '"Understanding reinsurance ", November , 2004, p.10

able to commit a defined amount of capacity for a certain line of product and client/county. Risks demanding more capacity are typically escalated for special approval by senior underwriters of risks committees.

Some risks – especially in the field of natural perils - have a greater accumulation potential. Accumulation arises from dependencies between individual risks. This can be the concentration of risks, eg houses or cars, which may by affected by the same loss event, eg a windstorm, or a concentration of shares in the same large risk, eg a pharmaceutical firm, through different reinsurance treaties, making the reinsurer more exposed to a single loss occurrence. In order to control these risks successfully, it is important that they be identified and dealt with the underwriting process. Capacity allocation is an important means to contain the exposure to accumulation risks: in a top-down process, capacity for a specific natural peril is allocated to specific markets and accumulation zones. Underwriting guidelines and clearing system – which show the total of cover provided for a single risk within the whole company - are further means of containing exposure to accumulation and peak risks.

3.3. Pricing and wording

The price has to be sufficient to cover the expected cost of acquiring the business, administering it and playing claims. Clearly the price must also provide the reinsurer with an appropriate return on the capital allocated to the risk. To arrive at a price, underwrites employ experience – and exposure – based models. Experience – based models use historical claims experience applied to the current situation. For such models to work, reliable and sufficient loss data are needed. Experience – based models are applied to price risks, eg fire risks – where a long history of incidents exists – or mortality risks were the pricing can be based on mortality tables and experience studies. When such data series are missing - for instance in the case of natural perils where perils are relatively rare – the correct price has to be determined by using exposure – based modeling. These models use scientific information and expert opinion. Claims experience is only used to check and calibrate the model.

When the primary insurer accepts the price and the terms and conditions offered by the reinsurer, a contract is drawn up between the two parties. This document often called a wording, describes the rights and duties of the contract parties, as well as the terms and conditions that accompany it. When agreement is reached, the risk is accepted in the reinsurers' portfolio.

4. ASSET MANAGEMENT

Reinsurers invest the premiums they receive for providing reinsurance cover in the capital markets, a task assumed by asset management. Asset management

is part of the risk management process as it delivers portfolio data to risk management and – as with underwriting – it has to respects limits and guidelines on where to invest. This is to ensure that assets are allocated in a way that matches the characteristics of the corresponding liabilities.

The coordinated management of booth sides of the balance sheet is known as asset and liability management (ALM). In the ALM process, information on liabilities must first step obtained. In doing so, quantifying currency exposure and payout patterns are of major importance. As a next step, the financial risk factors which affect liabilities have to be identified, assets which match the characteriscs of liabilities are chosen[2].

5. THE FINANCIAL STABILITY OF THE INSURANCE COMPANY

The gross premium is composed by the net premium and the supplement of premium.

The establishment of the net premium depends on:

- the annual average damages parameter (i);
- the quadratic average deviation(σ)- to estimate the dispersal of the annual parameters in comparison with the period average.

The establishment of the premiums tariffs it is done for each category of insured goods.

The manager of the insurance company is interested to know for each year of the following period:

- which is the level of damages that he must pay;
- the ratio between the damages and the net premium income for each category of goods;
- the probability that the damages are upper than the net premium income: $P_{(D>PnT).}$

In establishing the net premium there are interfering deviations - in comparison with the average of several years risks parameter – reverberated in the differences between the damages that should by paid in the present period and the damages recorded in the reference period it is using the quadratic average deviation(σ):

$$\sigma = S \cdot \sqrt{n \cdot q(1-q)} \quad (1)$$

S = the insured sum of a insured good;

n = the number of insurance goods;

q = the probability that a damage does take place;

1-q = the probability that a damage does not take place.

[2] Swiss Re : Additional research: '"Understanding reinsurance ", November , 2004, p.13

q at a good's level = = net premium ratio; (2)

q at all goods' level = = net premium ratio; (3)

Pn/b = net premium/good; $\frac{Pn/b}{S}$

Pn_T = total net premium. $\frac{Pn_T}{S_t} = \frac{Pn/b \cdot n}{S \cdot n}$

The range in which the damage can oscillate is [3]: (4)

The rate of financial stability offered by the size of K ratio:

$$D : [\, Pn_T - \sigma;\ Pn_T + \sigma] \tag{5}$$

So K is lesser so financial stability rate is bigger.

The probability that an insurance company is confronting with the situation in which the total damages surpass the total net premium income is equal to the probability that the total damages are lesser than the total net premium income: $K = \frac{\sigma}{Pn_T}$

$$Pn_T = \frac{K}{2}100 \tag{6}$$

The number of years hereupon interferes an unfavorable year (a) can be established according to the relation:

$$a = \frac{1}{P_{(D>PnT)}} \tag{7}$$

The improving of the financial stability rate can be done by[4]:

- the increase of the insured goods number ;
- the increase of the net premium rate;
- the ceding in reinsurance.

To know if it is impressive or no to cede in reinsurance must be calculated the maximum insured sum for each insured risk (X), which the insurer should keep to obtain an adequate financial stability rate:

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[3] Alexandru, Felicia, Armeanu D., *Asigurări de bunuri şi persoane: aspecte teoretice, aplicaţii practice*, Editura Economică, Bucureşti, 2003, p. 84

[4] Alexandru, Felicia, Armeanu D., *Asigurări de bunuri şi persoane: aspecte teoretice, aplicaţii practice*, Editura Economică, Bucureşti, 2003, p. 85

$$X = 2K^2 \cdot Pn_T \quad (8)$$

K = the average financial stability rate for all risks;

Pn_T = the net premium at the level of the insurance company.

Thus, supposing that an insurance - reinsurance company has insured 1000 goods (n) from a certain category, each of them being insured for the sum (S) of 100 $ The net premium rate practiced by the insurer (% Pn_0) is of 1%. Thus we can calculate the effect of increasing the net premium rate to 1,5% (% Pn_1) on the financial stability rate of the insurance company (%Δ_K):

We can notice that the increase of the net premium rate from 1% to 1,5 % caused an increase of the financial stability rate by 19,36%.

6. TYPES OF REINSURANCE

$$\%\Delta_K = I_K - 100;\ I_K = \frac{K_1}{K_0}100;$$

$$K_1 = \frac{\sigma_1}{Pn_{T1}} = \frac{S \cdot \sqrt{n \cdot q_1(1-q_1)}}{q_1 \cdot n \cdot S} = \frac{100 \cdot \sqrt{1000 \cdot 0{,}015(1-0{,}015)}}{0{,}015 \cdot 100 \cdot 1000} == \frac{384{,}38}{1500} = 0{,}25$$

$$K_0 = \frac{\sigma_0}{Pn_{T0}} = \frac{S \cdot \sqrt{n \cdot q_0(1-q_0)}}{q_0 \cdot n \cdot S} = \frac{100 \cdot \sqrt{1000 \cdot 0{,}01(1-0{,}01)}}{0{,}01 \cdot 100 \cdot 1000} == \frac{314{,}64}{1000} = 0{,}31$$

$$I_K = \frac{0{,}25}{0{,}31}100 = 80{,}64\%;\ \%\Delta_K = |80{,}64 - 100| = 19{,}36\%$$

6.1. Proportional reinsurance

Proportional reinsurance (mostly known as *quota share reinsurance*) involves one or more reinsurers taking a stated percent share of each policy that an insurer produces ("writes"). This means that the reinsurer will receive that stated percentage of each dollar of premiums and will pay that percentage of each dollar of losses. In addition, the reinsurer will allow a "ceding commission" to the insurer to compensate the insurer for the costs of writing and administering the business (agents' commissions, modeling, paperwork, etc.).

The insurer may seek such coverage for several reasons. First, the insurer may not have sufficient capital to prudently retain all of the exposure that it is capable of producing. For example, it may only be able to offer $1 million in coverage, but by purchasing proportional reinsurance it might double or triple that limit. Premiums and losses are then shared on a pro rata basis. For example, an insurance company might purchase a 50% quota share treaty; in this case they would share half of all premium and losses with the reinsurer. In a 75% quota share, they would share (cede) 3/4th of all premiums and losses.

The other (lesser known) form of proportional reinsurance is *surplus share*. In this case, a "line" is defined as a certain policy limit - say $100,000. In a 9 line surplus share treaty the reinsurer could then accept up to $900,000 (9 lines). So if the insurance company issues a policy for $100,000, they would keep all of the premiums and losses from that policy. If they issue a $200,000 policy, they would give (cede) half of the premiums and losses to the reinsurer (1 line each). If they issue a $500,000 policy, they would cede 80% of the premiums and losses on that policy to the reinsurer (1 line to the company, 4 lines to the reinsurer 4/5 = 80%) If they issue the maximum policy limit of $1,000,000 then the reinsurer would then get 90% of all of the premiums and losses from that policy.

For example, supposing there is an export contract of 750.000 $, that is insured for 600.000 $, the premium rate practiced by the insurer being of 1%, and his personal retain is of 150.000 $, and the rest is ceding in reinsurance: to the reinsurer A - 15% of insured sum, to the reinsurer B - 25% of insured sum, and to the reinsurer C - 30% of insured sum. If a loss of 100.000 $ occurs as a consequence of taking place an insured risk, applying the proportional responsibility principle we can establish the damages obtained by the insured from the insurer:

$$D = P = 100\,000\frac{600000}{750000} = 80.000\ \$$$

Thus there is about a proportional reinsurance contract and the damages undergo by the insurer is:

$$Da = \frac{D}{S_A} \cdot \frac{own\ retention}{S_a} = 80\,000\frac{150000}{600000} = 20.000\ \$$$

The damages suffered by the reinsurers are:

Dr_A = D · quota share with A = 80 000 · 20% = 16 000 $

Dr_B = D · quota share with B = 80 000 · 25% = 20 000 $

Dr_C = D · quota share with C = 80 000 · 30% = 24 000 $

The insurance premium is:

Pa = CP · Sa = 1% · 600. 000 = 6. 000$

Premiums are shared on the pro rata basis:

$$Pas = Pa \cdot \frac{own\ retention}{S_a} = 6\,000 \cdot 25\% = 1\,500\ \$$$

Pr_A = Pa · quota share with A = 6 000 · 20% = 1 200 $
Pr_B = Pa · quota share with B = 6 000 · 25% = 1 500 $
Pr_C = Pa · quota share with C = 6 000 · 30% = 1 800 $

6.2. Non-proportional (excess of loss) insurance

Non-proportional reinsurance, also known as *excess of loss reinsurance*, only responds if the loss suffered by the insurer exceeds a certain amount, called the retention. An example of this form of reinsurance is where the insurer is prepared to accept a loss of $1 million for any loss which may occur and purchases a layer of reinsurance of $4m in excess of $1 million - if a loss of $3 million occurs the insurer pays the $3 million to the insured(s), and then recovers $2 million from their reinsurer(s). In this example, the insurer will retain any loss exceeding $5 million unless they have purchased a further excess layer (second layer) of say $10 million excess of $5 million.

Excess of loss reinsurance can have two forms - *"Per Risk"* or *"Per Occurrence"* (Catastrophe or "Cat"). In per risk, the cedant's insurance policy limits are greater than the reinsurance retention. For example, an insurance company might insure commercial property risks with policy limits up to $10 million and then buy per risk reinsurance of $5 million in excess of $5 million. In this case a loss of $6 million on that policy will result in the recovery of $1 million from the reinsurer.

In catastrophe excess of loss, the cedant's insurance policy limits must be less than the reinsurance retention. For example, an insurance company issues homeowner's policy limits of up to $500,000 and then buys catastrophe reinsurance of $22,000,000 in excess of $3,000,000. In that case, the insurance company would only recover from reinsurers in the event of multiple losses in one event (i.e., hurricane, earthquake, etc.).

For example, supposing that an insurance company accomplished several insurance contacts with several companies against the risk of fire. The insurance company protects each of these contracts through reinsurance contracts with policy limits up to 5.000.000 $. Its own retention is of 1.500.000 $.

The A, B and C companies suffered losses of 1.400.000 $, 2.600.000 $ and 8.200.000 $ respectively. Knowing that the insured sum for A, B and C companies are of 6.000.000 $, 7.500.000 $ and 8.000.000 $ respectively, we can establish the losses suffered by the insurer and respectively by the reinsurer.

The losses suffered by the insured companies will be covered as follows:

The Company " A": the loss =1.400.000 $ < retention, so it will be covered by the reinsured ;

The Company " B": the loss = 2.600.000 $ > retention;

the loss =1.400.000 $ < reinsurance contract limit, so the reinsured will cover the retention, and the reinsurer covers the loss less the retention (2.600.000 - 1.500.000)

The Company " C": the loss = 8.200.000 $ > retention;

the loss = 8.200.000 $ > reinsurance contract limit, so the reinsured will cover the retention and the loss that excels the limit (1.500.000 + 2.500.000), and the reinsurer covers the share of loss until the maximum limit(5.000.000 - 1.500.000)

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Assessing Croatian Medical Herb Industry Potential For Going Global

Đula Borozan
Full Professor
Faculty of Economics in Osijek
J. J. Strossmayer University in Osijek
Osijek, Croatia
e-mail: borozan@efos.hr

Željko Erkapić, M.Sc.
Panservis, d.o.o.
Osijek, Croatia
e-mail: zeljko.erkapic@os.t-com.hr

Abstract

Medical herbs have significant potential for global business. Contemporary trends, concerning health and healthy approach to life, hugely contribute to this. However, medical herb industry is marginalized in Croatia. Although, share of medical herbs in total Croatian exports is small, Croatia has comparative advantages for medical herb production.

The main purpose of this paper is to discuss readiness of Croatian medical herb industry for global market entry. Since successful global business has been based on sustained competitive advantages, prerequisites and changes for creating them are discussed in this paper as well.

Key words: *medical herb industry, Croatia, global business, export opportunities, competitive advantages*

1. INTRODUCTION

Medical herbs are general term for all herbs having certain medical ingredients that may be used in a direct or indirect way. Indirect way of usage refers to processing, drying and industrial refining of medical herbs. Using medical herbs without industrial refining refers to the direct way of usage.

Croatian General and national encyclopedia (2006) treats medical herbs as herbs containing pharmacological active ingredients (alkaloids, glycosides,

saponins, tans, essential oils, resins, mucus, etc.) that are used in medicine. According to the Croatian Custom tariffs (CT) (Official Gazette 49/96) under medical herbs are specified the most important species of herbs, such as: chamomile, sage, mint, linden flower, mallow, root of ginseng, root of licorice, etc. Medical herbs come in all variety of shapes, sizes and perfumes.

Since the new possibilities for medical herb usage in different industries caring about human health and better quality of life have been opened, medical herbs attract more and more attention in the global market. Although the medical herb export market share in total Croatian exports is small,1 there is a growing potential for medical herb production and exports. The importance of medical herbs and their large potential for growth and new value added creation is recognized in many Croatian strategic documents, for example, in Croatian Export Offensive (2007).

The main purpose of this paper is to discuss readiness of Croatian medical herb industry for global market entry. The trends underlying global market will be identified and the position of Croatian medical herb industry in domestic market will be analyzed in this paper as well.

The sales potential of medical herbs in global market is determined by trends being set in the USA and European markets. These trends are mostly linked with health and healthy approach to life. Consequently, medical herbs are used in almost all segments of human activities being connected to human health care. Taking into consideration abundance with clean water, unpolluted land and the other natural resources that are extremely preserved, compared to the large part of Europe, as well as long tradition, inherited expertise and know-how in medical herb cultivation, Croatia has certain comparative advantages for growing the most qualitative sorts of medical herbs. Thus, medical herbs have good prerequisites for becoming Croatian global product.

If the target is to reap all the benefits of a global market, however, comparative advantages are not sufficient. In addition, they are not sufficient regarding the requirements for sustainable development and achieving sustained prosperity. Prosperity developing from comparative – natural – advantages, so-called inherited, is limited by the amount of natural resources available, and therefore ultimately temporary. Successful global business is based on sustainable competitive advantages – created prosperity. It demands implementation of many changes – a whole range of adaptations and modifications in own business, to create values

[1] For example, in 2004 the export share of oil seeds, medical herbs and some other agricultural products (CT group 12) accounted 2.66%, while the import share accounted 3.27% at the same year. Source: Croatian Chamber of Economy, http://hgk.biznet.hr/hgk/fileovi/7244.xls (accessed 25th December 2006)

that are necessary for global business. These modification requirements will be discussed in this paper as well.

2. MOTIVES OF CROATIAN MEDICAL HERB INDUSTRY FOR GOING GLOBAL

Going global is motivated by a number of reasons. Foley (1999) differentiates between traditional (sales to other markets, avoid changing domestic conditions, access to lower cost structure) and untraditional motives (exploit global presence and global money flows). There are also more reasons and motives underlying the intent of Croatian herb industry to compete in global herb market.

From traditional reasons, one should point out the economy of scale. Furthermore, considering general and entrepreneurial framework conditions prevailing in Croatian market, which are quite unstable, especially when collecting receivables comes into question, thinking about the sale of medical herbs to foreign buyers seems to be logical and effective. Doing business abroad brings more certainty in domestic business and simultaneously contributes to domestic economy and to strengthening image of the country in a whole („made in Croatia").

Exploitation of global presence (in production and in sale abroad) becomes the main untraditional reason for global business. As it has already been mentioned, Croatia has certain comparative advantages in production of medical herbs. Herb products originated in Croatia with well-known quality and image as well as with the global brand awareness will generate opportunities for distribution over the whole world. It is worth to mention that global market entry will enable Croatia to involve in world financial flows, and therefore to expand its possibilities for capital investment in foreign countries, as well investments in domestic market. These opportunities drive globalization process, i.e. global business.2 Global business demands from companies (or industries) to think globally, source globally, make globally, sell globally, learn globally, but act locally (Sawhney, 2003 and 2005).

[2] There is no consensus among economists about the meaning of global business, and when a company is truly global. Although one can find in literature definition that a truly global company accounts at least 20% of their sales in each region of the triad (North America, Europe and Asia) and less than 50% in their home region (Tarrant, 2005), in this paper global business refers more to business concept – how to do business - than to geographical concept - where to do business or with how many countries to do business. Global business means to do business international and to develop organizational culture and value system that allow transfer of company's resources anywhere in a world in order to develop and exploit competitive advantages. It also means to recognize the similarities around the world and to be flexible enough to adapt the products according to country's or cultural differences.

3. POTENTIAL OF CROATIAN MEDICAL HERB INDUSTRY FOR GOING GLOBAL

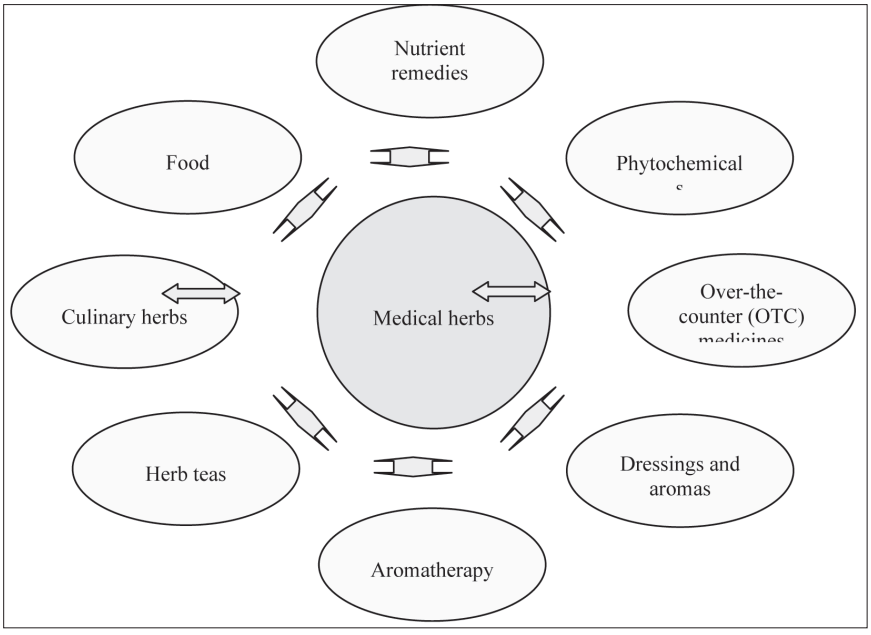
Readiness assessment of an industry for global business is based on several conditions (see Foley, 1999). One of the frequently mentioned conditions is business experience in domestic economy. Why is this condition so much important? Certainly, it is natural that product or company has to be confirmed firstly by its quality domestically, i.e. that it met the requirements, tastes and habits of domestic market.3 Domestic experience enables it to identify its core competences on which it may build its competitive advantages, and create strategy to enter and compete in global market place.

It is very hard to make decision whether the industry or company is completely ready for global move. There are numerous questions that demand specific, precise and clear answers. In the continuation of this paper, the position of the Croatian medical herb industry in domestic market and its readiness for global competition will be assessed.

The buyers

New possibilities for using medical herbs have been opened in different industries that are concerned with human health and better quality of life through the prism of ecological approach. The picture 1 illustrates the most important product groups that use medical herbs as raw materials.

Picture 1: Products that use medical herbs as raw materials



[3] Born global companies are exception (see for example Karra and Phillips, 2004).

It is important to point out that primary usage of medical herbs as raw material is particularly crucial in products that are being consumed in the form of food or food supplements and drinks (i.e. as healthy food products). Furthermore, as a secondary effect on human life, but not less important, medical herbs is also used in manufacturing pharmaceutical, cosmetic, aroma-therapeutic and phytochemical products.

Medical herbs may be offered to different buyers in different forms and under different quality. This is highly depended on the buyer requirements. Medical herbs are possible to sell dried with a certain part of dry substances, in form of extracts, tinctures, essential oils, etc. Certainly, the higher medical herb processing level requires higher production costs, what implies higher prices at the end.

In Croatia, the capacity for herb farming and processing is large. So, the Croatian companies like Pliva, Belupo, Podravka, and Franck have potential to process herb raw materials and to manufacture final medical herb products which can meet highly sophisticated requirements of foreign buyers.

Finally, one should note that the symbiosis between human beings and medical herbs has existed for centuries. This trend is present nowadays more than ever, especially because the scientific and medical research findings confirm the importance of medical herbs in keeping and improving health and the quality of life in general.

Competitive advantages of medical herbs

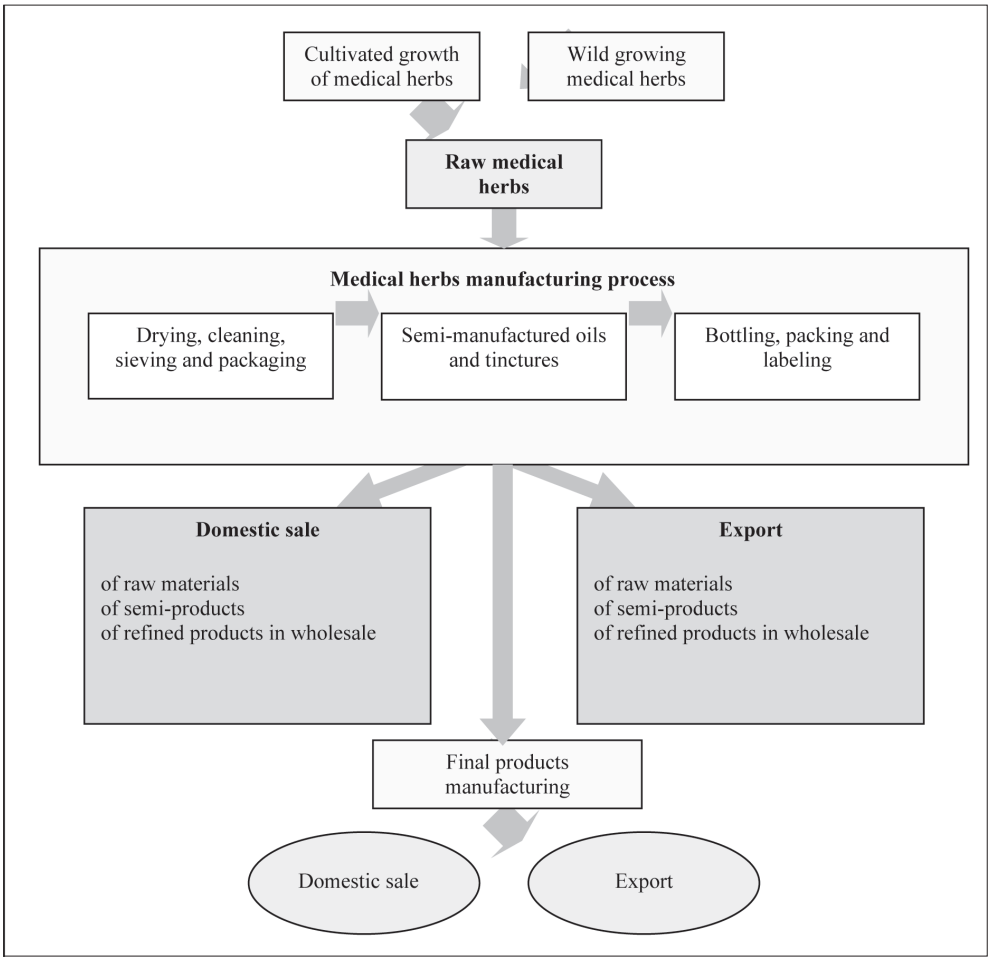
In order to discuss the competitive advantages of medical herbs as global product, human needs for them should be determined. According to the Maslow's need hierarchy theory (*see Wahba and Bridwell, 1976),* the need for medical herbs belongs to the existential needs. However, since medical herbs meet needs also beyond existential ones, they can be partially included in so-called luxury goods. Therefore, people will be ready to pay even higher prices for medical herb products in general. Furthermore, relatively inelastic demand for medical herbs and the trend of healthy life, as well as strong accountability in medical values of their usage, contribute also to their sale success.

In a nutshell, there are two main factors that will impact the price of medical herbs in global market: first, the human intent to meet the need for healthy life and second, the tradition of medical herb usage as an expression of accountability developing over centuries. Therefore, each product having a health component as something natural and inseparable from human being becomes priceless for modern person. Certainly, quality – having an important impact on price as well as on product brand – implies an opportunity window for possible product differentiation for demanding buyers in different markets that are ready to pay well for quality, image and health.

Croatian market has certain prerequisites for such product differentiation and brand creation. The well known «Hvar's lavender» is an example of such possibility. One should also point out that in some cases of medical herb distribution in bulk, brand creation is not possible entirely, but differentiation in term of quality standardization is possible and justified.

The process of medical herb production can have crucial importance for reaching target quality and better price in market. It is well-known that ecological production is especially valuable worldwide. It supposes the production without chemical preparations and mineral fertilizers during the growing of herbs. By using the ecological approach in the production process of medical herbs, better image and better price can be realized, especially in the sophisticated markets as the markets of West Europe and the USA are.

Picture 2: Simplified process of medical herb production and review of possible sale direction in domestic or foreign markets (through all production level)



Distribution channels

Medical herbs distribution is possible in all levels of their processing (Picture 2). The lower the processing level of medical herbs, the highest orientation of herb manufacturers to middlemen and wholesalers is. There are numerous middlemen and wholesalers in Croatia and in Western Europe. When the higher processing level comes into question, such as the tincture, essential oils and extracts production, and where the price is positively correlated with the quality, it is better to contact end-users, as are for example pharmaceutical or cosmetic companies to get higher prices and therefore make higher profits.

It is not always possible to determine the best distribution channel that should be appropriate for all cases and situations. The practice confirms that the direct contact with end-user is usually the best solution, although it is not achievable in every situation. Different free and commercial data bases available on Internet and yellow pages offer valuable information about potential buyers around the world. The buyer addresses are also available through direct contact with commercial attaches in foreign embassies. The choice of direct distribution channels and developing sound business relations with end-users enables leverage in the core competitive competencies and creates competitive advantages. This kind of business communication requires refining product quality to the buyer requirements. Direct contact enables negotiation, better coordination and eventually removal of impurities in final products, which existence is not allowed in medical herb production.

The importance of medical herbs in value added creation

In order to understand better the importance of medical herb production in Croatia for value added creation, some facts and regularities underlying such agricultural production should be recognized.

In agricultural areas of Croatia, especially in the Slavonia and Baranja region, grains (wheat and corn) and sugar beet (almost 75%) are prevailed. There are two very important reasons for that. The first reason refers to tradition of growing these herb sorts. Since Croatian farmers have found out that these agricultural products have strategic importance for a country, they will expect that government promotes and protects such production in order to provide food for people and livestock. Certainly, such approach is not consistent with the principles of market economy and value added creation. The motto «My grandfather sowed wheat, my father did the same, so I should keep the family tradition» is not sustained. The second reason, maybe more significant one, is grounded in fact that these agricultural products, especially wheat, are an instrument of pressure of small farmers to Croatian government (that is the most important buyer of their products) to solve their market and social problems.

Both reasons are wrong. First, it is known that growing agrarian sorts bring less profit per area hectares, even taking into account subsides and guaranteed purchasing price, than the medical herbs bring (for example, chamomile and mint). The reason for that is not only a huge supply of these sorts, but their imports with prices lower than domestic ones are. Second, instead of producing less profitable wheat and then using it as an instrument of pressure to government, Croatian farmers should be reoriented to growing more profitable sorts, such as medical herbs.

Taking into consideration all of mentioned reasons it is evident that main barriers to new value added creation in agriculture in general, and therefore in medical herb production can be find in stereotypes prevailing in the mind of farmers. Indicating the importance of medical herbs in today's agricultural production and minimizing such stereotypes, the ground basis of medical herb manufacturers may be created. It will be able to supply not only Croatian market but certain parts of the European and world markets. Prerequisites for increase in value added and profits should be set by sound reforms in agriculture, including medical herb production. Simultaneously, respectable cluster of suppliers, manufactures and exporters of medical herbs should be created with the goal to increase the future Croatian share in global medical herb market by following the contemporary trends of healthy life.

4. ATTRACTIVENESS ASSESSMENT OF THE MEDICAL HERB INDUSTRY

In this paper, the analysis of medical herb industry, i.e. the attractiveness assessment of this industry is made by means of the Porter five competitive forces model (Porter, 1988). This model helps in understanding the situation in Croatian medical herb industry and in formulating the global market entry strategy.

The bargaining power of buyers

In Croatian market, there are a relatively small number of big medical herb buyers such as Pliva, Belupo, Podravka and Franck. Considering their size and market share, they can influence the small medical herb farmers and manufactures. Furthermore, such big buyers, regarding their production capacity, demand large volumes of medical herbs. Concerning the fact that Croatia is an import-oriented country with powerful import lobbies, there is a possibility that these large-volume companies will buy medical herbs from abroad. Obviously, the bargaining power of buyers grows stronger compared with the power of manufactures.

Certainly, the medical herb manufactures have some advantages compared to buyers. Concerning contemporary trends that underlie the importance of medical herbs in human health, they are aware that there is no important

substitute to medical herbs, when human health comes into question. Therefore, medical herb manufactures can demand higher prices for better quality of their raw materials.

Furthermore, the buyers are well informed regarding prices, market shares, financial position of manufactures, competition, etc. They can influence the medical herb raw materials prices by «blackmailing» the small manufactures with the possibility of cheaper medical herb imports from abroad. Opposite to this, medical herb manufacturers, composed from small entrepreneurs, can not sophisticate and differentiate their offers to make higher prices in average. This business move - to raise product quality and to promote the new products - demands extra investments. Therefore, the bargaining power of buyers is high in this segment.

Lack of brand is strongly correlated with the poor differentiability of products. This makes advantage for buyers. Regarding their size and reputation, some buyers can impose certain requirements regarding standardization in quality to small entrepreneurs in order to make their own final products more profitable. Therefore, the pressure of buyers is also strong in this segment.

Summing up all of these advantages and disadvantages, either on the side of the manufacturer or on the side of the buyer, the bargaining power of buyers in medical herb industry is extremely high.

The threat of substitute products

If medical herbs are understood as natural organic products that people use in everyday life in different ways and forms, this will create the valuable confidence between people and medical herbs, which is additionally confirmed by scientific findings.

Medical herbs, as a specific products being used to improve human health and quality of life, do not have significant and good enough substitutes. Therefore, buyers regardless of their power do not use substitutes in a remarkable volume. So, the threat of substitute products in medical herb industry is low.

The bargaining power of suppliers

In order to assess the bargaining power of suppliers, several issues should be considered. Input differentiation is relatively medium because some suppliers have differentiated their products, while the others have not. The quality of inputs (seeds, mechanizations, manures, land, experts, etc.) varies in medical herb production. Furthermore, these suppliers are not recognizable enough, what contributes to the increase in power of suppliers.

Regarding the substitute inputs for medical herb production, manufacturers always have options; they can buy seeds or grow them, buy mechanization or they can rent it, employ additional seasonal workers or full-time workers or do some other things that can put suppliers in unfavorable position. Regarding intensity of rivalry among suppliers of inputs in medical herb industry, it is quite high, because many suppliers operate in market, what minimizes their bargaining power. Suppliers are limited by costs that impact the possibility for product differentiation because high production costs reduce their space for action and at the same time this lowers their bargaining power.

Because medical herb suppliers are mostly small entrepreneurs, there is no threat of forward integration, i.e. that a supplier will buy its buyer and so ensure its sale.

Summing up, the bargaining power of suppliers is relatively low.

The threat of entry

The threats of entry have important impact on industry's competitiveness for several reasons.

Entry to a medical herb industry as a start up project does not demand relatively large investment. Entry barriers and regulations in terms of different licenses and permits, minimal capital, number of bureaucratic and legal procedures, time and cost are not so burdensome. In Croatia, the larger issue regarding new entry is connected with mental barriers of farmers. They resist changing and learning about growing new sorts besides wheat, corn and sugar beet due to «long tradition» or farmer conformity.

Furthermore, because of high bargaining power of buyers in medical herb industry that dictates the prices of herbs in form of raw materials, manufacturer can not set one-sided markup and profit, what is quite unattractive for new entrants.

Taking into consideration the above mentioned reasons, the threat of entry in medical herb industry can be defined as medium.

The intensity of rivalry

Rivalry among existing competitors can be assessed from different aspects. For example, fixed costs emerging in medical herb industry may significantly impact price setting mechanism. Since appropriate mechanization (tractors, combine harvesters, dryers, etc.) has been required for such production, the question of organizing production in a way that fixed costs do not become endangering item in price calculation demands full attention. Therefore, the sound business politics is needed. Those firms, that would combine in an efficient and effective

way the key business parameters and be enough cost-acceptable, will exhibit larger rivalry compared with their competitors.

It is well known that if there were the larger product differentiation among existing competitors, the smaller rivalry would be between them. Furthermore, it is already mentioned in this paper that medical herbs as product are not differentiated against achieved qualitative standardization. This implies the existence of high rivalry. In addition, the brand being extremely important in global competition is hardly achievable.

Rivalry among existing competitors in growing medical herb industry is relatively medium. In Croatia, medical herb industry is atomized, i.e. there are a lot of small entrepreneurs that do business and go to market unorganized. In forthcoming future, concentration is required, through manufacturing association or trade association, in order to minimize rivalry of atomized supply and to direct them to market.

To summarize, rivalry among existing competitors in medical herb industry is medium to high.

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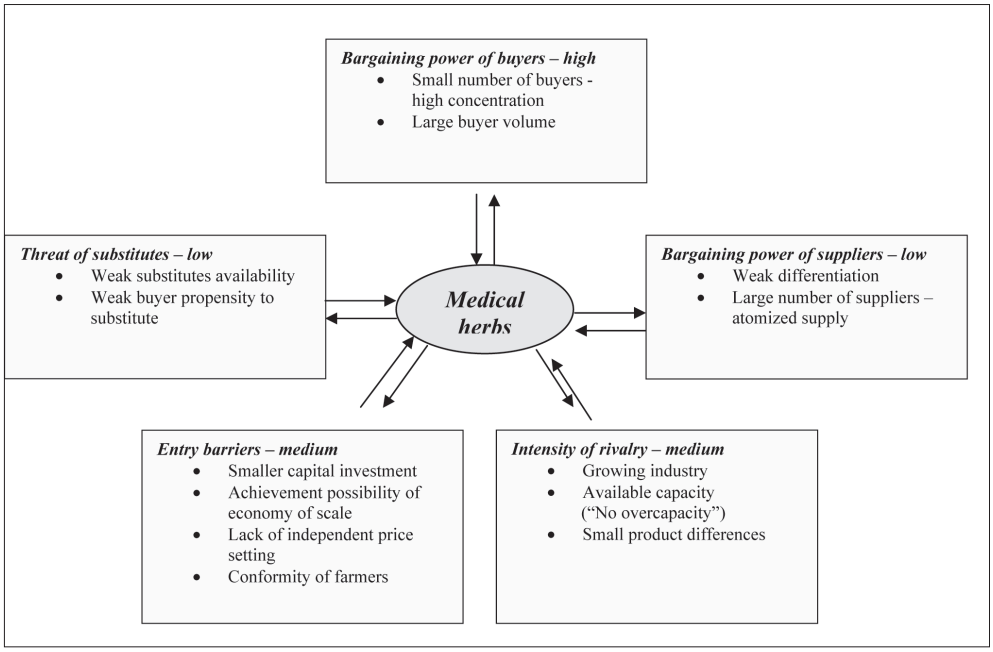
The state of competition in medical herb industry is diagrammed in Picture 3.

Picture 3: Forces driving medical herb industry competition



The following conclusion can be drawn from the applied model: the pressure of analyzed five forces is medium to low. This means that the attractiveness of medical herb industry in term of profit potential is medium to high.

Porter's model suggests the usage of the following generic strategies to maximize certain competitive advantages and to ensure above-average returns for a firm in a medical herb industry:

1. low cost and price strategy
2. product differentiation strategy
3. focus strategy.

All strategies can be used in medical herb industry. However, only combination and choice of the most acceptable parts of mentioned strategies may ensure the success in international framework conditions.

The low cost-price strategy puts emphasis on cost cutting technologies and simultaneously on sustaining the product quality level. It is known that the costs influence the price, but also that competitiveness in international marketplace can be improved with specialization and maximization of economy of scale. Product differentiation strategy puts emphasis on creative flare and innovativeness, greater product reliability, practicability of usage and top service to customers. A focus strategy, whether anchored in a low cost-price base or a differentiation base, intends to act to those market segments being the most important for medical herb manufacturers.

5. ADAPTATION OF MEDICAL HERB PRODUCTION FOR GOING GLOBAL

Making decision to going global, taking into consideration the company's expectations about advantages and disadvantages of such activity, demands not only detailed assessment and research, but also development and implementation of global mind-set, as values and abilities necessary for doing business in international environment. According to Begley and Boyd (2003) a global mind-set refers to the company's ability to develop criteria for business performance that are not dependent on the assumption of a single country, culture or context and to implement those criteria appropriately in different countries, cultures and contexts. In addition, in medical herb industry one should:

- make concentration of medical herb manufacturers to ensure more efficient international market entry;
- improve and organize distribution channels;
- anticipate new trends and requirements imposed by medical herb buyers in term of quality;
- develop research and development activities to ensure innovations in all value added activities;

- develop the need for long-life learning and learning by doing, especially in the field of international business.

Besides mentioned, there are a numerous different questions that companies should ask and in the same time seek the most appropriate answers. Some of these questions that will occupy their thoughts and motivate them to problem solving activities are the following:

1. What will happen in medical herb industry if sale potential rose significantly with the international market expansion in a way that demands structural reforms and reorganization in the whole industry?
2. Will the separation of products, aimed to exports in sophisticated foreign markets in relation to the need of domestic market, suppose necessarily logistic adaptation in production process?
3. Does the whole industry have the capacity and capability to do required modifications of products?
4. What type of foreign market entry is the most appropriate for the industry? What does the foreign market entry strategy depend on?

International expansion of Croatian medical herb industry open the whole range of issues regarding protection of cultures and ecologies; *inter alia*, the challenge of keeping local cultural traditions, traditional approach to herb growing, land protection from pollution, etc. Jagtenberg and Evans (2003) pointed out that the protection of cultures and ecologies must be made a clear priority.

6. CONCLUSION

Farming, processing, refining and distribution of medical herbs in international framework conditions is very important concerning their usage in important industries such as food, chemical, pharmaceutical, cosmetics and many others.

In total Croatian production, medical herb production is not adequately valorized regarding its potential that it has in foreign markets.

The proximity to large import markets, such are German and Italy, offer abundance of possibilities to better (and wiser) use of comparative advantage build on unpolluted land. This supposes focusing and better organization of medical herb manufacturers as well as improvement in distribution channels. Croatia cannot dramatically change its position on global medical herb market without significant increase in volume, i.e. economy of scale. However, it can produce larger volume of medical herbs by:

- giving up of some traditional sorts that are neither market demanded, nor profitable in favor of medical herb production;

- using large agricultural areas which have not been cultivated for many years and which have therefore been appropriate for ecological production of medical herbs.

Medical herb export expansion will contribute to the increase in Croatian total exports. Croatia is certainly import-oriented country; international business with medical herbs will open new opportunities and challenges. Therefore, government should foster development of this industry and strategies that make medical herbs as Croatian product more attractive for global market entry.

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Credit Scoring As A Method Of Managing Credit Risk In Bank Institutions In Poland

Izabela Pruchnicka-Grabias, Ph.D.
Assistant Professor
University Of Economics In Warsaw
Warsaw, Poland
E-mail: ipruch@wp.pl

Marta Świeczka
University Of Economics In Warsaw
Warsaw, Poland
E-mail: martaswieczka@o2.pl

Abstract

Throughout the recent years, in conjunction with progressing development of small and medium-sized enterprises (SMEs) the role of a bank credit has been considerably increased. This has led to extended variety of credit offers proposed by banks. Expectations of customers, who wish to receive a decision concerning granting a credit as soon as possible, have also increased. For this reason nowadays banks face the challenge of utilizing these methods of credit risk analysis which can provide mutual benefit – both for the client and for the bank.

The aim of this elaboration is to present the rules of applying credit scoring, the most efficient method used in the process of credit risk assessment for natural persons and SMEs. It has been shown here that the method's level of complexity is low. The characteristics of application the scoring technique to the Polish realities have been analyzed inter alia on the basis of an interview carried out in ten of the leading Polish banks.

1. CREDIT RISK IN THE BANK ACTIVITY

1.1 The term and classification of credit risk

The term of credit risk is applicable to nearly all spheres of life. In the popular comprehension the term is characterized by a simple and homogeneous meaning, however in expert fields it is explained in a different way.[1] The bank-

[1] Kraska M. „Credit scoring i credit rating - zastosowanie w banku komercyjnym" - Wydawnictwo Stardruk, Warsaw 2004. pp. 13-16.

related risk is usually defined as a danger of worsening the financial result and of arising irregularities which can lead to diminishing of the potential profits, loss of liquidity, decreasing the ownership capital and in extremal cases even to bankruptcy of a bank.[2]

The most notable type of all banking risks is credit risk. There are two reasons for this. Firstly, credit risk is the oldest form of financial market risk. Secondly, it poses a serious threat to an effective activity of the bank, because the credit activity is the main source of the bank's profits.[3]

Credit risk is defined as a threat of a debtor's not repaying his or her liabilities, not only because of credits taken together with interests and other commissions, but also because of bails granted, letters of credit, interbank deposits, exchange operations, derivatives transactions, trading commercial papers and shares.[4] One must remember that there is always a risk existing in the bank activity, but it can have various levels of intensity which depends on a credit's size, kind, purpose of use and client's ability to pay it off.[5]

In the subject's literature one can encounter the division to *active* and *passive* credit risk. Through the term of active credit risk one understands the risk related to granting credits (the debtor fails to pay capital instalments and interests on his or her credit taken in accordance with the time limits defined in the credit agreement), whereas the term of passive risk is understood as a risk linked with collecting funds necessary to run a credit activity.[6]

1.2 Substance of credit capacity

Credit capacity is a term particularly related to credit risk.[7] In the Polish *Bank Law* it is defined as follows: "Through *credit capacity* one comprehends the capacity to repay a credit together with the interests in the time limits defined in the agreement."[8] The above-mentioned bill makes granting a credit dependent on a positive assessment of one's credit capacity. Only in exceptional cases the bank may grant a credit to customers who do not have a credit capacity under certain circumstances, that is of establishing a special way of assuring the credit as

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[2] Rajczyk M. „Podstawy bankowości komercyjnej" – Fundacja Banku Śląskiego, Bielsko-Biała 1997, p. 50.
[3] Kraska M. „Credit scoring i credit rating...", op. cit., p. 20.
[4] Zawadzka Z. „Zarządzanie ryzykiem w banku komercyjnym" – Poltext, Warsaw 1996, p. 25.
[5] Iwanicz – Drozdowska M., Nowak A. „Ryzyko bankowe"- Warsaw School of Economics, Warsaw 2002, p. 25.
[6] Jaworski W.„ Bankowość- zagadnienia podstawowe" – Poltext, Warsaw 2005, p. 227.
[7] Kraska M. „Credit scoring i credit rating...", op.cit., p. 21.
[8] A Polish bill of August 29, 1997– „Bank Law" – dz. U. Nr 140, poz. 939, art. 70.1.

well as presenting a recovery program, realization thereof will ensure restoration of the credit capacity in a fixed time.[9]

The fact of having a credit capacity by a potential debtor is a necessary condition (excluding the aforementioned exceptional circumstances) but not sufficient for granting a credit by the bank. The second element of the decision concerning granting a credit constitutes the scale of the risk connected with a given credit transaction. The level of this risk affects both the volume and the form of the required legal protection and securing credit's interest. *The Bank Law* does not impose any defined methods of the credit capacity assessment, each bank has a free hand in this area.[10] Credit institutions define their rules concerning granting credits which make it possible to choose the right debtors guaranteeing in a maximal extent meeting their commitments.[11]

1.3 Managing credit risk

Credit risk has a special characteristic, namely it is impossible to entirely eliminate it from the bank's activity. A bank taking a risk must always be prepared for some losses. We can speak about the bank's *effective activity* which delivers profits, when the risk level fits into reasonable limits, that is the gain accomplished by the bank surpass the losses resulting from the risk taken.[12] Therefore proper managing the credit risk is a substantial element of the bank's activity as this largely influences the bank's success or failure.[13] The term of managing the credit risk can be defined as a set of actions aiming at optimalizing the relation between the volume of the credits, the operational surplus/profit and the credit risk.[14]

Running a credit activity's superior aim is to maximize the profit and creating conditions for the bank not to exceed the assumed losses. The fundamental part of the process of managing the credit risk is its measuring. In the space of many years one has developed numerous methods and models serving this purpose.[15] Nowadays a modern approach to managing the credit risk process should consist of: forming the risk using advanced statistical-mathematical methods, an active modelling the credit portfolio's structure and traditional elements such as for instance concentration limits.[16] Good results are delivered by using

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[9] Gospodarowicz A., Możaryn H. „Identyfikacja i szacowanie...", op. cit., p. 27.

[10] Dębniewska M., Sołoma A. „Bankowość – produkty, usługi, rynek" – Wydawnictwo Uniwersytetu Warmińsko – Mazurskiego, Olsztyn 2003, p. 87.

[11] Nowak M. „Ocena zdolności kredytowej...", op. cit., p. 70.

[12] Kraska M. „Credit scoring i credit rating...", op. cit., p. 22.

[13] Gospodarowicz A., Możaryn H. „Identyfikacja i szacowanie...", op. cit., p. 19.

[14] Borys G. „Zarządzanie ryzykiem...", op. cit., p. 48.

[15] Krysiak Z. „Ryzyko kredytowe a wartość firmy – pomiar i modelowanie" – Oficyna Ekonomiczna, Kraków 2006, pp. 27 – 28.

[16] Gątarek D., Maksymiuk R., Krysiak M., Witkowski Ł. „Nowoczesne metody zarządzania ryzykiem finansowym" - Wydawnictwo Wig – Press, Warszawa 2001, p. 85.

several methods simultaneously and comparing the results obtained from each of them.

2. THE LITERARY RUDIMENTS OF CREDIT SCORING

2.1 The term and substance of credit scoring

In practice scoring systems have been used already for several decades. Studies prove that they underline 30 – 40% of the world's credit decisions. First scoring models have been introduced in significant banks and credit cards drawers. It has been aimed at perfection and speeding up making credit decisions, unification of the process of examining customers' applications and reducing costs of making these decisions. Throughout the recent years scoring systems have been also applied to other areas of loan portfolios (e.g. for small enterprises and by mortgage loans) and their application has been extended to new domains, also non-economic ones.[17]

To put it simply, credit scoring can be defined as a method of assessing an entity's financial situation through assigning suitable points defined in the scoring card to the assessed variables. After precise summing them up these points constitute a score (expressed by means of a numerical code) which makes it possible to classify a potential debtor to an appropriate risk group.[18]

The aim of the scoring method's application is prefiguring the risk connected with a possibility of the debtor's failure to meet his or her commitments. Undoubtedly an asset of credit scoring is that methodology is relatively simple and comprehensive, while the data on which it is based are empirically proven.[19]

The applied scoring methods are based on the scores of the previous customers who are similar to those to be assessed. Usually those customers are examined who have recently applied for a given product. Characteristics of the client and his environment facilitating the risk prefigurement should be used in the scoring system. The most frequently applied variables are connected with the risk of the debtor's insolvency and refer to its various traits. Some of these variables have a task to examine the customer's ability to stabilize, other look into the customer's financial inclinations, his or her resources and possible spendings.[20] As mentioned above, the choice of the examined criteria depends on the results of a research carried out on a certain population of customers. Therefore it is worth noticing

[17] Matuszyk A. „Credit scoring – metoda zarządzania ryzykiem kredytowym" – Wydawnictwo CeDeWu. Warszawa 2004, p. 48.

[18] Kraska M. „Credit scoring i credit rating...", op. cit., p. 28.

[19] Matuszyk A. „Credit scoring – metoda zarządzania ryzykiem kredytowym" – Wydawnictwo CeDeWu, Warszawa 2004, p.45.

[20] Ibidem, pp. 45 – 46.

that each scoring system may contain a different group of indicators affecting the score or various assessments of the same indicators may not give the same score. The reason for this is that in each country we encounter different economic and social realities.[21]

2.2 Application and classification of credit scoring

Apart from classical, applied to debtors, scoring models can help make decisions concerning for example limit restoration on the basis of the customer's behavior (behavioral scoring), prevent customer's outflow (attrition scoring), suggest which customers should be sent a new product offer (mail solicitation scoring), help assess the probability of bank's regaining the debt (collection scoring) and give an immediate reply concerning the possibility of a card payment (authorization scoring).[22]

In the subject's literature one can encounter many different classifications of credit scoring. However, most frequently, apart from the above-mentioned, a classification concerning methodical concepts is distinguished. On this level there are three sorts of scoring:

Application scoring – was developed and propagated in the United States at the beginning of the 1980s. At present it belongs to the most popular scoring methods worldwide.[23] Application scoring involves an assessment of a single credit application or an application concerning another product. Its aim is to examine the probability that the debtor can meet his commitments. The debtor fills in a suitable application containing a series of questions. Each answer is assigned to a certain number of points. All the points gathered are precisely summed up and if the total number meets the so called cut-off point – the customer is granted a credit. Otherwise the application is rejected.[24]

Behavioral scoring – its first concept emerged in the 1960s in the United States. The system of behavioral scoring concerns the bank's regular customers because the assessment is here based upon a record of hitherto existing co-operation with a given customer and not, like in the case of the application scoring, upon a submitted application. Behavioral scoring is applied mainly by defining a new credit limit as well as by modifying an already existing limit. The assessment of the customer is made by means of collected historical data and for this reason the method is more thorough and credible. It must be added, though, that the process

[21] Janc A., Kraska M. „Credit – scoring …", op.cit., pp. 107 - 108.

[22] Gruszczyński M. „Prognozowanie ryzyka kredytowego" – Materiały z konferencji naukowej pt. „Prognozowanie w zarządzaniu firmą", Wydawnictwo Akademii Ekonomicznej im. Oskara Lange'go, Wroclaw 1997.

[23] Janc A., Kraska M. „Credit – scoring …", op.cit., pp. 36 – 37.

[24] Matuszyk A. „Credit scoring ...", op. cit., p. 64.

of its implementation and adaptation to the requirements is much more complex than in the case of application scoring.[25] Behavioral scoring, regardless the forty-years application, seems to be poorly developed and rather neglected, however it belongs to these areas which are going to progress in the nearest future.[26]

Profit scoring – its idea has grown upon the conviction that it is the profit (and not the factors defining the debt repayment risk) is a criterion that enables to more accurately make a decision concerning granting a credit. It is a system of score assessment which mainly aims at maximizing the profit (if it is worked out in connection with the consumer service) and not minimizing the risk of non-fulfilment the agreement. The profit assessment is a new and still-developing technique but there is a shortage of models effective enough to be easily applied.[27]

Moreover, credit scoring can be divided regarding branches where it is applied and here the literature provides such sorts as: bank credit scoring, insurance credit scoring, marketing credit scoring and other (applied e.g. in medicine, in taxes and so on).[28]

2.3 Advantages and drawbacks of credit scoring

Nowadays credit scoring occupies a leading position in the area of natural persons' credit risk assessment. Both in the literature and in practice it is often described as the most effective method. Apart from many advantages concerning its application in credit risk assessment (they are described below), credit scoring has also an influence on improving the bank's activity in such areas as IT, finances, management and marketing.[29]

The main asset of the scoring method lies in the fact that conducting it is not much complicated. This is why it saves time necessary to analyze a credit application. As a whole a well-prepared scoring model brings about decreasing the number of bad credits, increasing the efficiency of the credit clerks' work and minimizing the service costs. What is more, for a person applying for a credit, using credit scoring means decreasing the number of documents required to conduct the assessment of his or her credit capacity.[30]

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[25] Janc A., Kraska M. „Credit – scoring …", op.cit., p. 37.
[26] www.przedsiebiorstwo.org/credit, 2007
[27] Ibidem.
[28] Compare: Boguszewski L., Gelińska B. „Podstawy statystyczne i uniwersalna funkcjonalność scoringu" – Materials of the 2nd Scientigic Conference titled „Interdisciplinary application of quantitative methods", Students' Association of Quantitative Methods by the Statistics Chair of the Gdansk University, Szczecin 2004.
[29] Krymarys – Balcerzak A., Janc A. „Funkcjonowanie...", op. cit., p. 134.
[30] www.stafsoft.pl

Undoubtedly, a very important advantage of this method is its objectivity and uniformity in accomplishing an assessment. The application of scoring guarantees that by assessing each client the same criteria are being taken into account.[31] The automated process of assessing limits the role of the human factor to a necessary minimum which eliminates a possibility of a subjective assessment. Regardless the person assessing a given customer, an interpretation of the received outcome is always homogeneous within a given bank.[32]

In spite of the fact that scoring has many advantages, it is hard to pass over some allegations that are put against it. One of ist limitations concerns the necessity to possess an appropriately developed database essential in creating a scoring card. This constitutes a necessary condition without which the implementation of credit scoring is unreal. Another equally important limitation is that the system (or the scoring card) may quickly become out of date and that there is no ability to adapt itself to short-term changes occuring in the society. This is due to the fact that the scoring card is built on the basis of the data stored in the credit history of a certain group of people who took a credit in the past and its task is to assign the customers to appropriate groups of risk in the future. The correctness of the card's functionning is therefore determined by the permanence of the social-economic realities.[33] However, especially in the developing countries, where the realities undergo sudden changes causing instability of the economic conditions, the data on the scoring card may very quickly become out of date. Many authors reproach the founders of the scoring method with too little number of characteristics assessed and with the choice of criteria which do not have a direct impact on the assessment of one's financial credibility, as well as with discrimination of certain social groups (for instance regarding their age or the place of residence. Criticism is also mounting over the classification of examined entities which limits itself to just two possible classes of risk: a "good" one, and a "bad" one.[34]

Despite the existing disadvantages, the scoring, thanks to its simplicity and effectiveness, is a system commonly applied worldwide. It is hardly imaginable that a banking activity could be deprived of the scoring method. However, it is vital that the scoring is present also in other disciplines, serves not only the purpose of assessing debtors. There is no doubt that in the future the application of the presented here method is going to expand. A methodological variety and a universal functionality will guarantee popularity for the scoring wherever there is

[31] Janc A., Kraska M. „Credit – scoring …", op.cit., p. 30.
[32] Kraska M. „Credit scoring i credit rating...", op.cit., p. 65.
[33] Ibidem, p. 81.
[34] Janc A., Kraska M. „Credit – scoring …", op. cit., pp. 30-32.

a need for an automatic, objective assessment of an entity in the rush of routine decisions.[35]

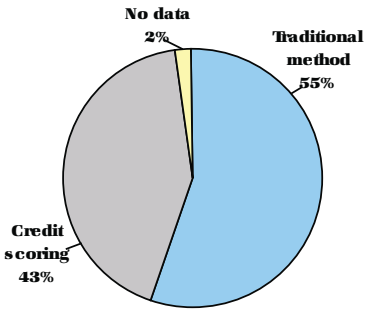
3. THE SCORING METHOD OF ASSESSING THE CREDIT RISK OF NATURAL PERSONS IN BANKS IN POLAND

3.1 The application of the credit scoring in Poland

The analysis of methods concerning the credit risk of natural persons in banks in Poland is focuses on two particular methods, namely the traditional one and the credit scoring. The application of these techniques constitutes a basis of classification of the Polish banks into two groups. In the first group of banks applying the traditional method to assess the credit risk there are all those institutions in which the credit risk is examined by means of the traditional technique towards each sort of credit offered by a given bank.

Whereas in the second group of banks using the credit scoring there are those banks which apply a statistical scoring card at least to one sort of credit offered by a given bank.[36] The relation of applying the traditional method and the scoring in commercial banks in Poland is shown in the chart below.

Chart 3.1 – The application of the credit scoring in commercial banks in Poland.



Source: „Credit scoring i credit rating – zastosowanie w banku komercyjnym" M. Kraska - Wydawnictwo Stardruk, Warsaw 2004, p. 123.

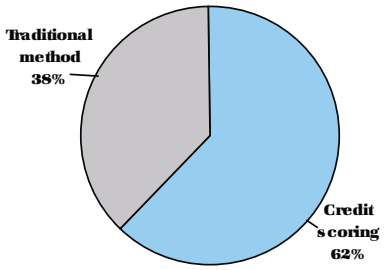
On the basis of the chart shown above it can be stated that there is no commonness yet in the application of the scoring method in the Polish banking. Only in 43% of the examined commercial banks the credit risk assessment is based upon credit scoring. This is because the Polish market belongs to young

[35] Boguszewski L., Gelińska B. „Podstawy statystyczne i uniwersalna funkcjonalność scoringu" – Materials of the 2nd Scientigic Conference titled „Interdisciplinary application of quantitative methods", Students' Association of Quantitative Methods by the Statistics Chair of the Gdansk University, Szczecin 2004

[36] Kraska M. „Credit scoring i credit rating...", op.cit., p. 127.

and still developing markets in this area. The main limitations concerning the implementation of the scoring method include the need to collect a sufficient amount of data necessary to create a scoring card as well as the access to the necessary scoring technology.

Chart 3.2 – The application of the credit scoring in banks belonging to the five hundred largest enterprises in Poland.



Source: „Credit scoring i credit rating – zastosowanie w banku komercyjnym" M. Kraska - Wydawnictwo Stardruk, Warsaw 2004, p. 124.

Within the banks which have been included in the group of five hundred largest enterprises functioning in Poland, the scoring method is applied by as much as 62% of them. The banks specialized in offering car credits and instalment credits dominate in this group. The credit scoring in these institutions is extremely useful as it enables to assess the customer's credibility quickly and precisely.37

3.2 The application of the credit scoring on the example of Ing bank Śląski

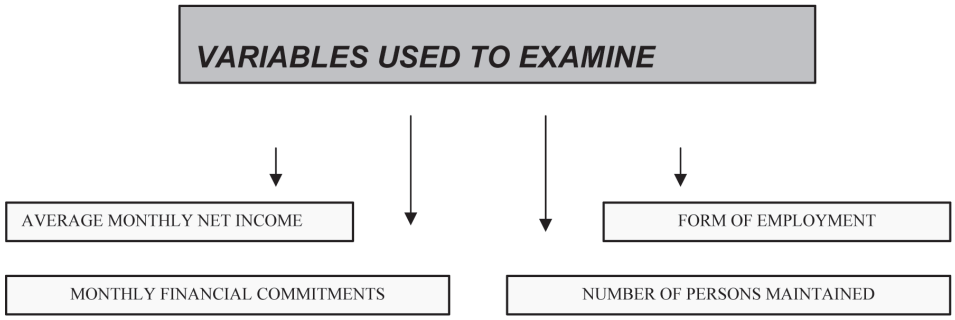
For the needs of the present elaboration there have been conducted the research in ten Polish banks using the credit scoring (ING Bank Śląski, PKO S.A, Millennium Bank, BGŻ S.A., Fiat Bank Polska S.A., Toyota Bank Polska S.A., Volkswagen Bank Polska S.A. Lukas Bank S.A., Kredyt Bank S.A., GE Capital Bank S.A.). However regarding the absence of essential differences between application the scoring method in the analyzed banks, a detailed description of the scoring has been made only on the example of ING Banku Śląski.

In ING Bank Śląski the scoring method is used for all the products offered by the Bank. A customer who comes to the Bank with the intention of taking a credit, at first undergoes an income analysis which aims to examine his or her credit capacity. This analysis is conducted by an employee of the institution by entering data to a special calculator. The most important variable being taken into account in this process is the income of a potential debtor. In ING Bank Śląski an average monthly net income obtained by the debtor from a basic

[37] Ibidem, p. 124.

employment relationship is used in calculations, without taking into consideration any additional incomes that a given customer can have. Except for the above-mentioned income, a number of other variables are used when assessing one's credit capacity. They are presented in the diagram below:

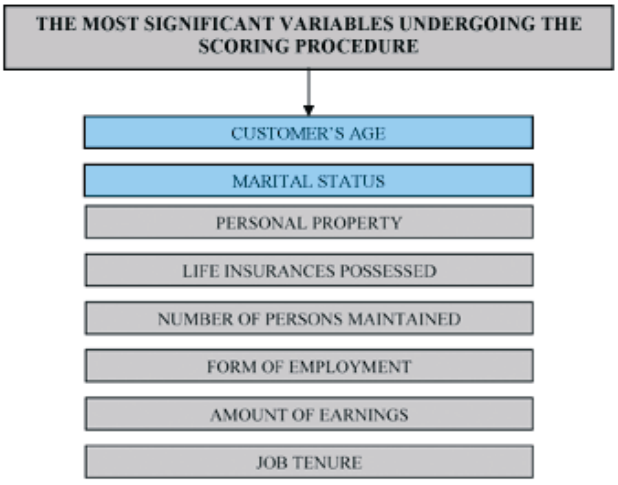
Diagram 3.1 – The classification of variables used to examine the credit capacity in ING Bank Śląski.



Source: Own elaboration based on an interview in ING Bank Śląski.

A customer who has a credit capacity fills in a credit application which is then sent to the computer system in the Credit Department of the Bank's Head Office where the data undergoes the scoring procedure.[38] The most important variables assessed in ING Bank Śląski are presented in the diagram below:

Diagram 3.2 – A list of the most significant variables undergoing the scoring procedure in ING Bank Śląski.



Source: Own elaboration based on an interview in ING Bank Śląski.

[38] Ibidem.

Considering the fact that the way of scoring the individual variables is a particularly protected secret of ING Bank Śląski, below there is an exemplary and open for general use model of a scoring card presented for a better illustration of the subject.

Table 3.1 *– Exemplary, simplified version of a scoring card.*

CHARACTERISTICS AND THEIR ATTRIBUTES	WEIGHT
OCCUPATION OR TYPE OF CUSTOMER'S WORK	
Professionalist or member of top management	10
Skilled worker	8
Clerical worker	7
Student	5
Unskilled worker	4
Part-time worker	2
HOUSING STATUS	
Landlord	6
Tenant	4
Living with a homestay family	2
ASSESSMENT OF CREDIT CREDIBILITY	
Very good	10
Average	5
No data	2
Low	
PERIOD OF EMPLOYMENT AT PRESENT POSITION	
More than twelve months	2
Less than twelve months	1
HOME TELEPHONE	
Yes	2
No	0
NUMBER OF PERSONS MAINTAINED	
None	3
Obe	3
Two	4
Three	4
More than three	2
BANK ACCOUNTS KEPT	
Both savings accounts and personal accounts	4

Only a saving account	3
Only a personal account	2
No account	0

Source: based on www.nbportal.pl, 2007

Table 3.2 – An interpretation of the outcome

TOTAL POINTS	AN INTERPRETATION OF AN OUTCOME
30 – 43	GOOD CUSTOMER – a credit is granted
15 – 29	AVERAGE CUSTOMER – granting a credit on condition of establishing additional protection
0 – 14	BAD CUSTOMER – refusal of granting a credit

Source: based on www.nbportal.pl, 2007

In ING Bank Śląski the characteristics may differ depending on which credit is applied for by the applicant. Some characteristics are more important in the case of a credit card, while other by the assessment of e.g. a car credit or a mortgage credit.[39]

Conclusion

As it has been presented, the credit scoring is a relatively non-complicated method of measuring the credit risk. Moreover, most of experienced bankers consider it as the most effective tool of assessing the credit capacity of natural persons and small and medium-sized enterprises.

It is the low level of procedures complexity that is undoubtedly the reason of a common application of the scoring method by the banks functioning in Poland. This gives the aforementioned institutions a possibility to use cheaper software than in the case of more complex methods and therefore lower costs of running a banking activity. This is probably the reason why it has been applied in banking for more than forty years in spite of numerous drawbacks describe above.

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[39] Ibidem.

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The Role Of Institutional Support In Fostering Entrepreneurship

Đula Borozan
Full Professor
Faculty of Economics
J. J. Strossmayer University in Osijek
Croatia
e-mail: borozan@efos.hr

Marija Popović, M.Sc.
Republic of Croatia Customs Board
Osijek, Croatia
e-mail: mpopovic@carina.hr

Abstract

Under favorable circumstances, especially regarding institutional conditions, entrepreneurship can be a powerful engine of economic growth. To have a positive impact on economic growth, entrepreneurship has to be productive and driven by opportunity.

This paper presents a study of a small wood-processing firm that has, it seems, a financially promising business idea. But, the paper indicates that good business idea and business expertise are not sufficient for start-ups.

The main purpose of this paper is to discuss the role of institutional support in fostering entrepreneurship. Financial support being frequently constraint under undeveloped financial market is a part of institutional support. The paper indicates the need for faster financial market development in Croatia because it is underdeveloped. The paper also points out the need for existence the other forms of entrepreneurial financing besides bank credits, such as venture capital, business angels and corporate share issuing.

Key words: *entrepreneurship, Croatia, institutional environment, financial funds, small wood processing firm*

1. INTRODUCTION

It is well-known that entrepreneurship, under favorable circumstances, can be a powerful engine of economic growth. To have a positive impact on economic growth, entrepreneurship has to be productive one in a sense of Baumol (1990).[1] Productive entrepreneurship cannot be taken for granted and the economic and social incentives (i.e. economic-social context) determine what type of entrepreneurial activity are most prevalent in a given setting (Aidis 2003). This is very important for the transition economies. According to Dallagio (1997) and Aidis (2003) transition economies, like Croatia, are mostly characterized by a high level of unproductive activities. In addition, they are often rent-seeking and economically destructive. The GEM researchers[2] found out that the impact of entrepreneurship on economic growth and development depends on the type of entrepreneurship: necessity driven entrepreneurship has no effect on economic growth and development while opportunity driven entrepreneurship has a positive and significant effect.

The positive role of entrepreneurship in economic growth involves more than just increasing output or income per capita. It involves initiating and constituting changes in the structure of business as well as accelerating the generation, dissemination and application of innovative ideas, products and services. It expands the economic capacities of an economy fuelling the drive for the increasingly efficient use of all physical resources and facilitating the effective use of human capital and other intangible resources. It facilitates also the creation of new employment opportunities. This is especially important in societies undergoing rapid economic changes like the transition countries, - Croatia for example. Croatia has gone through rapid and turbulent changes caused by Homeland war and transition of its political economy. The transition has been followed by vigorous changes not only in economic system but in cultural and political system, too. Entrepreneurial culture development, being not treated as a condition or a positive spur for economic growth within the old Croatian system, has become one of the crucial prerequisite for its sustainable economic growth. All new and strategically important Croatian documents – "55 Policy

[1] Baumol (1990) pointed out the need to distinct between productive, unproductive and destructive entrepreneurship, where productive entrepreneurial activity refers to any activity that positively contributes to net output of the economy. On the contrary, unproductive entrepreneurial activity refers to any activity that does not contribute to output or economic growth; in specific situations the activity can reduce output or restrain country's growth. Destructive or rent-seeking entrepreneurial activity leads to the misallocation of scarce resources into pursuits that from the viewpoint of the economy are useless and are carried out for the self-serving purposes of the entrepreneur.

[2] GEM is a large multinational project focusing on the collection and analysis of internationally comparable data on entrepreneurship and its impact on economic growth (www.gemconsortium.org).

Recommendations for Raising Croatia's Competitiveness" (National Council for Competitiveness, NCC, 2003) and "Strategic Framework for Development 2006-2013 (State Office for Development Strategy, 2006) - indicate the importance of entrepreneurial culture development as the crucial driver of economic growth and new job creation. Entrepreneurial culture and entrepreneurship in general attract attention not only in Croatia, but also in developed countries.

However, entrepreneurial culture is not a sufficient condition for entrepreneurship development and conducting successful business. In addition, it can not ensure that entrepreneurship will have a positive impact on economic growth. Business success for entrepreneurs and a positive impact on growth depend on many factors; three distinct sets of variables being confirmed in practice are frequently mentioned in the literature: the institutional environment, sociological variables, and personal and psychological characteristics (see Djankov et al., 2005).

Institutional environment is extremely important for each country, and especially for transition countries. The quality of institutional environment and its impact on entrepreneurship attract a lot of attention among social scientists, policy authorities and practitioners (see, for example, Baumol, 1990; Desai et al., 2003; Douhan and Henrekson, 2007). In Croatia, its importance was pointed out by research findings also (see GEM Croatia, 2003 and 2006). Douhan and Henrekson (2007) showed that under unfavorable institutional circumstances rent-seeking and predatory entrepreneurship, via the political system, offer greater profit opportunities than the market and that it will not have a positive impact on economic growth.

This paper presents a study of a small wood-processing firm that has, it seems, a good and financially promising business idea and expertise. But, the paper will indicate that they are not sufficient for start-ups in cases when entrepreneurs do not own financial funds, and that a diversified and consistent institutional infrastructure support system for entrepreneurship should be developed.

The main purpose of this paper is to discuss the role of institutional support in fostering entrepreneurship. Financial support being frequently constraint under undeveloped financial market is a part of institutional support. The paper will indicate the need for faster financial market development because it is underdeveloped in Croatia. The paper will also point out the need for existence the other forms of entrepreneurial financing besides bank credits, such as venture capital, business angels, corporate share issuing, and changes in the bank guarantee approval system. Practice in developed countries indicate, right these – alternative sources of financing to bank credits – are very important in fostering entrepreneurship (see for example Desai et al., 2003, Douhan and Henrekson, 2007).

2. ENTREPRENEURIAL DYNAMICS IN CROATIA

In the early 1990s, small business sector in Croatia was generated mostly from newly registered firms, privatized small and medium-sized enterprises (SMEs) and from small family craft firms (Borozan, Pfeifer, 2001). Theoretically and empirically confirmed expectations about small and medium-sized enterprise effectiveness and their contribution to economic growth in developed countries start to give positive results in Croatia, too. According to the data of the Financial Agency (FINA)[3] in 2005 in Croatia there were 71,803 small and medium-sized companies with approx. 814,000 employed persons. They accounted for 98.5% of the total number of Croatian companies, 51.9% of the total employment (in comparison with 36.7% in 2002), 38.4% of the total income generated in Croatia (for comparison's sake, the share of SMEs in the total income of transition countries goes averagely from 55 to 70%), and only 26.1% of the total income generated abroad.

Macroeconomic indicators indicate the following trends in 2006 in the Croatian economy:[4] increase in industrial production, continuation of income growth generated in tourism, slow increase in exports, keeping stability of kuna parity, decrease in unemployment and keeping inflation on low level. But, positive movements can not completely compensate the negative movements and unfavorable issues, such as: high unemployment rate, increase in external debt, higher increase in imports than in exports and therefore increase in trade deficit. It should be noted that higher economic growth rates are precondition for minimizing negative trends in Croatia.

Economic growth in 2006 was faster than two years ago. Real GDP increases from 3.8% in 2004, 4.3% in 2005 to 4.7% in 2006. However, consumption gave the most important contribution to economic growth what can jeopardize Croatian future economic outlooks. But, its share in GDP is lower in comparison to previous years, what can be explained partially by slower increase in wages. However, investment cycle being linked to larger investment by entrepreneurs in long-lasting capital, residential investment expansion and large state and municipal infrastructural investment projects have become more and more important drivers of economic growth. A large part of investment activities is connected to tourism which passed through good season again. The energy sector generated good results also. The largest shifts have been made in building

[3] Source: Lozić, V.: Malo gospodarstvo u 2005: Usporavanje uz skromne pomake, Lider, Specijal: Malo gospodarstvo, 24.11.2006, pp. 26-33

[4] For details see Croatian Chamber of Economy, Center for macroeconomic analysis / Selected macroeconomic indicators for Croatian economy, http://hgk.biznet.hr/hgk/tekst.php?a=b&page=tekst&id=413 (accessed 15.01.2007) or MELE (2006).

accessory gas station, modernization of the oil refinery, and new power station building.

Consumption loans rose in 2006 as well as bank loans to companies (14.3%) and residential loans (28.8%). The data of the Croatian National Bank (CNB) indicate almost 50% of approved bank loans went to households, while only 38.7% went to companies.[5] A strong increase in bank loans contributes to intense import growth. The imports increased faster in 2006 (10.5% in 2006 to 9.7% in 2005). In 2006, export rate was higher than import rate (14.3% to 16.7%). In Croatia, less than 10% of active companies export. Export per capita accounts $2,000. Taking into consideration the exports and imports, Croatia lags behind the leading Central and Eastern European countries. Besides the low level of exports, inadequate export structure is also a problem. The largest Croatian exporters are state companies and companies operating with loss.[6] In addition, the most of products aimed for exports have a low value added, what means that their production is based not on high technology and know-how, than on exports of raw materials and relatively cheap works. Shipbuilding, transits and industrial companies with long tradition, energy and petrochemical industries occupied the top 20 of the biggest Croatian exporters.

The above mentioned indicators indicate positive, but insufficiently large shifts in building the highly competitive economy that will be able to integrate itself in a global economy. Although national competitiveness depends on microeconomic competitiveness, government can encourage or discourage national competitiveness through institutional environment.

3. FOSTERING ENTREPRENEURSHIP THROUGH BUILDING THE SOUND ENTREPRENEURIAL FRAMEWORK CONDITIONS

Entrepreneurial framework conditions play an important role in entrepreneurship development. According to GEM[7], they include financial support (its availability and structure), government programs and policies aimed to foster entrepreneurship, education and training, R&D transfer, commercial and legal infrastructure, internal market openness, access to physical infrastructure, as well as cultural and social norms.

Entrepreneurial framework conditions in Croatia in terms of availability and quality are perceived by entrepreneurs as mostly unfavorable. This is especially true when financial support, government policies, programs and regulations,

[5] Source: CNB, www.hnb.hr/standardni_prezentacijski_format.htm (accessed 15.01.2007)
[6] Source:CNB, www.tportal.hr/gospodarstvo/poslovnivodic/page/2006/12/22/0363006.htm (accessed 27.12.2006)
[7] See GEM Reports, www.gemconsortium.org

education, R&D, internal market openness as well as cultural and social norms come into question (see for details Singer et al., 2006).

The Croatian government accepted in 2004 the Program for fostering small and medium-sized entrepreneurship with 42 specific projects. Ministry of Economy, Labor and Entrepreneurship was named as a pillar of this program. By using this program, the government wants to create conditions for achieving the following goals: [8]

- more balanced development of Croatia
- increase in enterprise number in the small economy
- building new entrepreneurial zones
- removal of administrative barriers
- increase in competitiveness (investment in development, education and new technologies)
- change in industrial structure in favor of production
- strengthening export orientation of the country
- favorable entrepreneurial climate development
- networking within small economy and small economy with large one (through cooperatives, clusters, etc.)
- employment increase to 2 employees per craft
- tax relief
- faster inclusion into entrepreneurship special target groups (youth, women, soldiers)
- entrepreneurial education and additional training for entrepreneurs.

In the last two years, many of the projects were started. However, entirely goal achievement requires hard work and enough time.

In order to minimize administrative obstacles and optimize thousands of rules and regulations, the government has started project named HITROREZ.[9] It also established new service of government administration - HITRO.HR intended for quick communication of citizens and business subjects with the state administration.

Hitro.hr is headed by FINA – leading service institution in financial sector. It is possible to establish a limited liability company on the HITRO.HR counters within FINA in an easier and quicker manner as well as to acquire all information and perform most of the required procedures for establishing the limited liability company in one location.[10]

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[8] Source: www.mingorp.hr/UserDocsImages/Program poticaja malih i srednjih poduzeća.pdf

[9] See www.hitrorez.hr/

[10] For more information about HITRO.hr see www.hitro.hr

Although, the government needs to help entrepreneurs by creating favorable entrepreneurial framework conditions, it can not guarantee a personal achievement and business success.

4. THE CASE OF THE SMALL WOOD-PROCESSING FIRM „SISKA"

The case being in the hearth of this paper is an illustrative example of necessity of institutional help and support for small entrepreneurs in order to a potentially profitable project could be realized. The case indicates the need for fostering financial market development, first of all, its structure and supply assortment.

Case description

The protagonist of this case is Mr. Mijo Coskovic, owner of a small firm «Siska» being in the wood-processing business. His past experiences and competencies were an adequate and qualitative basis for a new start-up. He founded his firm in 1993. in an extremely turbulent time in Croatia, when it was in the process of getting its independence and when large-volume wood-processing companies were destroyed due to accumulated problems. He treated this chaotic and turbulent situation as a good business opportunity. However, he experienced prevalent problems in this industry. They forced him to close production and to rent a business space and equipments to the partner firm «Sisarka» which is in ownership of Italian holder. In the partner firm, he was an executive director the entire time. Unfortunately, this firm also fell into trouble and Mr. Coskovic was forced once again to think about a new start.

Countries

His present goals are to become a manufacturer of torn oak staves and barrique barrels being suitable for cultivation of high-quality wines as well as to conquer domestic market, and after that foreign ones – primarily of new viticultural countries. Since Italian holder of «Sisarka» produced torn oak staves, Mr. Coskovic acquired know-how in production, and information about their usage and market demand for them abroad. Considering the barrel production possibilities in his firm, he started to collect all information about sales, production, demands, possible markets and financial fund sources.

Collected information that Croatian vintners want to produce barrique wine, that barrique barrels are not yet produced in Croatia, and that the barrel production is promising regarding profit, stimulated him to invest more efforts in realization of this business idea. The talks with several domestic vintners helped him to identify issues of domestic wine manufacturers, such as brand building, production of high-quality wine, lack of strategy in the Croatian wine industry and modes of foreign market entry, etc. Consequently, he decided in his project

named "National Program Proposal" to link the interests of Croatian vintners, state firm «Croatian forests» - supplier of raw materials and wood-processors in supply of qualitative products in markets.

«Jump and swim»

Since SWOT analysis helps the organization in synthesizing all information about external threats and opportunities facing a firm, its internal strengths and weaknesses, SWOT matrix of «Siska» is presented in continuation of this paper. It should be pointed out that the items of SWOT matrix (Table 2) were derived from a series of analysis conducted in M.S. thesis of Marija Popovic titled «Developmental alternatives of a small wood-processing firm» (2003); *inter alia*, analysis of Siska's environment, financial feasibility of the project, long-run profitability and attractiveness of domestic and foreign barrel market, success factors in barrique barrel production, etc.

SWOT analysis is the well-know technique that is used in situation analysis, i.e. in bridging the strategic gap between the position in which a firm is right now and where it wants to be. In order to formulate a successful market strategy, strengths, weaknesses, opportunities and threats should be analyzed. Strength and weakness represent present state based on the past, and opportunities and threats represent future based on the present and the past (Renko et al., 1999, p. 151).

Conducted analysis of strengths, weaknesses, threats and opportunities of the firm «Siska» resulted in formulating four generic strategies. They can be used in determining the Siska's future business trajectories (Table 2).

Table 2: SWOT analysis of capacity for production, opportunities and generic strategies

	STRENGTS - enthusiasm, vision - informal contacts - no own money in business venture - approach to investors - the idea about «National program» - know-how in entrepreneurship and wood-processing activities - availability of equipments and business space - availability of highly skilled workers	WEAKNESSES - expensive raw materials - lack of image and brand - lack of certificates about product quality - lack of experiences in barrel production - insufficiently sourced market - lack of financial funds - questionable dynamics of raw material delivery
OPPORTUNITIES - increase in high-quality wine demand - increase in interest of domestic vintners for barrique barrels and their production - availability of highly skilled work forces - large demand for barrels from new viticultural countries - lack of domestic made barrique barrels	Jump and swim Start to produce barrique barrels, supply them to domestic vintners, and direct exports to Australia. Simultaneously work on brand and image development. Connect domestic suppliers («Croatian woods») and buyers via «National program» Point out mutual interests and promote domestic made products. Make interesting vintners or others investors in project financing.	Wait and collect scientific certificates Produce torn oak staves and barrique barrels only for scientific testing in cooperation with vintners (domestic or foreign). After announced positive results from institutes, start to produce barrique barrels.
THREATS - strong foreign competitions - affection of buyers to renamed image - strong bargaining power of buyers and suppliers - high customs and taxes in the EU countries for certain Croatian products	Neutralize risks Produce only torn oak staves. Consider possibilities for forward integration with famous foreign coopers.	Give up Treat knowledge and acquaintanceships collected in preparations and negotiations as treasure that can be useful in future.

The first strategy «jump and swim» aims to leverage the firm's strengths in exploiting the opportunities. It means start to produce torn oak staves and barrique barrels. According to this strategy, the firm needs to offer barrels to domestic vintners, and exports should be directed to high-quality wine manufacturing

countries. Raw material suppliers should be connected with domestic vintners through mutual interests, and the firm should simultaneously work in brand and image building.

The second strategy «wait and collect scientific certificates» is derived from the firm's weakness acceptance with respect to market opportunities. According to the strategy, the firm should produce barrels only for the need of scientific testing in cooperation with domestic and foreign vintners. Only after collected favorable findings, the start of barrel production is strongly recommended.

According to the third strategy «neutralize risks», the firm should produce torn oak staves, and give up entirely from barrique barrel production. The strategy recommends production of torn oak staves for foreign buyers.

The fourth strategy «give up», based on the firm's weaknesses and threats in a firm's environment, suggests giving up from any production. It suggests also treating collected knowledge and acquaintanceships as a fortune that should be use in the future.

* * * * *

The strategy of starting production of torn oak staves and barrique barrels showed as the best strategy. The reasons for that are derived from possibilities generated by this strategy, such as:

- to get a loan under relatively favorable conditions because it is about production of export interesting product (barrique barrels) or even better to use alternative financial sources
- to get government support to improve the business conditions given by the only raw material supplier («Croatian forests»);
- to use the advantages of the early entry in domestic and foreign market (Australia's market for example)
- to develop know-how in barrique barrel production thanking to business contacts with French coopers
- to build brand and image of the firm
- to get certificates about barrel quality and
- to build confidence by buyers simultaneously with production.

Financial analysis indicates also the production of torn oak staves and barrique barrels are an optimal business option. Since the production process of barrique barrels lasts three years, incomes collected from the sale of the oak staves are necessary for doing business. Internal rate of profitability of 35% indicate the production of torn oak staves and barrique barrels are profitable, and business can become self-financing only in the 8th year of production. Credit funds can be returned in the 5th year of business since the rate of return before interests

and taxes accounts 1.71%. That means that firm will realize 1 EUR and 71 cents on each invested EUR.

The basic disadvantage of this strategy is connected to an «early entry» in domestic market. Two reasons stand behind this:

- first, domestic vintners do not have confidence in the quality of «Siska»'s barrels;
- second, domestic vintners do not yet have certain own strategy in high-quality wine production.

Challenges

In barrique barrel production key success factors are: availability of raw materials, financial funds and production know-how, image, recognition and product quality, strength and expansion of network with domestic and foreign vintners, demand for barrique barrels in domestic and foreign markets and business contacts. The key success factors in the oak staves and barrique barrel production are not entirely uncontrollable for Mr. Coskovic. Business will be profitable only if qualitative raw materials and sufficient financial funds are available, if image on quality is built and if high-quality wine demand exists.

The case of the firm «Siska» indicates the promising profitability of the business. However, the risks in the barrique barrel production are really high. One needs to obligate in amount of 500,000 EUR, and there is uncertainty whether the market will accept barrels from this producer. Will the Croatian vintners participate in that project as the project of mutual interest, or will they prefer buying the barrels from French coopers that have great image for high-quality wines production? The second important risk refers to buying raw materials in a certain volume and quality. Besides this, he needs to employ another 35 workers, and pay them wages. First barrique barrels can be sold in the third year of the business. Till the 8th business year credits are necessary for business financing.

The firm owner turns to the Croatian Bank for Reconstruction and Development (CBRD) and Zagrebacka bank. He demands support from Croatian Agency for Small Business (HAMAG); the Ministry of Economy, Labor and Entrepreneurship, Vukovar-Srijem county, Croatian Chamber of Economy and Croatian forests. However, he got only declarative supports.

Nobody as private entrepreneurs that risks his/her own funds and reputation will be motivated to correctly evaluate business program, to choose right people, to face the competition and uncertainty and to finish with business success. Certainly, a business success is not guaranteed regardless the quality of business program and plan.

Mechanic who wants to improve his work
should first sharpen his tools.

Confucijus

5. CONCLUDING REMARKS

In the EU countries small and medium-sized entrepreneurship is the driver of economic growth and new jobs creation. This is an acceptable development model for the development of Croatian economy, too. Whether the small and medium-sized entrepreneurs will become the drivers of Croatian economy, depends highly on the government that needs to create favorable environment for productive entrepreneurship.

The case of the firm Siska, i.e. start-up of the project considering the barrique barrel production can contribute to the fostering and matching several industries, such as forest industry, wood-processing industry and wine industry. Contemporary trend in European wine industry indicates the vintners tend to produce high-quality wines. They keep the existing wine areas on the same level or even they reduce them to achieve better wine quality. Croatia is not famous for large areas under vineyards, but it is famous for good grape sorts and favorable climate. These conditions are excellent prerequisites for high-quality wine production. In order to improve wine quality, Croatian vintners import oak barrels. Without these barrels they can not get high-quality wines. The project of barrique barrel production being the base of the case in this paper emerged as recognizable business opportunity. This is the best motive for starting a new project and it has the best impact on economic growth.

On way from identified good business opportunity to its realization there are many constraints. Among them, the burdening one refers to obtaining financial funds. An entrepreneur can obtain financial funds from banks or from state institutions as are, for example, HBOR. It gives credits through commercial banks with which it signed contract. Banks act carefully when it is about start-up firms; they ask for high guaranties. Only SMEs with projects fitted to incentives determined by government can get guaranties from HAMAG or Croatian Guarantee Agencies. By foreign bank entries in domestic market, Croatian citizens have become their target. Therefore, money supply in citizen crediting overcome the quantity of money directed to firms. Only recently, banks have been opening to firms as their important clients in the forthcoming future.

The case analysis being in this paper briefly presented, indicate it is about probably profitable project that promotes national interests and positively contributes to economic growth. Simultaneously, it opened numerous

perplexities and fuzzy questions not only for entrepreneur alone but also for the quality of institutional environment. To foster entrepreneurship in Croatia, it is extremely important to faster financial market development in terms of structure and supply assortment. Regardless of the fast bank credit growth, lower interest rates, longer deadlines for credit payments and subsided lines (like those ones supplied by HBOR), there are numerous projects, especially in the early start-up phase, that are too risky for financing by bank credit, and for which capital is necessary. In such cases, venture capital funds and business angels have an extremely important role. In Croatia, there were only four financial companies in 2006 that could be grouped according to their characteristics to the group of VDF intermediaries (SEAF Croatia, Quaestus, Horizonte and Copernicus Kapital).[11] Data on three fund activities (SEAF Croatia, Quaestusi Copernicus Kapital) indicate that they had 46 transactions, out of 30 new investments. That means that an average investment amount was EUR 2 million. Compared with the other CEE countries, this is undoubtedly the least average (in these countries averagely investment amounts were between EUR 5 and 8 million).[12] Business angels have had an even less remarkable role in Croatia. Partially this can be explained by undefined legal framework. Furthermore, GEM findings for Croatia indicate entrepreneurs have more problems with securing guaranties than with the price of capital (Singer et al., 2006).

Sustainable development in Croatia is not possible until institutional entrepreneurial framework conditions get better; among others as it is indicated by the case, through faster financial market development. A necessary prerequisite for this is to establish the legal framework that will regulate the venture capital funds and business angels operating.

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[11] Source: Rizični kapital, Banka, March 2006, p. 70

[12] For more information about these funds see “Kapital koji nedostaje”, Tržište kapitala, Banka i Arhivaanalitika, March 2005, pp. 32-35.

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Considerations Regarding the Euro Adoption in Romania

Laura Voila
Faculty of Economical Sciences and
Business Administration
Babes-Bolyai University
Cluj Napoca, Romania
E-mail: lvoila@yahoo.com

Abstract

All the candidate countries to the integration into the European Union are speeding up towards a full integration although, the complete process is not possible without an adequate monetary frame. Both the European Union and the candidate countries are completely aware of this truth, so, for that matter, the solution proposed for the Monetary and Economic Union varies quite a lot from one country to another[1]*. The experience of the past ten years shows us that a rushed euro adoption can transform the way towards the complete and efficient integration into an extremely difficult one. That is why the specialists suggest that the transition to euro must not be uselessly accelerated and the adoption of the European currency must not become a purpose in itself. Besides the fulfilment of the nominee convergence criteria, the accomplishment in the shortest time possible of the real convergence must retain the authorities' attention from each country. As a consequence, the time period between the moment of adhesion and that of the effective entrance in the ERM II mechanism will have to be used by our country with wisdom for deep economic restructuring, for the accomplishment of some investment programs meant to reduce as much as possible the difference from the actual EU standards.*

Key words *– adhesion criteria, nominee convergence and real convergence, strategy and monetary policy*

The abandonment, on the 1st of January 2002, of the national currency, by more than 300 millions of Europeans, in favour of Euro, has meant a movement of great ampleness. Each country had to get used to manipulate new payment instruments and especially to estimate the value of their own products in a different monetary unit than that the prices were expressed in before.

[1] Ionescu L. – The issue of a Monetary Anchor Within the Prospect of EU Accession, Mai 2000

Monetary Europe was not suddenly constituted the day the unique currency replaced the national ones. The construction of the European monetary system had more stages during which, the links between the European currencies tightened in order to reach a European Union (EU), an economic and monetary union (EMU) and a unique currency, managed by a european system of central banks (ESCB).

Jacques Rueff said: "L'Europe se fera par la monnaie ou elle ne se fera pas[2]" – point of view according to which the monetary integration is not just a goal in itself, but also an important mean of reaching a generous and ambitious wish – Europe's political unification. The transition to the unique currency represents the most significant part of the monetary unification process, initially represented by the will of the European countries, to adhere to a world monetary order, supervised by the United States of America, then, to recreate this order at an european scale, within the "monetary snake" at the time that SMI proved unable to assure efficiently the stable exchange rates, and then, to free from the US dollar by creating European Monetary System.

If the european countries accepted to engage in these stages, despite the constraints that these stages impose, is because the building of the european monetary system is capable of offering decisive advantages to the participating countries. Started in 1972 with "the monetary snake", the european integration within the European Economic Community continued in 1979 with the creation of the European Monetary System (EMS), then with the beginning of a process that would lead to the unique currency. The system functioning is backed up by the ECU and by the definition of pivot exchange rates, the base of the exchange mechanism.[3]

The decision of integrating in the european structures is the only correct and useful for long term development of our country. The adhesion to the European Union represents a progress catalyst and an instrument for Romania to exceed the differences that separate it from the present level of the European Union, both in the economic and institutional fields and also the performance of the society as a whole. This will also involve of course a long term effort and will, first of all, suppose abandoning the anachronistic mentalities for a society of competition, performance and welfare.

The adhesion to the European Union, in 2007, represents a significant forward step, but the process of gaps reduction will still continue for a long time afterwards. The adhesion to the Euro region will represent a second very important step in

[2] Jacques Rueff – *Une monnaie, l'euro, une banque centrale, 12 pays*, Montreal speech, September, 2002

[3] Trenca Ioan – International Monetary-financial Transitions, course

this process. According to the present arrangements, euro "adoption" cannot take place earlier than two years after the date at which Romania is part of the Union, especially because the conditions that have to be accomplished in order to make the entry within this process possible will not be accomplished during the first year after the adhesion to the EU. Although the adhesion to the euro region is in itself a strategic objective of great importance, the actual moment in which the decision is put into practice will have to be chosen which great care, in order to see which are the advantages, but also the restrictions that this process imply.

ERM and ERM II.

Opinions regarding the participation at the Exchange Rate Mechanism

The initial Exchange Rate Mechanism (adopted in 1979) was a many-sided exchange rate system. Each participating currency had central parities established in comparison with the other currencies (derivatives from the ecu's exchange rate by cross), in comparison to which it can range from -2.25% to +2.25%. Once with the beginning of the third stage of EMU, on the 1st of January 1999, when the unique european currency was adopted – the many-sided system was replaced with a two –sided one, ERM II, through which each participating currency has a central parity defined in comparison with the euro, and the range varies from -15% to +15%. In case of some pressure appearing on the exchange rates, the European Central Bank is obliged to give support to the national central bank, intervening automatically when the exchange level reaches the borders of the range (marginal intervention) and has the possibility to sustain the national central bank's interventions when the exchange rate is inside the range values.

According to the Maastricht Treaty, the new candidate countries that adhere to the EU will become member states with a temporary derogation in what regards the common currency. This means that at a certain point in time, after the adhesion, the new member states will enter ERM II, and then on the condition of accomplishing the "nominee convergence" criteria, they will adopt the euro.

The Maastricht Treaty was in such a way conceived that the *nominee convergence* criteria are considered necessary and sufficient for a country to adopt the euro, respectively:

- A budgetary deficit under 3%;
- A total national debt lower than 60% of GDP in the year of adoption of the unique currency;
- An inflation ratio that should not exceed with more than 1,5% the average inflation of the three most developed states of the EU;

- An interest rate for the ten years public securities that should not exceed with more than 2% the average interest rate of the three most developed countries as defined above;
- In addition, a high degree of exchange rate, without one-sided depreciation in respect to euro, for at least two years, is necessary.

All the countries that will adhere to the EU set themselves to have a crossing period through the ERM II as short as possible, although there are no formal restrictions regarding this period of time. To avoid an excessively long participation and at the same time to assure a smooth transition through ERM II, the moment in time of entering this mechanism has to be established by taking into account the level of nominee convergence" criteria fulfilment.

THE NOMINEE CONVERGENCE AND THE REAL CONVERGENCE

The Maastricht Treaty does not refer to any real convergence criteria that should assure a high level of similarities for the candidate countries' economies. It is possible that the initial omission to be due to the fact that until the beginning of the 90's, the EU was a club of the reach countries (with one or two exceptions), and the economic structures of these were alike. When they became aware of the importance of the real convergence for a successful integration of the countries in the Central and Eastern Europe, the Treaties were already signed. In exchange, the past years, both the European Commission and the European Central Bank warned in a more and more transparent way about the risks of a rushed adoption of euro by a country whose real convergence with the West European structures is insufficient.

The most important *real convergence* criteria regard:

- The degree of openness of the economy (expressed through the weight factor that the amount of the exports and imports of a country has in the GDP);
- The weight factor of the bilateral / two-sided commerce with the member countries of the EU in the total foreign trade;
- The structure of the economy (expressed by the weight factor that great economy's sectors have in the GDP building: agriculture, industry, services);
- The GDP per head level.

SOME EVOLUTIONS OF THE EUROPEAN ADHESION

Some aspects are very important from the point of view of choosing the best course for the romanian economy, in its way to the euro region. A first aspect refers to the accountability of each candidate state in the elaboration of an own

strategy. Although it is stipulated that after the adhesion to the European Union, the monetary and exchange policies of each state become object of the common interest, it is also specified that the choice of monetary and exchange policies after the adhesion to the EU become primary a responsibility and a prerogative of that member state.

Another aspect is that it is expected that the authorities of each state do not take decisions of their own, not agreed with the European Commission and with the European Central Bank. All countries must take part for at least two years to the ERM II before the assessment of the level of fulfilment of the nominee convergence criteria.

A third element of great importance is the emphasis that is made more and more on the fulfilment of the real convergence criteria before adopting the euro. The European Commission and the European Central Bank advise a division in time of the process, on one side, through the postponing of the ERM II entrance, and on the other side, through the spending inside this mechanism of a larger number of years than the minimum stipulated, in order to get the best preparation both from the point of view of the nominee criteria and of the real ones.

It is obvious the interest that the European Commission and European Central Bank have in not letting insufficiently prepared countries to make pressures on the euro adoption only on the ground of fulfilling of the nominee convergence criteria.

An important aspect is that mentioned in respect to the principles which guides the European Commission in the relation with the new candidates:

- The multi-sided work frame: none of the countries must take any decisions of monetary or exchange policy on its own, without consulting the European authorities;
- The missing of a unique course for the euro adoption;
- The case by case treatment: the last two principles are relevant for Romania, which thanks to its characteristic will take a different course from that of the majority countries of the 6th wave of adherence
- The principle of equal treatment in time and space: it can be interpreted and in some cases, derogations can be accepted (for example, for Italy and Finland, shorter periods of participation to the ERM II have been accepted: for instance, 14, respective 16 months), but it is improbable that such a treatment extends also to the new member countries.

As a conclusion, the theoretical and practical frame in which the entrance in the ERM II mechanism takes place and afterwards the euro adoption, is greatly known and predictable. Still, the European Commission and the European

Central Bank can interpret and analyse the situation according to the level of each candidate.

ROMANIA'S SITUATION CONCERNING THE CONVERGENCE CRITERIA

Romania is different from the majority of the candidate countries, because it has no problems in what the budgetary deficit and the national debt are regarded (area in which other countries must make the most important adjustments); in exchange, the level of inflation and the interest rate represents a reason of concern for Romania.

Romania's provisory budgetary deficit for the year 2006 is of 2,4% of GDP and respects the Maastricht criteria of 3%. The public debt of Romania also respects the Maastricht nominee convergence, with a level of 13% of GDP forseen for the year 2006. At this respect, Romania's performance is higher than the majority of other east-european countries.

There are also aspects of the nominee criterai that Romania does not fulfill yet. The most important at this respect is the level of inflation, still modest comparing to other east-european countries (6,4% anual average for 2006).

Tightly bounded to the inflation criteria and its still high level is also the criteria regarding the interest rate for the long term public securities in national currency. If on the foreign capital markets was possible the issuing, in 2002, of some public bonds in euro with 10 years due, on the home market due to the still high inflation ratio, the maximum due that could be reached was 5 years. By the progression of the deflation process and the economic operators will be convinced of its security, there will be possible to be issued public securities with a longer due, so that this criterion could be fulfilled.

The criterion regarding the stability of the exchange ratio depends on the fulfilment of the inflation ratio criterion. In the past years the depreciation of the Romanian lion in comparison with the euro followed closely the performance regarding the inflation in order not to affect in addition the Romanian exports' competitively. Only when the inflation will be brought to a single figure and will be going down the exchange rate will be able to show a level of stability compatible with the fulfilment of this criterion.

In what real convergence criteria is concerned, we can say that the appreciation in real terms of the exchange rate is good both from the nominee convergence criteria (contributes to the inflation ratio reduction) and from the real convergence point of view (shortens the necessary time for the alignment of the GDP per head levels). In conclusion the problem is to find some ways of stimulating the exports other than by depreciating the national currency. These measures have to be taken at microeconomic level, each Romanian exporter to be interested in

a better capitalization of its resources of productivity and efficiency. The great competitive must not mean just lower costs, but also invention incorporated in the product, delivery in time, specific products for specific clients, own delivery network, service and warranty periods.

In conclusion, our country has delays both at the nominee and the real convergence criteria. Although the last do not appear expressly in any treaty, they must not be ignored, because an evolution of Romania inside the EU could lead to more costs than benefits if the necessary measures are not taken for the competitive of all economic structures.

ORIENTATION OF THE MONETARY POLICY

Accomplishing the target for the inflation ratio of 4% in 2007 is the main objective of the monetary policy this year. The realization of this objective creates the premises so that in the near future, its level should be able to get to 4-5%. The transition to the direct targeting of inflation is much favoured by the adoption by the Parliament of a new statute of the Romanian National Bank, in order to fully align the Romanian banking law to the provisions of the communitarian acquis.

More difficult to influence are the long term interests from the economy. At present, there are no securities with 10 years due, and their appearance is conditioned by the credibility of the policies adopted by the Romanian authorities and by the credibility of the inflation ratio reduction. Besides, the Romanian financial market is still under the level of other countries that entered the EU. Even admitting that the other conditions would be fulfilled, the financial market does not have the maturity and deepness needed for absorbing securities with such a long due.

Starting with 2005, the National Bank of Romania adopted a new objective of monetary policy, the inflation targeting. In a strategy aiming directly the inflation, as often as the inflation projections deviate from the aimed objective, the monetary policy reacts, using both "classical anchors" (interest rate, RMO ratio) and the one of the exchange rate. This strategy has been applied in Romania starting with 2005, till the ERM II entrance. The National Bank has fewer interventions on the market, leaving more and more the currency market to find its own rate equilibrium.

After the moment of the entrance into the ERM II, it is possible to keep the direct inflation targeting as an objective of the monetary policy, but it is evenly possible to pass to a strategy directly aiming the exchange rate. It might be possible that, by that time, Romania significantly grows its degree of economic

openness, so that the transmission channel through the exchange rate becomes efficient.

After the euro adoption, the responsibility of the monetary policy leading goes to the European Central Bank, which that practices a strategy based on two pillars: a quantitative one given by the forecast of the evolution of the monetary amount in a large way (whose relation with the inflation is considered to be stable and predictable on a long term) and a qualitative one that takes into account more financial-banking figures (the evolutions of the financial markets, the evolution of the shares and real assets, the evolution of the inflationist expectations).

Once the probable date of adopting the euro has been announced, the decisions of macro- and micro economy must be subordinated to this option.

From here, some fundamental aspects derive:

- The advantages of a low level of inflation must be explained to the political class and to the population in a repeated way in order to have their support when is needed;
- The independence of the central bank must be both theoretically and practically guaranteed in order not to be caught in conflicts;
- the simultaneous trial of aiming directly the inflation and the exchange rate needs help from the Government in order to promote a cautious fiscal and salary policy;
- important is also the keeping under control of the credit expansion;
- it is necessary of a very good communication between the Government and the central bank;
- The awareness of the fact that on a unique market the competitiveness is won by innovations, delivery in time, service, warrants and knowing the clients.

We can draw two recommendations for the monetary policy[4]:

a) the period for operating in ERM II must not exceed the two minimum years due to the difficulty of reconciliation of the rate policy with the inflation objective;
b) the ERM II entrance must be made only when the convergence criteria are fulfilled at a high level

Conclusions

As a conclusion, being a component of the economic policy, the monetary policy aims to have an influence on macroeconomic figures. Its particularity is

[4] Mugur Isarescu – Romania: drumul catre euro, Prezentare la Conferinta organizata de Colegiul Academic al Universitatii « Babes-Bolyai », 2004

about the fact that it is used as a lever, either if it is about the quantity of currency in circulation, or if it is about the price at which it is obtained. The intervention on the currency through its consequences on a number of intermediary variables must have an influence on the economic activity or prices.

Within the euro region, the monetary policy has as the final macroeconomic objective the price stability. The accomplishment of this objective represents the main mission of the European System of Central Banks, in particular, of the Governors' Committee of the European Central Bank – the decision resort, ESCB having for this purpose a series of essential instruments. These instruments give it the possibility to control the monetary creation of the credit institutions. Making the financing more or less expensive, it slows or favours the credit distribution, the main source of monetary creation in the economy.

The adoption of euro is seen as a guerdon of the European integration. The candidate countries are speeding up towards a full integration although the complete integration is not possible without an adequate monetary frame. Although both the EU and the candidate countries are completely aware of this truth, the solution proposed for the Monetary and Economic Union varies quite a lot from one country to another[5]. The experience of the past ten years shows us that speeding up the euro adoption can transform the way towards the complete and efficient integration into an extremely difficult one. That is why the specialists suggest that the transition to euro must not be uselessly accelerated and the adoption of the European currency must not become a purpose in itself. Besides the fulfilment of the nominee convergence criteria, the accomplishment in the shortest time possible of the real convergence must retain the authorities' attention from each country. As a consequence, the time period between the moment of adhesion and that of the effective entrance in the ERM II mechanism will have to be used by our country with wisdom for deep economic restructuring, for the accomplishment of some investment programs meant to reduce as much as possible the difference from the actual EU standards.

Romania's path to the complete integration and the adoption of the single currency is a very difficult, complicated and long one. In the opinion of the Governor of the National Bank of Romania, it would be more realistic that the accession to the ERM II mechanism is proposed for 2009-2011, and that the adoption of euro should be made only in 2011-2013.

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Public Private Partnership in Water Management Economy In Serbia

Sofija Adzic
Professor
Faculty of Economy in Subotica
University in Novi Sad
Republic of Serbia
E-mail: sadzic@eccf.su.ac.yu

Marko Bajcetic, B.Sc.
Public Water Management Company »Vode Vojvodine«
Novi Sad, Republic of Serbia
E-mail: mbajcetic@vodevojvodine.com

Abstract

Based on the analysis of water economy (namely, water management) as the activity that deals with prevention of detrimental impact of waters, their protection and providing for water use in the function of development in economy and among the population the conclusion was reached that there was the need for revitalization, modernization and new construction of water management structures and systems. The accomplishment of the above-mentioned requirements shall result with the improvement of quality and spectrum of the existing and new offers for water management services.

Water management in Serbia is a part of public sector that is looking for solutions for setting up of conditions and directions for transition and integration processes. One of such directions implies the harmonization of partnership with private sectors, namely entrepreneurs who shall establish the system of water management efficiency, economic viability and effectiveness through its known instruments, measures and motivation.

Public private partnership is the necessity in water management in Serbia having in mind the crisis physical and functional capacity of structures, taking into account the water use needs and requests of users. Physical and legal entities, domestic and foreign with public sector commit strategically to partnership having in mind the advantages of faster construction and use of infrastructure, lowering of costs, risk optimization, improvement of services and managerial management. Accepting of partnership by expert public is certainly a vital factor as their information and participation is expected from the first up to the final stage. Partners

in development of co-operation have to be ready to involve all available resources developing the capacity and responsibility, patience and flexibility having in mind social responsibility.

Water management in Serbia and the society and economy on the whole are in the process of transition and integration changes. In addition to standard institutional changes at macro and at the level of water management another target strategic commitment is setting of legislative and institutional structure for introduction and implementation of the EU Water Framework Directive. This is certainly a difficult road that requires, primarily, a comprehensive reform of property and setting of managerial management with improvement of entrepreneurship in particular.

Key words: *partnership, water management, strategy, transition, integration*

I. INTRODUCTORY CONSIDERATIONS

Water, water management structures, fee payers, users, taxes, fees, tariffs and prices are parts of a set of elemental terms making the basis for setting up of a consistent water management system.

Water that appears as surface and ground water, natural and artificial, makes the centre-anchor characterized by, historically speaking, different relations that have evolved up to the emergence of contemporary methods and forms of management. It is an irreplaceable condition of life and business activities. The survival is not possible without it and a man has been fighting all the time with it destructive power.

The accomplishment of planned and organized water management[1] is possible through development and functioning of water management structures and systems, namely undertaking of certain measures of investment and non-investment character.

Basic considerations in making decisions on water use and construction of water management structures refer to[2]:

1. **What** shall be built and used? This question raised in a society imposes the division between public and private goods, namely if a society decides to build certain public property it shall result with the reduction of possibility of private consumption in its total availability;
2. **How** shall something be built and used? This implies deciding if the construction shall be carried out in private or in public sector and if more capital or workforce shall be used;

[1] Djordjević Branislav, (1990) "Vodoprivredni sistemi" (Water Management Systems), Naučna knjiga, Beograd, pp. 9.

[2] Stiglic E. Džozef, (2004) "Ekonomija javnog sektora" (Public Sector Economics), prvo izdanje, Ekonomski fakultet, Beograd, pp. 72.

3. **Who shall** something is built for? It is the issue of distribution, namely usefulness that one group may have and the other may not although there is also the interest for building of some other public property;
4. How the **decisions** on construction and conditions of use are made? In a public sector this decision making is collective, which means complex.

In addition to provision of large resources, deciding on construction of certain water management structure or system requires also the previous analysis of all the pressures and risks that water and construction imply as well as direct benefits for the user and certain area, namely region.

Considering the transition processes, the first task of water management in Serbia is to implement the subject and process restructuring. This includes the defining and placing of certain technical-technological characteristics, property features and economic characteristics of each individual property in well defined water functions.

The budget resources, namely public revenues, make the most frequent source of financing, i.e. involvement of the state in the field of economy with different characteristics within public sector as the system of different institutions.

In addition to classical fiscal sources of financing it is also necessary to include sources of financing coming from the system of partnership in water management so that they are in the function of integration of water economy of Serbia into European economic trends.

Along with the above-mentioned restructuring and for the needs of integration processes, it is also necessary to define a range of category items that relate primarily to economic terms[3] such as costs (administrative, capital, direct, indirect, environmental, resources, external, financial, non-proportional, maintenance, operational, opportune), analyses (cost benefit, cost efficiency, economic), functions (implicit and explicit), costs and benefits as well as water management categories, good ecological, chemical status of surface and ground waters, water use, water management services, quality standards, water bodies, river basin, sub-basin etc.

Taking into account the amount of funds for investments and maintenance, the significance of water and water management structures and insufficiency of funds for investments, the model of public-private partnership (PPP) has been taken as a possible model. PPP is a set of joint initiatives of public sector and private entrepreneurs that can appear in different modalities.

[3] Potkonjak Svetlana, (1991) "Ekonomika vodoprivrede" (Economics of Water Management), Poljoprivredni fakultet, Novi Sad, pp. 11.

II. THE NEED FOR PARTNERSHIP AND PRIVATE SECTOR IN WATER MANAGEMENT IN SERBIA

Public-private partnership (PPP) implies the co-operation between public authorities with the private sector, either at the level of central or local community aiming at satisfying certain public need[4] such as water management.

The partnership provides a new quality of relations between the state and entrepreneurs because it is balanced in distribution of risks and rewards in relation to the existing narrow contractual relations in the public procurement field. This does not mean that each partner participates equally as such participation depends on their capacities and roles in partnership.

Contracts in the field of long term co-operation of water management (public) and private sector include the activities of financing, implementation and operationalisation of projects in the field of construction of water management infrastructure and provision of services.

PPP is based on recognizing of benefits that water management and private sector can achieve through merging and linking of financial resources, knowledge ("know how") and skills aimed at improvement of basic conditions for all the citizens.

In this sense, PPP implies the spectrum of models known as BOT models as possible relations between structures in power (public sector) and other non-government organizations (private sector) aimed at realization of projects or provision of services.

Mutual relations between water management and companies belonging to private sector are traditional and well known and that is why they resent entering into more complex relations. The government fears that private sector might take the advantage of them and private sector think that they shall get additional burden from the government and waste time.

There are three **causes and conditions** that are in favor of establishment of PPP in the sphere of water management:

1. Crisis
2. Leadership
3. Driving forces

PPP contributes also to better allocation of public revenues and secures dynamic management with public finances and public infrastructure and it represents a new philosophy making it possible for the state to return to the

[4] Akintoye Akintola, Beck Matthias (2003) "Public-Private Partnership", Blackwell Publishing, pp. 36.

framework enabling it to deal with and direct more towards its original functions: to represent the citizens and provide services that cannot be transferred onto the private sector.

When it comes to construction, maintenance and use of water management structures (dams, accumulation lakes) and water supply systems, irrigation and drainage systems our existing legislation allows for PPP to be set up for the period of 30 years. The **advantages** provided by co-operation with private sector are reflected in:

Successful partnership in water management is characterized by:

A. COMPATIBLE OBJECTIVES that consists of understanding and setting of objectives of others observing the differences and motives.

B. STIMULATIVE SOCIETY that shall create the foundation stone for sustainable inclusion in the private sector through legal and regulation framework and political environment.

Stimulative society consists of the following six components the interests of which are confronted:

- Public in the widest possible sense,
- Users,
- Political factor,
- Legislation,
- Administration,
- Private entity interested in partnership.

C. ACCEPTANCE that implies resolving of problems resulting from

- Increase of tariffs for use of water management structures
- Narrowing of field of acting of users of water management structures due to complete or partial privatization.

D. CREDIBILITY AND TRANSPARENCY. It is difficult to achieve positive business result through co-operation of different participants from water management and private sector so that credibility of managers and other leaders and transparency of the process are necessary. Namely, mutual trust and safety are things that are needed.

Significant elements of durable PPP in water management include:

1. EMPLOYMENT OF RESOURCES

This implies that all the partners need to employ their resources (natural, material, financial and human) in order to increase their interest which also includes risks and rewards sharing.

2. CAPACITY BUILDING

Water management projects require significant institutional changes and large capital investments and that is why the capacity building of all the participants is necessary.

3. ROLE AND RESPONSIBILITY

Defining of roles and responsibilities is a significant element that is necessary for the development of successful partnerships through harmonization aimed at the best possible utilization of resources of both parties.

4. FLEXIBILITY

Partnership should take the advantage of the existing water management experiences and it should also rely on comparative advantages of certain resources in investing, selection of technologies and plan of activities as the reply to extraordinary circumstances.

5. TIME

The process of understanding water management issues that need to be resolved and their effects on potential partners as well as of the needs of potential partners is time consuming.

6. PATIENCE

In PPP the attention has to be paid to the balance between quick responding to the most urgent crisis and development of integrated solutions that shall last. That is why it is not realistic to expect that the inclusion of the private sector shall quickly result with overcoming of shortcomings in water management institutions and activities or that it will compensate immediately all previous shortcomings in resources and financing by public sector.

7. SOCIAL RESPONSIBILITY

Water use and water management services provide for public benefit, namely the benefit that should be available to everyone. The improvement in provision of such services refers actually to improvement of quality of living.

In order to make a valid decision on constituting of a concrete **model** of co-operation between public and private sector in water management it is necessary, primarily, to consider the uncertainty of future period when the decision shall be implemented. Consideration of impact of uncertainty on the decision itself and its consequence are typically identified with the risk analysis. There is no unique definition of risk as it content is determined on the basis of a problem that is analyzed. The term itself implies the unfavorable outcome. In our case, the risk shall be defined as the possibility for different social, economic and political

losses to occur. The most difficult among them are, certainly, the exhausting of scarce water resources, pollution of surface and ground waters, soil acidification, destruction of natural landscape etc. that are transferred as permanent onto future generations.

Thus, in selection of concrete public private partnership in water management it is necessary to aggregate the appropriate risk indicator that should have two basic dimensions:

- Probability that an undesired outcome shall occur, and
- Assessment of scope of social and economic damages that shall occur due to an unfavorable outcome as well as identification of entities that have been affected up to the worst extent.

According to that, the risk analysis is dealt with separately as an integral part of decision making process in selection of concrete model of public private partnership in water management and it includes:

1. Consideration of possible causes of unfavorable results of implementation of a concrete model of partnership between water management and private sector.
2. Defining of quantitative measures (criteria) for its setting.
3. Consideration of possible detrimental effects.
4. The relationship of decision makers and users in (1), (2) and (3).

Successful modeling of public private partnership in water management is carried out by means of finding answers to two key questions.

First, how to develop the appropriate methodology of multi-criteria analysis in order to provide quantitative and qualitative measuring of consequences of implementation of certain model of public private partnership in water management classified according to their similarities:

- Impact on human life and health
- Impact on long-term economic development and transfer of consequences of water exploitation and pollution onto future generations
- Impact on increase (reduction) of costs of business operations and costs of living
- Impact on public finances.

Second, how to develop methodology of multi-attribute analysis of usefulness of concrete model of public private partnership in water management based on taking the following phenomena into account:

- Three basic aspects of human behavior:

- Rational behavior
- Emotional (irrational) behavior, and

- Preferring personal to general interests.

- Problems caused by impossibility (exact) of statistical testing of social and economic consequences of implementation of concrete model of public private partnership in water management.

- Preferring the current economic and political benefits to long-term ones

- Difference in risk extent between decision makers and users.

- Problem of solution imposing by narrow political or economic groups, and

- Problem of inequality of time frame in emerging of certain problems in implementation of concrete models of public private partnership in water management.

III. STRATEGY OF PPP IN WATER MANAGEMENT IN SERBIA IN THE CONTEXT OF TRANSITION AND EUROPEAN INTEGRATION

The strategy in partnership refers to making of business decisions regulating mutual relations and relations with the community[5], namely where individual fields of activities, sources of activities, benefits and advantages in satisfying the needs of water management users and society are defined. The strategy is also understood as the decision determining the direction of development, which is the objective of partnership strategy, with rational response to events in the environment in which the activity is carried out based on evaluations of previous development and forecasting of future events. Partnership has to take the advantage it disposes with or it may dispose with for the purpose of better positioning of economy that is in compliance with objectives and values and with organizational structure of water management.

The strategy, as the decision on basic methods of accomplishment of objectives in partnership is oriented towards the selection of a business area of water management in the fields of primary agricultural production, industry, transport, tourism etc. and financial resources from the above-mentioned fields aiming at developing and keeping the unity.

The current strategy of water management system in Serbia is facing challenges brought by transition. Economic transition of water management implies the process of transformation from socialist-planned to market oriented activity[6]. Transformation of water management includes changes that refer to:

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[5] Akintoye Akintola, Beck Matthias (2003) "Public-Private Partnership", Blackwell Publishing, pp. 45.

[6] Adžić Sofija, (2006) Privredni sistem i ekonomska politika (Economic System and Economic Policy), Ekonomski fakultet, Subotica, pp. 454.

- River basin based integrated water management (water use, provision of water management services and activities that link them) with the development and introduction of market elements in designing, construction and use of water and structures,
- Adapting of water management to new state regulations in economy and economic development with new needs and requirements,
- Identifying, dividing and activating of property with different property relations and economic characteristics of water management properties,
- Setting of institutional and organizational units aimed at increasing efficiency, effectiveness, economic feasibility and equality.

Introduction of the above-mentioned changes is possible with:

- Development of standard and institutional infrastructure and system of water management,
- Development of organizational structure of water management adapted to a new organizational structure of economy and non-economic activities within new conditions for conducting of business activities,
- Changes in internal organization of water management companies aimed at their affirmation as the basic form of social-economic development of water management,
- Stabilization of water management policy.

Transition in water management is a complex process of inclusion into implementation of Water Framework Directive and setting of conditions based on integration and market conditions. The transition policy in water management should be based on practical water management policy where regulation of the basic, technical, economic and legal trends are linked, standards are set up as well as the institutions of the system for active elements of water management (waters, water management structures, fee payers and users). This policy is developed on temporary foundations while final solution is possible based on construction and regulation of economic and non-economic systems of the state and analysis of certain results[7].

The following problems have remained in structuring of contents and activities of political transition and transition management (water management):

- Precise defining of the role of the state in water management, namely in use of water and water management structures and activities that link them. The role of the state in water management should be in setting of conditions for inclusion and development of privatization function,

[7] Adžić Sofija, (2006) Privredni sistem i ekonomska politika (Economic System and Economic Policy), Ekonomski fakultet, Subotica, pp. 458.

restructuring of companies, development of their entrepreneur function, constant search for new offers both in water use and in services of water management structures and systems, development of financing system, fostering of financial links with a higher level of financial discipline and dislocation of social-political functions out of the company.

- Introduction and implementation of standard and institutional solutions and EU water related standards as well as those of foreign financial institutions aimed at obtaining of trust among foreign investors having in mind the risk rate and scope of investments in water management.
- More detailed elaboration of transition and transition water management in the sense of defining subjects and procedures with changes in attitudes and observing of rules and procedures.
- Precise and clear setting of objectives, measures and instruments (quantitative and qualitative water and water management balances, water regime, water management structures and services) of transition and management with transition.
- Obtaining of approvals from the relevant political, economic and social stakeholders aimed at setting of equal rules for all stakeholders in water management and their users.

The transition places the main emphasis on property reform that shall contribute to its essential improvement, which implies defining of property character on public and private property owned by the state or privately owned with a special issue in water management that refers to restitution of property. Property in water management comes from different sources of financing such as fiscal, para-fiscal and private, with different bases for exploitation and use. Sources of financing have been provided from the budget, contributions, fees, funds of companies and physical entities. Property that was built out of such funds consists of structures for protection against detrimental impact of external waters (dikes), internal waters (accumulations and drainage systems), water protection (treatment plant and equipment and devices for undertaking of biological-chemical measures) and water use (hydro-systems, multi purpose systems, accumulations etc.).

According to its geo-political position, water management in Serbia makes an integral part of Europe (Danube corridor) and through an integration process it is practically getting closer to Europe. The main problem of integration of water management is in economic sphere which is also the initial stage in implementation of the Water Framework Directive. Water management in Serbia is not in the position to carry out the integration on its own having in mind its infrastructure and use of natural resources and due to the impact of factors from the past and entrepreneurial initiative.

Factors from the past refer to use of low level technological systems, exploitation of water management structures, increase of water pollution rate, domination of manual (physical) and mechanical work.

The second important property of integration of water management is a continuous improvement of entrepreneurship that is oriented towards the result and under the influence of numerous factors that sources of use and funds depends on, as well as revenues and expenses, tariffs and fees, productivity and economic efficiency and finally profit.

The vision of water management in the context of European integration starts from low economic and development performances in relation to target environment. It should consist of:

- Intensification of investments in revitalization, modernization and new construction of physical infrastructure in water management,
- Activities in development of structure of water management services (according to quantity and quality),
- Improvement of standardization of water management in construction and maintenance of water management structures,
- Development of the system of sustainable development and system of water protection,
- Improvement of continuous training for managers, entrepreneurs for use of waters and provision of water management services,
- Activities in setting new development and research activities in all fields and branches of water management,
- Activating of function of regional policy in the field of water.

In addition to that, the purpose of strategy lies in adaptive capacity and capacity to learn not only on one's own example but also on experiences of others. Continuous process of adaptation means accomplishment of higher values for water management users as stimulation strengthening competitive advantages.

The EU integration process in financial, customs, transport, trade and other spheres has also been set in water management. As the basic foundation, the **integration** is included in the Water Framework Directive as the basis of water management and it consists of:

- Integration of environmental protection as a set of qualitative and quantitative economic objectives in protection of highly valuable aquatic eco-systems and ensuring general «good» status of other waters,
- Integration of all water resources in a river basin as a connection between surface and ground waters,
- Integration of all water uses, water functions and values in a shared political framework that consists of a combination of water quality in an

the environment and their use in economy, water testing and impact on human health,
- Integration of different disciplines, analyses and expertise by causing impacts and pressures on water resources and finding solutions for fulfillment of objectives referred to in the Directive in an economically viable and efficient way,
- Integration, namely clarity of water related legislation, in a shared system,
- Integration of all functions and stages of management and environmental aspects related to river basin based planning , including flood defense,
- Integration of all measures in a river basin management plan, including tariffs, economic and financial measures in a shared attitude to management of the relevant river basin,
- Integration of public in decision making process related to enactment of the River Basin Management Plan,
- Integration of different decision making levels in public sector that are of relevance for water resources and status of waters,
- Integration of member states in water management in river basins that stretch across the territory of several countries.

The basis for integration processes in the Republic of Serbia is made up of understanding of water as natural resource that can be considered food, raw material, means of work, energy, space for living and many other things at the same time. Water is a condition for survival of natural environment and human society on the whole and development and quality functioning of a society. Investments into water sector have been diverse and they have receded significantly within the last 25 years, which caused negative changes in water status.

In future, water management in Serbia should be carried out based on the following integration action elements[8]:

- Adopting of water management strategies,
- Faster and voluminous technological standardization of all the fields of water management, taking into account the requirements of the EU Water Framework Directive,
- Harmonization of legislation and institutional bases of the complete water management system with national and European legislation,
- Revitalization of the existing and construction of new water supply systems that shall require, according to estimates, 343 million EUR.

[8] Voda za XXI vek (Water for the 21st Century), (2006), Institute "Jaroslav Černi", Beograd, pp. 77.

These funds shall ensure the sufficient quantity of drinking water and increase the extent of connection of population onto the public systems providing the construction of regional water supply systems that shall require, according to estimates, about 71 million EUR.

- Construction, reconstruction and more efficient operation of waste water treatment plants with implementation of measures to control emissions from diffuse and other sources of pollution aimed at improvement of water quality in water courses. It is estimated that 290 million EUR shall be necessary for these purposes.
- Construction, revitalization and reconstruction of systems for irrigation water quality providing. It is estimated that 14,237 million EUR shall be necessary for these purposes.
- Construction and revitalization of drainage systems for the purpose of elimination of risk of excess water on the land. It is estimated that 32,785 million EUR shall be necessary for these purposes.
- Additional building, reconstruction and revitalization of the Danube-Tisa-Danube Hydro-system. It is estimated that 37 million EUR shall be necessary for these purposes.
- Construction and reconstruction of flood defense, i.e. structures for protection against floods. It is estimated that 33, 5 million EUR shall be necessary for these purposes.
- Construction and undertaking of measures for anti-erosion and torrent impacts of water. It is estimated that 19, 8 million EUR shall be necessary for these purposes.

Water management strategy is directly linked with partnership because it relies on mutual dependence of two or more participants. The actions of each of them are also based on expected actions of others that there is no control over and the result depends on actions of their partners. Strategy is the rule pursuant to which certain participants in water management partnership intend to act in case that their positions are threatened.

Strategic situation of partnership in water management includes also the elements of conflict situations, namely strategic decisions are made in order to resolve conflicted objectives and interests and provide for co-operation between the participants in partnership. There is never a clear situation in which one participant wins and the other one loses because solutions for water management issues that are satisfactory to participants in partnership are found through harmonization.

The strategy of entrepreneurship of water management is of exceptional significance for partnership. Entrepreneurship assumes undertaking of

business activities that unify all factors - labor, capital, land etc. In addition to that, entrepreneurship implies the inclusion and undertaking of initiatives, organization and reorganization of social and economic mechanisms aimed at directing resources into water management purposes, with acceptance of risks.

The parameters that can have a defined strategic profile of water management partnership are determined with five dimensions: 1) type of users of water and water management services; 2) assumption - given subject of source of revenues for partners; 3) basis for future changes of users of water and water management services; 4) the assumed orientation to growth in water management; 5) type of technology of utilization of water and water management structures that is relevant for partners' strategic management.

The concept of gap or difference between the expected and desired future status in water management makes the basis for strategic commitment. There are two options in gap defining. The first is to decide on future position of a partner at a certain moment in future that emerges with new forms of use of water and water management structures, cost efficiency etc. The second is the analysis of partner's position, i.e. their planned position in case that the strategy is preserved.

IV. PROBLEMS OF PERMANENT PRESERVATION OF PUBLIC PRIVATE PARTNERSHIP IN THE PROCESS OF EUROPEAN INTEGRATION

Public private partnership (PPP) as an expression of co-operation between public authorities in the field of water management with private sector, either at the level of central or local community aimed at satisfying of certain public need is affected by different risks due to shortcomings related to capacities in both public and private sectors.

That is why permanent partnership encounters many problems9, starting from the initial stage of identification up to implementation and project granting stages. A special problem is related to decision making that follows after the conducted evaluation and the conclusion that certain project is financial unfeasible although some economic benefits could be achieved. In that case, public sector can decide to provide the compensation for risks, which shall enable the fulfillment of PPP objectives.

Problems of permanent PPP are also identified as:

- Weak and temporary, namely short-term political support that occurs in unstable political situations in the country, namely in changeable standard

[9] Akintoye Akintola, Beck Matthias (2003) "Public-Private Partnership", Blackwell Publishing, pp. 58.

and institutional frameworks for utilization of all PPP sources and factors. Temporary political support occurs due to the possibility of non-election of political representatives that is emphasized, in particular, before and during the elections although implementation of PPP is water use and construction and maintenance of water management structures requires long-term bases and measures. Political support should be directed towards reality and objectivity of setting of one's own capacities to comprehend causal-consequential issues and methods of their resolving, having in mind their frequent and fast changes in time.

- Fixed legislation when it comes to conditions for conducting of business activities of PPP partners, standards and norms and limitations of market categories. Considering that PPP represents a set of different elements in assessment of risks and benefits, changes in their conditions require flexibility in legislation.
- The reserve of users in setting of conditions for financial sustainability of projects that is expressed when there are no set conditions for transparent, clear and precise method of information on participation of users in defining of sources and methods of financing, project value, distribution of risks and rewards and, in particular, on amount of resources, deadlines and holders of right to refund of such resources. In addition to economic reasons, the reserve of users can occur as the consequence of the total social-political situation (stability or instability), moral reasons and created level of connection between social and individual interests.
- Administering of conditions in provision of water management structures that reflect primarily in obtaining of certain conditions, approvals/authorizations and permits for the process of PPP planning and implementation. The problem is in very long periods of obtaining of public documents, periods of their validity, scope and completeness in defining of legal facts for rational techno-economic level.
- Free setting of prices of a private partner according to projection of necessary revenues and financial resources that does not have to reflect objective and actual costs and financial resources. This imposes the need for organization of a regulatory body. Regulatory bodies should take into account that setting of prices, which are monopoly prices, should be based on costs of reproduction of goods (purchase price) and profit depending on general and individual benefit. Changes in prices are possible depending on scope and quality of the offered goods and purchase price as well as on demand for such goods.
- Free acting of a private partner in PPP in water management can only be exercised in operational part that receives information, plans and requests the execution of the accepted offer for water management services, controls

the execution of services and informs public and users. It is not possible in regulatory aspect. Private sector expresses its freedom in the sphere of improvement of technical-technological processes and systems and construction and maintenance by means of innovation and creativity, better organizational and functional division, reduction of consumption and costs (variable and fixed) per types of goods, reacting to request of users and fulfillment of the same in compliance with capacities that allow favorable solution.

- The uncertainty of obtaining of a certain level of funds from the budget on a long-term basis in relation to periods of construction, namely utilization of water management structures (infrastructure)
- Precise defining and unilateral meaning in defining of certain terms, expressions and process in water management that shall reflect the relevant parts of PPP in an unambiguous way,
- defining of all types of risks in stages of project implementation starting from preparation, planning, organizational execution, control and supervision and public information on implementation of projects in water management.
- Absence of exact plan projections that shall point to medium term and long-term benefit for economic activities generated in a water management structure

Overcoming of problems and shortcomings that can be caused by PPP is possible by means of the following measures and instruments, relying on all the

- Precise and clear defining of PPP according to the definition issued by the EU Green Book containing the definitions of different forms of co-operation between public and private sector, the objective of which is to ensure financing, construction, renewal, management and maintenance of infrastructure
- Private partner should develop project documentation or take it over from a public partner, build, finance, maintain and manage water management structures in return for a fee from a public sector or user
- Determining of time frame and amount of funds that shall be the basis for the return of invested funds taking into account all material and financial resources and funds that are the subject of investing into water management
- Determining of precise structure and methods of functioning of a project from private persons and public partners that can be at different levels of a public sector (state, district, local self-government)

- Private partner should participate actively in all stages of project implementation (planning, building, reconstruction, execution and financing) and not only in defining of objectives that shall be accomplished with respect of public interest, quality of services and tariff policy
- Precise distribution of all risks between public and private partners. Precise distribution of risks should be set for all stages and functions during the construction of certain structure.
- Permanent allocation of obligations related to PPP by public sector in a long-term budget financing.

Having in mind the integration processes, the problems of partnership require in particular:

- Setting of a national framework, which implies setting of clear legal framework defining long-term and strategic objectives that shall foster and accomplish an increased efficiency, costs efficiency and effectiveness thanks to implementation of methods and way of work of private sector stakeholders,
- Subsidizing that shall motivate the initiatives for increase of competitiveness and quality of water management services. It can be in the form of loan, borrowing, proprietary share and public financing, providing that it cannot be higher than the assessed value of non-pecuniary benefit.
- Reduction of tendering risks via reduction of number of bidders with clearly defined criteria for project granting.
- Reduction of demand related risks that are achieved by means of granting a sufficiently long period for stable and secured revenue flow.

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The Impact of Romania's Tourism Legislation Upon the Development of this Sector

Monica Maria Coroş
Babeş-Bolyai University
Faculty of Economical Sciences and
Business Administration
Cluj-Napoca, Romania
E-mail: mmcoros@yahoo.de

Abstract

The current paper focuses on a very important aspect regarding tourism, the sector's legislation. In the present days everyone seems to be concerned with promoting Romania as an international tourist destination; it has almost become a kind of fashion. Romania's recent integration in the EU structure is going to generate many and very various influences upon the country's evolution, and especially in the field of tourism industry. In this respect, during the past years, there have been undertaken several attempts of creating and promoting our country's brand (all of these attempts have been sustained by various legal decisions). People tend to admit that Romania enjoys a great tourism potential but unfortunately it still is underdeveloped and underexploited. Doubled by an appropriate legal frame, this potential would eventually turn our country into an important competitor on the international travel and leisure market. A key element for our paper is the value added tax that is currently applied to tourism. We are going to analyze the development of Romania's tourism industry; then we are going to compare its evolution to the one of other former communist countries and not only. VAT issues are also going to be pointed out; again we are going to realize a comparison between Romania's and other countries' policies referring to the fiscal facilities applied to tourism. In the end we are going to make a few suggestions for the improvement of some legal aspects, with the purpose of helping to the development of this sector.

Key words: *Tourism development, VAT, Fiscal policies, Romania*

INTRODUCTION

Nowadays everybody seems to be concerned with the matter of promoting Romania as an international tourist destination. In this respect, during the past years, there have been undertaken several attempts of creating and promoting

our country's brand (all of these attempts have been sustained by various legal decisions). People tend to admit that Romania enjoys a great tourism potential but unfortunately it still is underdeveloped and underexploited. Doubled by an appropriate legal frame, this potential would eventually turn our country into an important competitor on the international travel and leisure market.

In the present paper we intend to focus on several aspects regarding Romania's legal framework related to tourism activities and we are also going to analyze their influences upon the tertiary sector. From the very beginning of our paper, we believe it is necessary to point out the fact that Romania has suffered and, unfortunately, continues to suffer of a continuous change of its legislation. This is also valid for the tourism legal framework. We hope that in this continuous legislating process will soon come to an end, as beginning with the 1st of January 2007, Romania has become a full member of the European Union. It is a well-known fact that the EU is characterized by legal stability and requires all of its country-members to clarify and stabilize their legislation. In this respect, Romania has already taken into consideration several measures for aligning its fiscal policies to the ones of the EU.

Our study shall refer to the relationship between the legal framework of tourism and its evolution following the events of December 1989. We are going to make a short presentation of Romania's international tourism activity compared to the one of its neighboring countries. Then, we shall continue by presenting and discussing two categories of legal factors. A first category includes those factors that we believe to be unfavorable to the development of our country's tourism activity. The second category includes those factors that are able to lead to the further development of Romania's tourism sector. As Romania suffers of an extremely rich tourism related legislative process, throughout the paper we are going to focus on the relationship between the Value Added Tax (VAT) and the country's tourism sector development, pointing out our country's tourism evolution as compared to the one of some of our neighbors.

In order to be able to properly analyze the above-mentioned phenomena we appreciate that there are a few theoretical aspects regarding tourism that we ought to clarify. Thus, we consider necessary to offer a few explanations of the concepts that we are going to use:

- *Tourism*, as part of the tertiary sector of the economy, also known as the *industry of services*, represents, according to the specialized literature "the activity of carrying out services, which handles the organization of enjoyment trips or for any other purpose, carried out through the means of specialized organizations, traveling offices etc, or on its own, for a time

span greater than 24 hours. Tourism includes all the activities that serve and satisfy the consumption and services needs of the tourists."[1] There are also connected services implied by tourism: transportation, health, and medical insurances, medical and healing services, feeding services etc. Tourism consists of two components that are strongly linked together: national tourism and international tourism. Tourism includes the trips from home to other places (both domestic and abroad), made for different purposes: recreation, healing, treatment, participating at different events (congresses, symposiums, conferences, seminars, trainings etc), business trips etc.

- *National tourism* is that activity of "any person – according to the definition of the *International Union of Official Tourism Organisms* – who visits a place, other than the one where he/she lives, inside the country's territory (inland), for any other reason than work and staying here for at least a night (or 24 hours)."[2]
- *International tourism* is the activity of "any person who travels to a foreign country, other than their homeland, for any other reason except for work."[3]
- The *international visitor* "is, from the statistics' point of view, any person who travels to a country, other than the homeland, for a time span no longer than 12 months, having any other reason except for work"[4].
- *International arrivals* include "the number of international visitors registered at their entrance in the country. /.../ The same foreign person can make during that time span several trips in the same country, being registered every time as a new arrival."[5]

MATERIALS AND METHODS

Our paper is mainly based on the analysis of the pieces of information gathered from: the specialized institutes (statistics presented by the *World Tourism Organization – WTO*, *World Tourism and Travel Council – WTTC*, *Romanian National Statistics' Institute – NSI*); the Romanian Parliament and Government

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1 Nicolae N. Constantinescu (coordinator), *Dicţionar de economie politică*, Bucureşti, Editura Politică, 1974, p. 782. [our translation]

2 *Ibidem.*

3 *Ibidem.*

4 *** Chapter 16: Commerce; Tourism; Services, in *Romania's Statistic Yearbook 2003 – Time Series 1990-2002*, Institutul Național de Statistică (National Statistics' Institute), http://www.insse.ro/ anuar_2003/ asr2004.htm. [our translation]

5 *Ibidem.*

(Romania's tourism related legal framework – both, ordinary and extraordinary governmental ordinances and ministerial decrees and orders, and bills or laws passed by the Parliament); from the national media and newspapers and from the Internet. Obviously, an important means of information is offered by the study of the legislation, as published in the country's *Official Monitor*. As we aim to identify the correlation between Romania's tourism legislation and its development, basically, we are going to realize a presentation of a document analysis (including here pieces of information, facts and figures mainly gathered form laws, newspaper articles and Internet sites).

The paper's hypothesis is: Romania's tourism sector is underdeveloped and poorly exploited mainly because of the fact that this area's legislative process is inconsistent and continuously changing.

RESULTS AND DISCUSSION

In the first part of this section we intend to present the situation of the Romanian tourism regulatory process, intending to also discuss some of its influences upon tourism. After having studied the Romanian Parliament's web site[6] we may show the fact that regarding tourism, there are over 400 legislating acts. Among these there can be identified laws passed by the Parliament, governmental bills, decrees, ordinary and extraordinary ordinances and other types of legislative acts, such as the methodological instructions for implementing the adopted regulations etc. We have to admit the fact that post-communist Romania needed to adapt its legislation to the new political realities but still we consider that this very large amount of regulations is far too big and that it generates negative influence upon the development of this sector in our country. Any legal framework is meant to facilitate the functioning of the regulated area of activities.

Romania's tourism legislation mainly covers the following topics[7]:

- the organizing, the functioning, the budget, the authorities and responsibilities, and the attributions and roles of the Romanian Tourism Ministry or Department and of other national, regional or local specific authorities;
- the establishment of the different organs and organisms related to the tourism activity;
- the aspects concerning the privatization process of the tourism facilities;

6 *** *Romanian Parliament, Chamber of Deputies*, http://www.cdep.ro/pls/legis/legis_pck.frame, last accessed on the 13th of March 2007.

7 *Ibidem*.

- the establishment of the less developed areas and of the areas for which there are governmentally sustained intentions for sustainable development;
- the regulations related to the connected services, such as: transportation, alimentation, accommodation and hospitality, etc;
- the free circulation of the people;
- the regulations regarding the authorizing and accrediting of the different specific services' suppliers;
- the legislation referring to environmental protection in the context of the tourism sector's sustainable development;
- the establishment of different collaborations and co-operations with foreign country's in matters relating to tourism;
- the decisions regarding Romania's affiliation to different international, regional and global, tourism organizations and structures;
- the strategies of our country's branding process and of promoting it abroad as an international tourism destination and inland, as a domestic destination; etc.

Some of the most important laws and regulations of our country's tourism activity are:

- The Legal Functioning Framework[8]:
  - the Law N° 755/2001 for the approval of the Government's Ordinance N° 58/1998 regarding the organization and the carrying out of the tourism activity in Romania;
  - the Governmental Provision N° 413/March 23rd 2004 regarding the organizing and functioning of the National Tourism Authority;
  - the Governmental Decree N° 135/January 29th 2006 referring to the modification and completion of the Governmental Provision N° 413/ March 23rd 2004 regarding the organizing and functioning of the National Tourism Authority;
- The Legal Framework of the Carrying Out of Tourism Activities[9]:
  - the Government's Ordinance N° 58/1998 regarding the organization and the carrying out of the tourism activity in Romania;

[8] *** "The Legal Framework", *National Tourism Authority*, http://www.mturism.ro/index.php?id=35, last accessed on the 13th of March 2007.

[9] *Ibidem*.

- the Law N° 755/2001 for the approval of the Government's Ordinance N° 58/1998 regarding the organization and the carrying out of the tourism activity in Romania;
- the Decree N° 691/September 26th 2002 for the change and completion of the Methodological Codes regarding the criteria and methodology for issuing permits and licenses for carrying out tourism activities, approved through the Decree of the Ministry of Tourism N° 170/2001;
- the Government's Ordinance N° 5/2003 for changing Art. 33 of the Government's Ordinance N° 58/1998 regarding the organization and the carrying out of the tourism activity in Romania;
- the law 229/May 23rd 2003 regarding the approval of Ordinance 5/2003 regarding the change of Art. 33 of the Government's Ordinance N° 58/1998 regarding the organization and the carrying out of the tourism activity in Romania;

- The Activity of Authorization[10] focuses on the following areas of interest:
  - licenses and permits for carrying out tourism activities;
  - tourist accommodation facilities' certificates of classification;
  - tourist guides;
  - downhill ski slopes and cross-country ski routes;
  - travel and hiking routes;
  - authorization of leisure activities;
  - coaches (for tourists' transportation);
  - constructions and buildings in the field of tourism;
  - seaside;
  - rural tourism;
  - spa tourism;
- Tourist Protection:
  - lifeguards;
  - mountain rescuers;
  - other policies referring to tourist protection;
  - commerce activities involving tourism packages;
- National Programs:
  - *Superski* in the Carpathians;
  - the *Blue Flag* program;
  - *Q Brad*;

[10] *** "The General Legal Framework", *National Tourism Authority*, http://www.mturism.ro/index.php?id=46, last accessed on the 13th of March 2007.

- Tourist Resorts;
- Other Normative Regulations;
- Documents and Decisions Regarding Tourism Promotion Strategies:
  - The Decree for Approving the "Marketing and Promotion of Tourism Program" and the "Tourism Products' Development Program"[11];
  - "The Strategy of Romanian Tourism Promotion"[12].

There also are other problems related our country's tourism regulations. One of the most important matters that we wish to present is the fact that despite the declared intention of every Romanian "democratic" government (after 1989) of transforming tourism into a key domain of our country, in reality things are not quite so. Moreover, during the social-democratic governing of 2000-2004, in 2002, tourism was declared a national priority of our economy and simultaneously the former Tourism Ministry was included in the one of Transportations and Constructions, thus, becoming the last element of a very large ministerial structure: the Ministry of Transportations, Constructions **and** Tourism. Everyone is entitled to ask themselves: how can tourism be properly promoted when it is ruled by an heterogeneous structure that cannot focus on its main problems. Unfortunately, the present governmental coalition has maintained this structure. Obviously, tourism promotion still is mainly done at a declarative level.

In fact, Romania's tourism has for a quite long time been regulated by too many structures that aim to solve its problems; these were: the Ministry of Transportations, Constructions and Tourism, the National Authority for Tourism (nowadays a governmental structure), the National Agency for Governmental Strategies and many smaller organizations – all of them claiming to help develop and promote Romanian tourism. Last year, even the Ministry of Foreign Affairs elaborated a strategy for the development of Romanian tourism. Couldn't a single authority be enough?! We believe that tourism would be a lot better regulated, organized and promoted if only one structure were to be responsible for this. Finally, in December 2006[13], governors seemed to have developed a different point of view. Thus, tourism is nowadays represented by an independent structure – the National Tourism Authority – which is placed directly under the control of the country's Prime Minister. This authority has a leader who occupies

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11 *** *National Tourism Authority*, http://www.mturism.ro/index.php?id=45, last accessed on the 13th of March 2007.

12 *** *National Tourism Authority*, http://www.mturism.ro/fileadmin/turism/studii_nationale/Strategie_ ANT_01.08.2006.pdf.

13 Gabriel Botezatu, "Turismul autohton a 'evadat' de la MTC", in *Curierul Național*, 06.12.2006, http://www.bloombiz.ro/Turismul_autohton_a_evadat_de_la_MTC_--a69401.html, last accessed on the 8th of December 2006.

a ministry-ranked place in the government. Among the advantages offered by the development of a special authority for tourism matters we may mention two that are extremely important: visibility and representativity and also investments in key sectors.

Even more, for the past two years authorities have began to discuss about branding Romania. Being given so many different authorities, they have not yet managed to consent about their organizational structure and about who should get involved in the decision making process regarding the initial phases. Obviously, the key issues of such an important attempt – that of nation branding – still have to wait until someone finally decides to take them into consideration. We hope this is not going to take very long, in the context of the brand new tourism authority's establishing.

We are now going to shortly present and analyze the evolution of Romania's receiving tourism, beginning with the year 1989 and until now. The magazine *AnatMedia*, edited by the National Tourism Agencies' Association of Romania (ANAT), shortly presents the features of the development of Romania's tourism in the 1989-2003 time span:

- the decrease by 23% of the number of tourism accommodation's places[14]: 353,000 (1990), respectively 273,000 (2003);
- the regressive evolution of the net usage of the accommodation capacity coefficient: 58.7% (1989), respectively 34.6% (2003);
- the decline by 26% of the number of foreign visitors: from 6.5 million in 1989 to 4.8 million in 2003[15].

Based on the statistic data and facts offered by the NSI, in the *Statistic Yearbooks of Romania* of 2003[16] and 2005[17], as well as on the figures found in the media[18], we are going to try to realize a short presentation and analysis of the development of our country's tourism activity between 1990 and 2006; below data illustrate Romania's tourism activity measured at the level of accommodation facilities:

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[14] Only hotels are taken into consideration, the villas, motels and agrotourism facilities are excluded· [our note]

[15] Gabriela Stănciulescu, "Turismul românesc după 1989 (2)", Marketing Section, in *AnatMedia*, February 2005, http://www.anat.ro/index.php?p=events&cat=CAT0000171&ed=EDT0030913, last accessed on the 23rd of March 2005.

[16] *** "16.3.4 Tourists' Arrivals in Tourism Accommodation Facilities", Chapter 16 Commerce; Tourism; Services, in *Romania's Statistic Yearbook 2003.*

[17] *** "20.4 Tourists' Arrivals in Tourism Accommodation Facilities", Chapter 20 Tourism, in *Romania's Statistic Yearbook 2005*, National Statistics' Institute, http://www.insse.ro.

[18] *** http://www.wall-street.ro/articol/Turism/15237/In-doar-trei-luni-peste-1-milion-de-turisti-au-venit-in-Romania. [our translation]

Table 1. Romania's Tourism Activity

Romania's Tourism Activity (Thousand Persons in Accommodation Facilities)			
	Total	Romanians	Foreigners
1990	12297	10865	1432
1991	9603	8309	1294
1992	8015	6830	1185
1993	7566	6718	848
1994	7005	6149	856
1995	7070	6304	766
1996	6595	5833	762
1997	5727	4894	833
1998	5552	4742	810
1999	5109	4314	795
2000	4920	4053	867
2001	4875	3960	915
2002	4847	3848	999
2003	5057	3952	1105
2004	5639	4280	1359
2005	5805	4375	1430
2006[1]	1104	...	...

In order to be able to offer a global image of our country's whole international tourism activity, we need to centralize the facts gathered by the NSI in the *Statistics Yearbooks of Romania* of 2003[19] and 2005[20], thus we can illustrate the quantitative evolution of our country's international tourism activity in the 1990-2006 time span. The analyzed facts present both the arrivals of the foreigner tourists in Romania and the departures of the Romanians abroad, according to the used means of transportation:

[19] *** "16.3.10 Romania's International Tourism", Chapter 16 Commerce; Tourism; Services, in *Romania's Statistic Yearbook 2003.*

[20] *** "20.11 Romania's International Tourism", Chapter 20 Tourism, in *Romania's Statistic Yearbook 2005.*

Table 2. Romania's International Tourism – Arrivals By the Used Means of Transportation

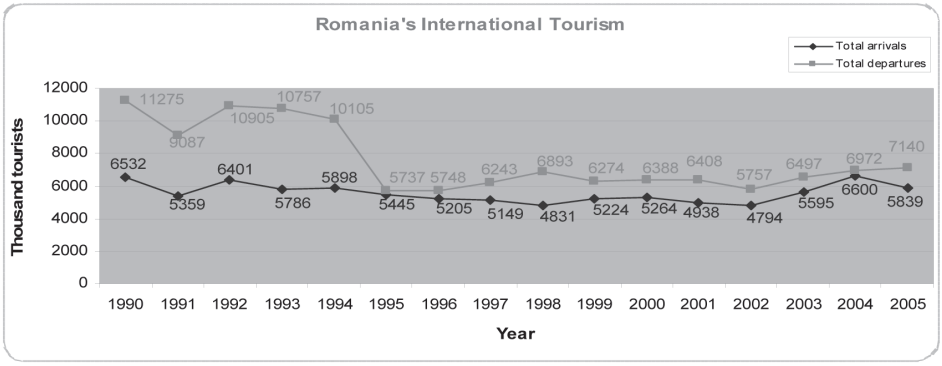
	Romania's International Tourism – Arrivals By the Used Means of Transportation (Thou. Pers.)				
	Total arrivals	Roads	Railways	Air	Naval
1990	6532	3670	2349	271	242
1991	5359	3729	1178	276	176
1992	6401	4826	1128	308	139
1993	5786	4309	1005	326	146
1994	5898	4557	902	289	150
1995	5445	4266	570	433	176
1996	5205	4073	492	479	161
1997	5149	3850	596	533	170
1998	4831	3529	589	553	160
1999	5224	3930	586	567	141
2000	5264	3808	660	655	141
2001	4938	3622	476	705	135
2002	4794	3594	374	689	137
2003	5595	4343	348	752	152
2004	6600	5401	308	705	186
2005	5839	4428	305	919	187

Table 3. Romania's International Tourism – Departures By the Used Means of Transportation

	Romania's International Tourism – Departures By the Used Means of Transportation (Thou. Pers.)				
	Total departures	Roads	Railways	Air	Naval
1990	11275	8396	2501	265	113
1991	9087	7408	1396	169	105
1992	10905	9601	1103	152	49
1993	10757	9036	1435	176	110
1994	10105	8057	1673	193	182
1995	5737	4288	985	299	165
1996	5748	4202	1065	324	157
1997	6243	4664	996	405	178
1998	6893	5308	976	448	161
1999	6274	4999	654	489	132
2000	6388	5018	687	535	148
2001	6408	5086	648	541	133
2002	5757	4886	251	527	93
2003	6497	5584	256	593	64
2004	6972	6010	224	687	51
2005	7140	6001	222	881	36

The figures are centralized and compared in the following graph:

Figure 1. Romania's International Tourism



Analyzing the above mentioned figures, keeping track of the ones mentioned before, and taking into consideration the fact that during 1990-2002, several trials to promote Romania as an international tourism destination were made (the picture album *Eterna şi fascinanta România*[21] of 1996-1997; the campaign "Come as a Tourist, Leave as a Friend", launched in 1998-1999; the participation to the Washington DC tourism fair in 1999; the projects initiated in 2001-2002 for the promotion of Romania's image; the program "Fabricat în România"[22] run during 2001-2004; the campaigns: "România mereu Surprinzătoare"[23] of 2004-2005) and in 2006 the international campaign "Fabulospirit" and the national campaign for inland tourism promotion "O călătorie este o lecție de viață. Alege oferta de turism intern"[24] we may conclude as follows:

- during the time span 1990-1998 Romania's international receiving tourism had a decreasing trend (with two exceptions, 1992 and 1994, when small increases were registered in comparison to the previous years); in 1998 the number of foreign visitors who entered our country represented only 73.95% of the figures of 1990; the main reasons for this situation can be explained through the negative image Romania has abroad, and due to the lack of any serious initiative to promote the country as an international tourism destination (until 1996 or 1997);
- the 1998-2000 time span had an ascending trend; by 2000 the number of international tourists had grew by 8.96% compared to 1998 and had

[21] *Eternal and Fascinating Romania.* [our translation]
[22] "Made in Romania". [our translation]
[23] "Romania Always/Simply Surprising". [our translation]
[24] "A Trip Is a Lesson of Life. Choose the Inland Tourism Offer" [our translation]

reached 80.58% of the figures of 1990; among the probable causes of this increase we may mention: the political change of November 1996, which has lead to the real democratization of Romania and to the improvement of the country's external image; as well as promotion activities based on the album *Eterna şi fascinanta România* and on the campaign "Come as a Tourist, Leave as a Friend";

- the 2000-2002 period did not confirm the same ascending trend; it was characterized by the decline of the number of foreign visitors; by 2002 it registered a decrease by 9.8% compared to 2000, representing only 73.39% of 1990's value; several causes can be identified for this phenomenon: the change of the government in December 2000, the inconsequence of the authorities regarding the implementation of a promotion campaign for Romania, scandals linked to the allocation and management of the funds for such approaches, the continuous worsening of the country's image abroad etc;
- the years of 2002-2004 registered a new ascending trend; by 2003, figures had increased by 16.68% compared to the previous year, and in 2004 arrivals of foreign tourists had increased again by 17.96%; by 2003 the number of foreign visitors represented 85.63% of that of 1990. In 2004 the number of Romania's international tourists had, for the first time since 1990, reached a greater value than the one of that year; by 2004 there had come to Romania more tourists with 1.01% than in 1990. Among the reasons of this favorable situation we may mention: strengthening of the nation's economy, as our economy tends to fulfill the conditions to become and be declared a true market economy; increasing Romania's attractiveness from the point of view of foreign investments; greater stability of the governmental policies, in the context of the nearing EU integration; fulfillment of the privatization of accommodation facilities and that one of other sectors linked to the hospitality industry; several trials to promote Romania's image, even though incoherent, also played an important role in the increase of the international visitors number;
- unfortunately, the year of 2005 does not continue to register an ascending trend; it is characterized by a decrease of the foreign visitors' number, by 11.51% as opposed to the previous year; among the possible reasons we may first of all mention the chicken fever that appeared last fall in Romania;
- last year, 2006, brought a brand new tourism promotion strategy, focusing both on the international tourism promotion – through the campaign "Fabulospirit" – and also on the promotion of the national tourism offer for the Romanian tourists – through the campaign "A Trip Is a Lesson

of Life. Choose the Inland Tourism Offer", initiated in July 2006. One may easily notice the fact that authorities have finally began to promote tourism both for foreigners and also for Romanians. Reality shows a decrease of the interest of the Romanians towards the country's tourism offer. Last year also brought another key decision regarding tourism, that of creating an authority – with ministerial rank – that should only focus upon tourism development.

We consider that we have to stress the fact that the first figures regarding Romania's international tourism, more exactly our country's foreign visitors (as shown above) refer to all the foreign citizens who have crossed the Romanian border, while the ones that follow refer strictly to the persons who have been accommodated in tourism specific facilities and do not include those persons accommodated in other facilities (of friends or relatives).

Another aspect closely linked to the manner how tourism related aspects are regulated in Romania refers to the National Statistics Institute of Romania (NSI). This organization has not yet aligned itself to the standards of the European statistics institutes; this is why, on one hand, in Romania there are still collected facts and figures that are not necessarily useful and, on the other hand, the information commonly collected by the Europeans are omitted. Such a situation only manages to harden the work of the persons who wish to study the phenomena linked to the development of tourism. Not having the possibility of using the same kind of data makes it almost impossible to predict anything for those who are interested to develop strategies for Romania's tourism, as different kinds of facts are rather difficult to use and compare.

In the coming lines we intend to present and discuss the relationship between services' VAT and tourism. Specialists consider that the governmental decision of 2002 to cancel the 0% quota of the VAT for tourism accommodation services was a tremendous disaster. In fact, by increasing this tax to 9 %, governors only managed to determine the rise of the services' prices and to make our country's tourism spots even less attractive than they were (due to the poor quality of the services). During the past year authorities have debated very much about increasing the existing VAT quota to 19 % or even 22 %. We are glad to be able to show that this has not yet been done, and we hope that the governors are going to consider reducing it instead of increasing it. Moreover, a reduced VAT quota should also be introduced for alimentation services. An increase of the VAT for accommodation services from 9% to 19 % would generate an important

increase of the services' prices, by at least 25 %[25]; on the other hand, by keeping steady the VAT quota for accommodation services and by not reducing that of alimentation, services would become more expensive with at least 5 %[26].

In the article "The Probable Increase of the VAT Will Keep Tourists at Home"[27], published in July 2005, *Capital* brought into discussion the topic of the VAT. Several aspects are worth to be mentioned:

- The Ministry of Public Finances wanted to raise the tourism VAT to 22%, canceling the (at that time) recently introduced reduced quota of 9%. Such a decision would obviously have generated an increase of the tariffs and a decrease of the tourists' number. Luckily, it was not implemented.
- The following table presents the estimated VAT rates of some Eastern-European countries for 2005, the expected values of the tourism demand and the GDP quotas:

[25] *** "Creşterea TVA ar scumpi cu minimum 25 % serviciile turistice", in Curentul, 03.09.2005, http://www.eafacere.ro/art_item.asp?artCatID=1681, last accessed on March 13th, 2007.[our translation]

[26] *** "România turistică: pleacă sau rămâne în cărți?", in *Banii Noştri*, 10.09.2005, http://www.9am.ro/ print_article.php?art_id=18183, last accessed on March 13th, 2007.[our translation]

[27] Laura Rădulescu, "Posibila majorare a TVA ține turiştii acasă", in Capital, No 27, 07.07.2005, p. 24; Anca Doicin, "TVA din România virează spre Europa", in Capital, 18.07.2006, on-line edition, http://www.capital.ro/index.php?section=articole&screen=index&id=24471&cauta="tva %20turism"#, apud SCC – Scot&Company Consulting and PWC – PriceWaterhouseCoopers. [our translation]

Table 4. VAT Quotas, Tourism Demand's Values and GDP Quota Estimates in Europe

VAT quotas for some Eastern-European countries for 2005[2]			Tourism demand's value and the GDP quota (estimates)[3]		
Country	VAT – Standard Quota	VAT – Reduced Quota	Demand's value (billion USD)	GDP quota of tourism (direct)	GDP quota in 2004 of tourism (indirect)[4]
Bulgaria	20 %	7 % (for nonresidential tourism activities)	n. a.*	n. a.	16.8 %
Croatia	n. a.	n. a.	n. a.	n. a.	24.2 %
Czech Republic	19 %	5 % (accommodation services)	24.7	13.8 %	14.5 %
Estonia	18 %	5 %	3.3	20.3 %	n. a.
Greece	n. a.	n. a.	n. a.	n. a.	14.3 %
Latvia	18 %	5 %	1.8	6.2 %	n. a.
Lithuania	18 %	5 %	3.9	8.5 %	n. a.
Hungary	25 %	15 % (all tourism services)	15	9.3 %	10.1 %
Poland	22 %	7 %	34.5	7.6 %	8.8 %
Romania	19 %	9 % (accommodation services)	8.2	1.3 %	5.9 %
Slovenia	20 %	8.5 %	6.8	12.4 %	14.1 %
Slovakia	19 %	19 %	9.1	12.4 %	n. a.

** Facts are not available.*

Sources: European Commission and World Travel & Tourism Council; SCC and PWC.

- According to the WTTC study, it was estimated that Romania was going to receive 1.3 billion USD from tourism, respectively 1.3% of the GDP. The value of the tourism demand was estimated for 2005 at 8.2 billion USD, and the jobs will represent 1.2% of the whole number of employed people of Romania. The same study considers that Romania is going to experience a real annual growth of 6.1%, being expected to reach 11.3 billion USD by 2015[28].

Anca Docin[29] shows in her article that Romania's integration into the EU is expected to generate small investors' and people's change in the perception of VAT. Some aspects mentioned by the author in her article "Romania's VAT Turns Towards Europe", published last July in *Capital* refer to the manner how

[28] Laura Rădulescu, "Posibila majorare a TVA ține turiştii acasă", apud World Travel & Tourism Council. [our translation]

[29] Anca Docin, *Op. cit.* [our translation]

Romania used to be different than the EU countries; she mentions our country's particularities: transition economy, lack of coherent regulating and legislating, many economic agents of which only few were willing to pay their debts. Another difference regards the VAT quotas. The European countries use reduced VAT quotas for more various categories of products than we do – non-food products, newspapers and magazines, pharmaceutical products, cultural events and cinema, as well as also for services, including tourism and financial services. This is possible all over Europe, mainly because of the fact that when preparing their national budgets, these countries' governors focus on certain economic strategies, in which fiscal policies play very important roles.

Table 5. European VAT Quotas30

Country	Standard VAT Quota	Reduced VAT Quota
Czech Republic	19 %	5 % – food, nonalcoholic beverages, medicines, books, newspapers, accommodation, funerary and cultural, services etc;
France	19.6 %	0 % – financial and banking services, health, education, exports etc; 2.1 % – newspapers, cultural events, medicines; 5.5 % – basic goods, magazines;
Germany	16 % (19 %)*	0 % – banking services, insurances, exports etc; 7 % – basic goods and services – food and beverages, medicines, newspapers, books, cultural events, etc;
Hungary	25 %	0 % – exports; 5 % – lecture/school books; medicines; 15 % – food, medicines, clothes;
Luxembourg	15 %	–
Poland	22 %	3 % – fresh food, agricultural services, forestry and pisciculture; 7 % – prepared food, books, newspapers, transportation;
Romania	19 %	9 % – medicines, hotels, books, orthopedic products, cinema, museums.

** Beginning with 2007 Germany's Standard VAT is 19 %.*

Another article we wish to refer at is "The Foreigners Spend One Euro in Our Country and Four in Poland and in the Czech Republic"; it brings the following pieces of information[31]:

- The main reason that generated this situation was the fact that Romania allocated five times less money for tourism than her neighboring countries; secondly we can also mention: the few highways, the "Balkan-type" nature/quality of services, the increase of the VAT, and the high prices.

30 *Idem, apud* SCC and PWC.

31 Laura Rădulescu, "Străinii cheltuie un euro la noi şi patru în Polonia şi Cehia", in Capital, No 28, 14.07.2005, p. 15. [our translation]

- The estimates of the WTTC for the year of 2005, regarding the evolution of tourism in Romania and in the neighboring countries are[32]:

Source: World Travel & Tourism Council.

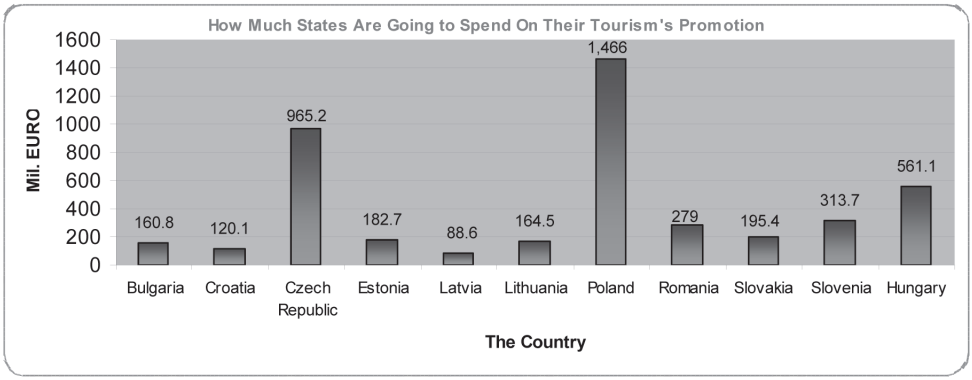
Figure 2. Estimates for 2005 Regarding a Series of Tourism Indicators

- According to the author of the article, the estimated facts do not confirm what the governmental authorities declare, that tourism would be a priority sector of our economy. Comparable countries (as sizes and population) will gain this year four times more money from tourism than Romania[33].
- Another aspect mentioned in this study refers to the estimates of the WTTC regarding the investments that are going to be made by Romania and the neighboring countries in tourism[34]:

[32] Laura Rădulescu, "Străinii cheltuie un euro la noi şi patru în Polonia şi Cehia", *apud* World Travel & Tourism Council. [our translation]

[33] Laura Rădulescu, "Străinii cheltuie un euro la noi şi patru în Polonia şi Cehia". [our translation]

[34] Laura Rădulescu, "Străinii cheltuie un euro la noi şi patru în Polonia şi Cehia", *apud* World Travel & Tourism Council. [our translation]



Source: World Travel & Tourism Council.

Figure 3. How Much States Are Going to Spend on the Promotion of Their Tourism

- Keeping track of the pieces of information from the above graphs we can see that Romania may only expect to gain from tourism according to the investments she intends to make in this sector and in its promotion.

CONCLUSIONS

Romania's post-communist governments have, unfortunately, not had a coherent strategy regarding the country's branding and promotion. Each one of them has tried to adopt a different strategy, ignoring the previous attempts in this respect. A beneficial decision, that is expected to determine a positive influence upon tourism is the liberalization of the Romanian air space, which has already lead to the entrance on our market of the low cost air transportation companies; the decision of opening the Romanian air space is being implemented from the 1st of January 2007, and we expect that it would lead to an important increase of the country's visitors. Moreover, Sibiu, together with Luxemburg is this year's European Cultural Capital, fact that is also going to contribute to the development of Romania's tourism activity.

In the following lines we are going to try to mention several categories of factors, which in our opinion influence themselves, through their natures, the low number of foreign visitors who come to Romania. Among them there are:

- the problem of global terrorism;
- the so-called myth of unsafe for the foreign visitors;
- the negative publicity promoted by the unsatisfied tourists – they function as negative image multipliers;
- the political and legislative inconsequence[35];

[35] Fulvia Meiroşu, "Turismul românesc creşte mai lent decât în alte state din zonă", *apud* the American foundation CHF, in *Capital*, No 29, 15.07.2004, p. 15. [our translation]

- the insufficient promotion budget, and as a consequence the inappropriate promotion of the tourism destinations and objectives (very often these are treasured as great secrets, rather than promoted);
- the underdeveloped infrastructure: only 50% of Romania's roads are made of asphalt; in Romania there is only one international airport with a satisfying capacity (*Henri Coandă* from Otopeni, near Bucharest); the railroad traveling conditions offered by SNCFR are below the international standards;
- the lack of foreign investments, especially because the state does not offer any facilities for the investors, but also due to: the weak infrastructure, to the inconsequent governmental policies, to the lack of fiscal facilities, to the incomplete legal framework, to the lack of credible pieces of information about the Romanian market, and to the corruption;
- the fear of political insecureness;
- the perception of the foreign tour-operators regarding Romania: an attractive country, but with a low level of accommodation services, as well as low quality health and medical services (except for the few important cities); corruption; the lack of professionalism of the Romanian tour-operators, as well as the low quality of the tourism products that are offered abroad; the weak development of the Romanian professional organizations for tourism and the low skilled managers who have businesses in this sector.

In the development of the tourism industry a key role is played by legislation. This is why we consider we have to point out a few legislative means that would help to the development of tourism in our country:

- the relaxation of fiscality – especially by the diminishing of the VAT for tourism accommodation and alimentation services, as well as also for other connected services;
- the maintainace of the reduced profit taxation for the small rural investors (SMEs) who carry out tourism services (6 % taxation over turnover, instead of 16 % of the profit);
- the encouragement, by offering fiscal facilities, of employing in the field of services of unemployed persons.

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14. *** http://www.wall-street.ro/articol/Turism/15237/In-doar-trei-luni-peste-1-milion-de-turisti-au-venit-in-Romania.

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Assessing the Croatian Competitiveness in the International Perspective

Đula Borozan
Full Professor
Faculty of Economics
University of J.J. Strossmayer in Osijek
Osijek, Croatia
E-mail: borozan@efos.hr

Anita Frajman – Jakšić
Assistant
Faculty of Economics
University of J. J. Strossmayer in Osijek
Osijek, Croatia
E-mail: afrajman@efos.hr

Abstract

Competitiveness has become the most important challenge which the countries have been facing in the increasingly competitive global economy. Croatia is not an exception. The main purpose of this paper is to assess the competitiveness of Croatia in the international setting. The assessment is based on the competitiveness indices that publish regularly the World Economic Forum and the International Institute for Management and Development. The results indicate that Croatia shares the same symptoms as the other countries in the efficiency-driven stage of economic development. However, it still has to improve the quality and responsibility of its institutions and to ensure that the activities of government are more efficient, effective and transparent. Namely, uncertainty stemming from uncertain and too changeable national framework conditions, weak and incredible institutions, inefficient judiciary, widespread corruption and the like has jeopardized the enhancement of business efficiency and the future competitiveness of Croatia.

Keywords: *competitiveness, Croatia, WEF, IMD, small country, international rankings*

1. INTRODUCTION

Contemporary global economy - driven by decline in barriers to the free flow of goods, services and capital as well as by frequent technologic changes, and followed by increasingly higher competition - is too complicate to be explained by traditional international trade theories (for example, by A. Smith's theory of absolute advantages or by D. Ricardo's theory of comparative advantages). In the past, economic development of a country was based on traditional basis, processes and inherited advantages, such as location, pools of labor and natural resources. In a contemporary economy, the advanced factor conditions based on knowledge, high technology and innovation represent the fundamentals for economic development.[1] The origin of this thought can be found in the learning of Harvard professor Michael E. Porter, synthesized in his book "The Competitive Advantage of Nations" and his later works. In this book, Porter (1990) introduced a new theory of competition and illuminated that the well-being of a country is created through strategic choices. Simultaneously, he abandoned the idea that the well-being is related to the inheritance and that the government is not only the central actor in an economy, but also the only one who is responsible for it.

Inherited prosperity is temporary, because it is derived from selling inherited natural resources and thereby it is limited due to their availability. Just opposite to this, created prosperity is based only on the innovativeness and productivity of companies which are the central actors in the economy. Created prosperity is unlimited and derived from products and services which generate added value and competitiveness. The role of government is to act more as a catalyst and to create a favorable and competitive environment which will encourage firms to innovate, raise their productivity and to enhance their performances. However, the important question is how to create the conditions for enhancing productivity and innovation. The answer to this question, embodied in applied government policies and programs, contributes to differencing among countries considering the achieved competitiveness.

Created prosperity can be a tool for understanding the achieved stage of economic development and it can lead the country to a preferably social situation. Economic development becomes the process of influencing growth and restructuring of an economy to enhance the economic well-being of a community (Dabson, 2005, p. 4). In order to achieve a sustainable economic development, the focus has to be given to sustained productivity growth. It should be noted that productivity growth is at the heart of competitiveness as Porter (1990) pointed out.

[1] The National Council for Competitiveness (NCC): Why competitiveness?, http://nvk.multilink.hr/konkurentnost1.asp (accessed October 24, 2006)

Neelie Kroess (2005), a member of the European Commission showed that competition must drive competitiveness of the European Union (EU) in the global economy and that protectionism is not the right response to economic reform challenges. According to Neelie "*to reach a high level of competitiveness we need not only to focus on global competition, but also on competition inside the EU and at national level… It is not through protectionism, but through competition that firms innovate, strive to get the best from their people, make the most effective use of their resources, push up quality and push down prices… Competition ensures that market forces operate effectively.*"[2] Therefore, the government should ensure that competition conditions are also fair for everyone being involved in competition.

In other words, the quality of general national framework conditions determines significantly competitiveness of a country. However, a stable and consistent macroeconomic policy, an efficient legal system and in general an efficient and effective institutions are not sufficient for maintaining and raising competitiveness. The well-being and prosperity of the country have been developing at the microeconomic level, which is based simultaneously on sound macroeconomic environment and development strategies (Porter, 1990). Government and business sector are interlinked in building the competitive economy and in developing a new added value. They need to remain in sync, as Garelli (2006) clarified.

Obviously, competitiveness is a multidimensional phenomenon, originated in attitudes, thinking and behavior of people. It is created at the microeconomic level, and at the same time determined by industrial politics and regional and national framework conditions. This paper focuses on the national competitiveness. Its main purpose is to assess the Croatian competitiveness in international perspective. Drawn from this assessment, policy lessons considering competitive position of small countries are discussed in this paper as well.

Porter (1990) emphasized that the competitive advantage of a nation is determined by the strength of its factor endowments, its demand conditions, the competitiveness of firm strategies, structures and rivalries in major industries, and by the strength and diversity of related and supporting industries. Furthermore, the national competitiveness can be measured by two sets of indicators: "*1. the presence of substantial and sustained exports to a wide array of other nations, and/or 2. significant outbound foreign investment based on skills and assets created in the home country*" (Porter, 1990, p. 19).

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[2] Kroess, N.: Competition Must Drive European Competitiveness in a Global Economy Villad'Este Forum, Cernobbia, Italy, 3 September 2005, SPEECH/05/477, http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/05/477&format=HTML&aged=0%3Cuage=EN&guiLanguage=en (accessed May 20, 2007)

2. MEASURING COMPETITIVENESS AND INTERNATIONAL COMPARISSON

Due to its complexity, the competitiveness of a country is defined in different, but similar ways by international observers and organizations (see for review Garelli, 2003, Annex II).[3] Considering the main purpose of this paper, the following definitions are especially fruitful. According to the Organization for Economic Co-operation and Development (OECD) competitiveness is "*the degree to which a nation can, under free trade and fair market conditions, produce goods and services which meet the test of international markets, while simultaneously maintaining and expanding the real incomes of its people over the long-term*". According to the International Institute for Management Development "*competitiveness of nations looks how nations create and maintain an environment which sustains the competitiveness of its enterprises*" (Garelli, 2003, p. 701). It should be noted that both are frequently used in literature addressing the national competitiveness because they put emphasis on the role of economic policy in shaping the business environment.

There are different ways of measuring competitiveness of a country and comparing it internationally. The most popular are made by the researches of the following international organizations: the World Economic Forum, the International Institute for Management Development and OECD. Each year the World Economic Forum (WEF), the International Institute for Management Development (IMD) and OECD publish rankings of national competitiveness among countries. However, the indices used by these organizations are not perfect measures of competitiveness. The indices contain many weaknesses that scholars and experts have been trying to overcome (see for example Causa and Cohen, 2004; Sahin at all, 2006).

Since the main purpose of this paper is to assess the position of Croatia regarding competitiveness within the international setting, and since Croatia is involved in international rankings of competitiveness organized by IMD and WEF, their definitions and methodologies are furthermore explained.

2.1. Global Competitiveness Report

WEF and University of Harvard have been publishing Global Competitiveness Report (GCR) since 1979. Currently, it is one of the most comprehensive reports of that kind and is also recognized as the one of the leading international comparison of the countries according to different microeconomic and macroeconomic factors influencing competitiveness and economic growth. The report is based on

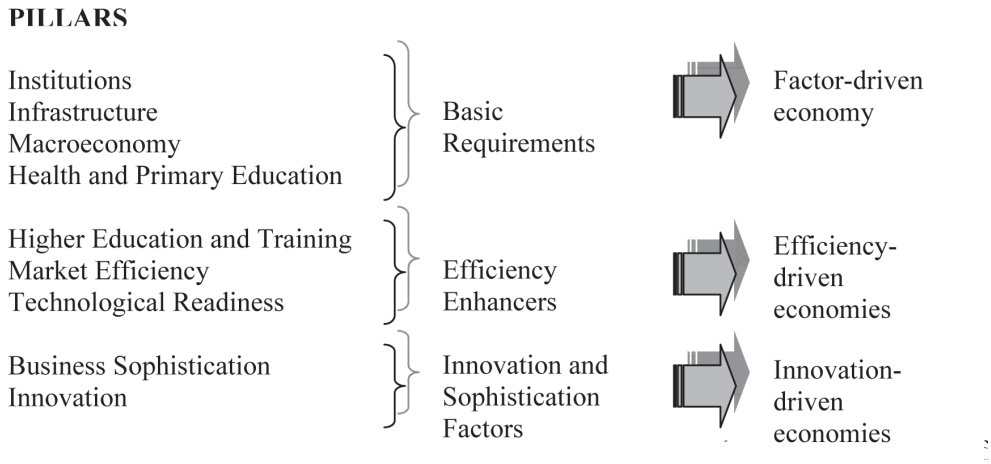
[3] Although some economists (e.g. Krugman, 1994; see for discussion also Reiljan at al., 2000) put the usefulness of the concept into question, and deny the ability of a nation to compete among themselves, there is a growing consensus on the elements of national competitive advantage.

two complementary indices of competitiveness - Global Competitiveness Index and Business Competitiveness Index.

Global Competitiveness Index is a relatively new index (created in 2004) that groups many factors being critical to driving productivity and competitiveness into nine pillars. The pillars - presented in Figure 1 - are organized into three subindexes: the basic requirements subindex, the efficiency enhancers subindex and the innovation and sophistication factors subindex. Each of them is critical to a particular stage of development: the first one to the factor-driven stage, the second one to the efficiency-driven stage, and the third one to the innovation-driven stage.

Global Competitiveness Index is based on three principles[4]: 1) determinants of competitiveness are complex; 2) the economic development is a dynamic process of successive improvement, i.e. it evolves in stages; 3) as economies develop, they move from one stage to the next in a smooth fashion.

Figure 1: Pillars of economic competitiveness



In the calculation of the Global Competitiveness Index, WEF uses both hard data (taken from statistics of international, regional and national organizations, 14 criteria) and survey data (21 questions, resulted from the Executive Opinion Survey). The rank of each country is a combination of publicly available hard and survey data. Details on methodology underlying the construction of the index are given in GCR (2006).

Business Competitiveness Index measures the country's ability of competitive growth from a microeconomic point of view. In other words, it assesses the factors that influence the competitiveness of an individual enterprise, as well as

[4] Sahin, S.O. at all: A new perspective in competitiveness of nations, REF, 2006, p. 9

the quality of business environment. Consequently, it is organized into two sub-indexes: the operation and strategy of an enterprise, and the quality of business environment. Business Competitiveness Index relies almost exclusively on survey data. It is extensively described in GCR (2006).

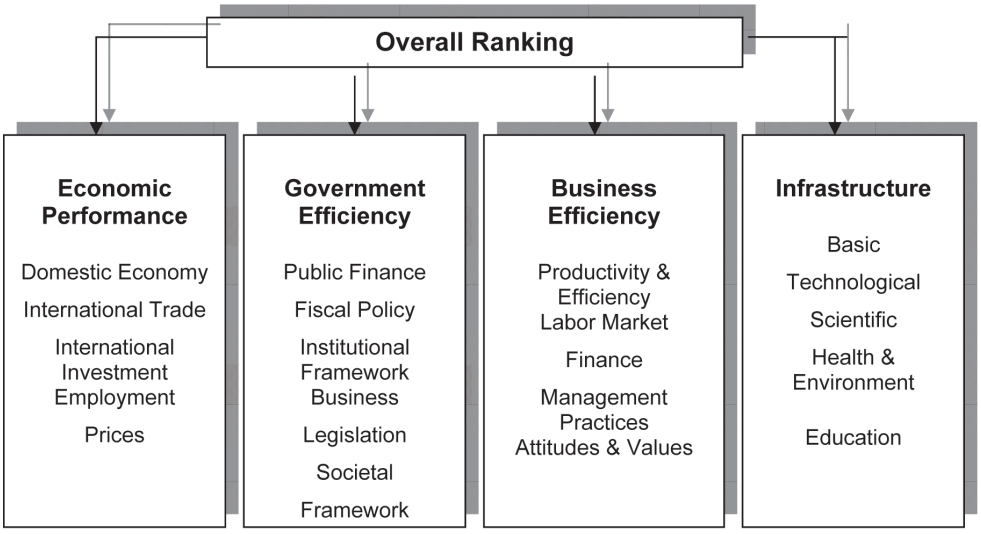
Although the international competitiveness of countries will depend on the ability of their industries to engage effectively in international trade, Porter (1990) noted that many factors that enhance or inhibit the competitiveness of industries are highly localized.

2.2. World Competitiveness Yearbook

IMD produces one of the world's most comprehensive annual reports on the competitiveness of nations – The World Competitiveness Yearbook (WCY). It has been published since 1989. The WCY analyzes and ranks the competitiveness of key players in world markets, i.e. the ability of countries to create and maintain an environment that sustains the competitiveness of enterprises.

WCY focuses on the outcome of the interaction of four main competitiveness factors – economic performance, government efficiency, business efficiency and infrastructure – which generally define a country's national environment. These factors together with their five sub-factors are represented in Figure 2.

Figure 2: Four competitiveness factors and their sub-factors according to WCY Competitiveness Breakdown



Source: IMD World Competitiveness Yearbook http://www.imd.ch/research/publications/wcy/upload/Book_Tour_2006_2.pdf

As Garelli stated (2006), on the basis of these four factors and more than 300 criteria, WCY assumes that healthy performance in these dimensions creates a national environment that sustains competitiveness. The criteria can be hard data (128 criteria obtained from international, regional and national sources), which analyze competitiveness as it can be measured (e.g. gross domestic product) or survey data (113 questions obtained by the annual Executive Opinion Survey), which analyze competitiveness as it can be perceived (e.g. availability of competent managers). Hard criteria represent a weight of 2/3 in the overall ranking, whereas the survey data represent a weight of 1/3. Details on methodology and principles of analysis are given in Rosselet-McCauley (IMD WCY, 2006).

3. CROATIAN COMPETITIVENESS IN INTERNATIONAL ENVIRONMENT

3.1. WEF's point of view

Croatia has been involved in GCR by WEF since 2002. In 2006, it occupied 51st place according to the Global Competitiveness Index out of 125 countries, participated that year in research (Table 1). Compared to 2005, the position of Croatia has been significantly improved regarding both, global and business competitiveness.

Table 1: Reports on the global competitiveness 2006 - 2007 (selected ranks)

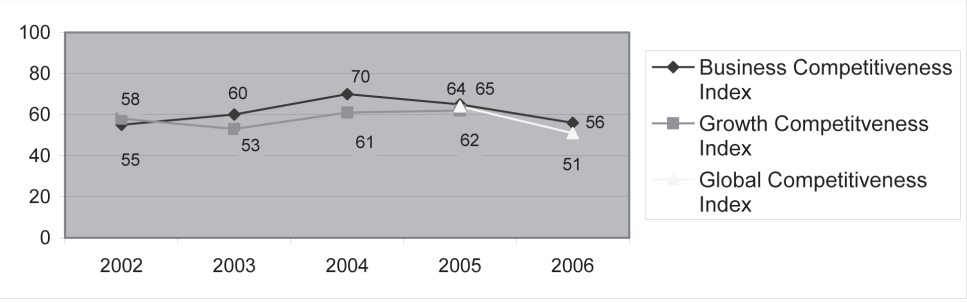
Global Competitiveness Index		
	2005	***2006***
Switzerland	4	1
Finland	2	2
Sweden	7	3
Denmark	3	4
Singapore	5	5
.....		
Estonia	26	25
Czech Republic	29	29
Slovenia	30	33
Slovak Republic	36	37
Hungary	35	41
Poland	43	48
.....		
Croatia	64	51
Turkey	71	59
Romania	67	68
Bulgaria	61	72

Business Competitiveness Index		
	2005	***2006***
USA	1	1
Deutschland	2	2
Finland	3	3
Sweden	8	4
Denmark	5	5
.....		
Estonia	27	24
Czech Republic	26	32
Slovenia	33	36
Hungary	38	39
Slovak Republic	43	40
Poland	44	53
.....		
Turkey	49	46
Croatia	65	56
Romania	71	74
Bulgaria	74	83

Source: Global Competitiveness Report, Executive Summary, 2006
Note: In 2005, rankings were calculated for 117 countries, whereas in 2006 they were calculated for 125 countries.

According to the Global and Business Competitiveness Index it can be seen that Croatia has begun to close the competitive gap created in comparison to the advanced ex transition countries, present Central and Eastern Europe's top performers (i.e. Slovenia, Hungary and the Czech Republic). Although 2006 was the last accession year for Romania and Bulgaria, they deteriorated, whereas Croatia and Turkey, the new candidate countries for the EU, progressed. However, the comparison to the previous years (Figure 3), puts the improvement of Croatia, considering global and business competitiveness, in the real framework. Compared to 2002, the improvement was slight, if we can talk about the improvement at all. In fact, a comparison according to ranks is hard to conduct and it does not lead to the consistent conclusions, due to changes in methodology and the number of countries participating in research. Nevertheless, the results can be valuable for government, the broader professional and general public, and institutions that influence the competitiveness of Croatia.

Figure 3: Trends of competitiveness in Croatia, ranks in period 2002 – 2006



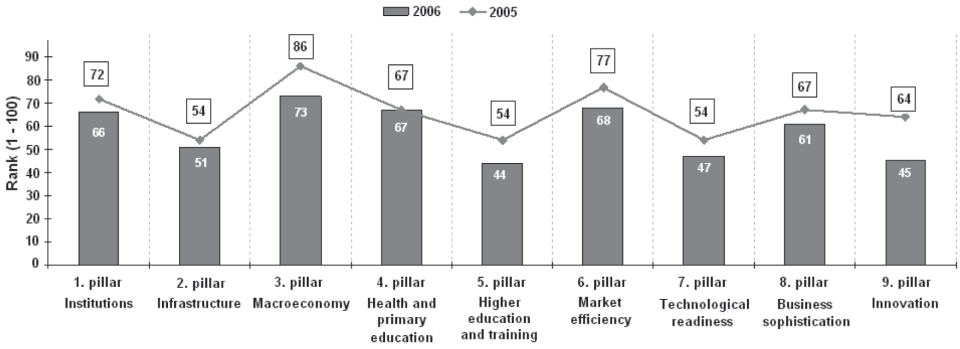
Source: Radman, 2006 according to GCR (2006)

Note: the number of countries covered in rankings in 2002 was 80, in 2003 102, in 2004 104, in 2005 117 and in 2006 125.

From 2002 to 2006 the position of Croatia improved, the global competitiveness became significantly better, but the growth competitiveness was not importantly changed.

Identification of the Croatian performance in certain areas, i.e. pillars enable us to understand the trends and to identify the areas in which the changes are necessary. The position of Croatia in 2006, compared to 2005 and regarding the competitiveness pillars, are shown in Figure 4.

Figure 4: Nine pillars of competitiveness according to WEF – the position of Croatia



Source: Radman, 2006 according to GCR (2006)

The progress of Croatian competitiveness in absolute terms is the result of improvement in almost each factor of competitiveness. From nine pillars of competitiveness, shown at the Figure 4, Croatia has the best position, considering the following criteria: higher education and training (the 44th place), innovation (the 45th place) and technological readiness (the 47th place). Each of them is extremely important in determining the future outlook of Croatia regarding competitiveness. Skilled workers, that are innovative and trained for using the most modern technology, are prerequisite for building, maintaining and enhancing of competitiveness.

The areas, in which Croatia achieved poorer results, and which demand intensive reforms can be found in domain of government and its activities. It is about macroeconomy, institutions, health and primary education. Compared to an economy, lagging behind in these areas, in its performance and preferences can be a hard burden and can jeopardize the future competitiveness of the Croatian economy. Furthermore, uncertainty stemming from uncertain and too changeable national framework conditions, weak and obscure institutions, inefficient judiciary, widespread corruption, bribe and the like can also jeopardize the enhancement of business efficiency and lead Croatia to lagging behind the EU. Considering the achieved stage of economic development – efficiency driven economy – Croatia should not face the problems related to the basic factors of competitiveness. The National Council for Competitiveness (2006) found out that Croatia has outgrown the problems with basic competitiveness requirements, except in part regarding the institutions. Anyway, further reforms in these areas should be conducted simultaneously with the improvement in business efficiency and innovativeness.

3.2. IMD's point of view

In 2006, the edition of World Competitiveness Yearbook IMD added two new countries, Bulgaria and Croatia. Consequently, the number of countries included in research reached 61. Selected results of The World Competitiveness Scoreboard in 2005 and 2006 are shown in Table 2.

Table 2: Selected World Competitiveness Scoreboard 2005 and 2006

Country	Rank in 2006 (N = 61)	Rank in 2005 (N = 60)
USA	1	1
Hong Kong	2	2
Singapore	3	3
Iceland	4	4
Denmark	5	7
. . .		
Finland	10	6
. . .		
Estonia	20	26
Czech Republic	31	36
Slovak Republic	39	40
Hungary	41	37
Slovenia	45	52
Poland	58	57
. . .		
Bulgaria	47	-
Turkey	51	48
Romania	57	55
Croatia	59	-

Source: IMD World Competitiveness Yearbook, 2006

The results of rank list also indicate (as well as the rank list of WEF) that small countries (in terms of population) can occupy the leading positions on the list. It seems that "*...greater degree of adaptability and flexibility which is so essential in our fast-changing world is easier to create in countries with small populations*." (Schubert & Martens, 2005, p. 28)

Absence of Croatia in rankings in 2005 does not enable identification of progress in competitiveness. However, it is possible to notify that Croatia is positioned not only behind the leading Central and Eastern European (CEE) countries, but also behind the new EU countries – Bulgaria and Romania, as well as the other candidate country – Turkey. The origin of this unfavorable Croatian position is related primarily to weaker achievement in the area of business efficiency, especially in unsatisfied managerial practice, i.e. ability of Croatian companies to operate in an innovative, profitable and responsible way (Table 3). Furthermore, government being responsible for the national framework conditions contributes to that position. The national framework conditions do not motivate enough

companies to increase in innovativeness and productivity. On the other side, they limit those companies which are innovative and productive and which have a growth potential. For example, the labor regulation and labor market reflect the rigidity of institutions and their incompetence to adapt to changeable business framework conditions. Simultaneously, it indicates the lack of common sense in keeping rigidity because it is about a country in which youth unemployment (age of 15 to 25) accounted 20% in 2005.[5]

Table 3. Results of ranking Croatia in 2006 according to sub-factors (61 countries)

FACTORS	SUB-FACTORS	RANK
	Domestic economy	55
Economic performance	International trade	10
	International investment	48
55th rank	Employment	59
	Prices	34
	Public finance	47
Government efficiency	Fiscal policy	53
	Institutional framework	57
55th rank	Business legislation	56
	Societal framework	47
	Productivity	44
Business efficiency	Labor market	59
	Finance	58
61st rank	Management practices	61
	Attitudes and values	59
	Basic infrastructure	50
	Technological infrastructure	49
Infrastructure	Scientific infrastructure	55
50th rank	Health and environment	49
	Education	44

Source: Radman, 2006 according to IMD WCY (2006)

Croatia occupied an extremely bad position according to attitudes and values. Considering the stylized facts that the wish for success and readiness to hard work are critical qualities for competitiveness enhancement (Garelli, 2006), and that the changes in value system (that determines the behavior of individuals in a business world, their relations to corruption and bribe, to favoritism and the like) are happening incrementally, slowly, over the time and in dependence on expectations, the complex program of changes in each segment of society should

[5] Source of data: the Croatian Employment Service, 2005

be created. The program should encompass the whole Croatian population and be followed adequately by media and juridical.

Although the government efficiency corresponds to the rank of economic performance in Croatia (see Table 3), government performance is not consistent to economic performance. The comparison of the contribution of economic performance and government efficiency, i.e. government and enterprises, to the country's overall competitiveness (see IMD, 2006), indicates that the Croatian government has a negative contribution to the overall competitiveness. Countries which occupied mostly the top positions on the rank list (e.g. Finland and Denmark), and also some CEE countries (e.g. Slovak Republic and Russia), have a positive contribution.

4. CROATIAN COMPETITIVENESS – CONCLUDING REMARKS

According to the international rankings of WEF and IMD, Croatia has achieved positive movements considering competitiveness. In 2006, it occupied 51st place out of 125 countries included in Global Competitiveness Index by WEF. According to IMD, it is still positioned at the bottom of the list consisted of approximately 60 countries. In both rankings the leading CEE countries are better positioned (for example, Hungary, the Czech Republic, Slovenia), and Bulgaria and Romania, considering some specific factors, too. In both cases, it is about the countries, which Croatia was successfully compared to at the beginning of the transition process (1989 and 1990) and from which it recorded better results. Obviously, these countries have done their homework much better and 'run' more quickly than Croatia.

Based on the results of both rankings and assessments of the Croatian position, several facts can be highlighted:

- Small countries (in terms of population) can build their competitiveness by balancing between aggressiveness and attractiveness, leaning on wise strategic choices and processes.

Positioning of small countries in terms of population among the top ten the most competitive countries, such as Switzerland, Finland, Sweden, and Denmark removes the doubt about the possibility of small countries in building and sustaining competitiveness. Croatia, with less than 4.5 million inhabitants, is a small country which export aggressiveness through achievement of greater competitiveness is a development imperative and a basis for solving accumulated problems, such as large foreign debt, trade deficit and big unemployment. In order to improve its position, Croatia can learn exactly from the experience of these small, but top positioned countries considering competitiveness. These countries have developed a winning combination of world-class education and

research system and outstanding capacity for innovation. They have sound, transparent and responsible institutions, and highly sophisticated business culture. Furthermore, economic and social politics, from the most of these countries, is based on the so-called Nordic model, which assigns the new role to public sector in building national competitiveness (for description of the model see Schubert & Martens, 2005).

- Sustained competitiveness is not connected only to well-functioning markets and the performance of the private sector but also to an efficient and effective public sector. Consequently, in order to build a health, sustain and highly competitive country, the role of government and public sector should be changed.

The IMD's results indicate that proactive government policy, directed to support and foster the competitiveness building, contribute significantly to its enhancement. This role of government is especially important in small countries because they are exactly the countries which face the strong imperative of export propulsiveness. Under the conditions of highly competitive world market, only competitive companies can prosper. Government can make general national framework conditions and entrepreneurial framework conditions favorable or unfavorable for entrepreneurship and for enhancing productivity and innovativeness through its policies and programs. The cases of the Nordic countries indicate that in the process of building sustainable competitiveness, public sector has an important role – the size of the state is not important, but the quality of services provided. The way to improve public management, deliver value for money, provide transparency and public accountability have become the key challenges considering the role of public sector in creating the sustainable competitiveness. The Nordic model responds successfully to these challenges, and consequently it becomes the study subject and the source of inspiration for many European countries. 'Value for money' and forward-looking, lean, efficient and relatively free of corruption are extremely important characteristics of public sector and government that should be built in the CEE countries, and consequently in Croatia.

- Under assumption that continued efforts in reforms they are theoretically and practically well founded, continued and consistent, and that they are keeping the same direction contribute significantly to raising the competitiveness.

Transition processes suppose the development of pluralistic relations in all areas of business, social and political life. Among others, they require transformation of the central planned economies to the market driven ones. Such transformation is based on conduction of numerous economic reforms. The pace, dynamics and quality of reforms determine economic performance and outlook of these

countries. The cases of the CEE countries during 1990s and at the beginning of the 21st century indicate that those countries, being consistent in reform, occupy better places on competitiveness rank list. The accession to the EU does not mean that a country should stop with reforms. Just opposite to this, further reforms are necessary to catch up with the countries having much better competitiveness, future outlook and standard of living.

- Competitiveness in a country should be continuously analyzed in all of its complexity and disintegrated according to the particular factors in order to improve competitiveness.
  The factors underlying competitiveness are numerous and heterogeneous; they are interconnected and they mutually influence each other. Although none of them alone can ensure competitiveness of a country, poor quality in one of them can jeopardize competitiveness and the country's future outlook. Consequently, weaknesses have to be continuously identified and addressed in a proactive way.

- Competitiveness is a passion to be better, a passion that should be shared by all the actors, and integrated in every aspect of people, government and enterprise behavior and decision making. Furthermore, the transform of competitiveness into economic growth and development demands commitment from all the actors, as it is illuminated in Garelli (2006).

Government is not the only one responsible for economic development – it is a process that supposes proactive behavior, collaboration and responsibility of all the actors; including government (on all administrative levels), private sector, academy and non-government institutions.

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Ivana Barković (born in 1972) is an associate professor at the Faculty of Law in Osijek. She is currently teaching the course of Economic Policy and Entrepreneurial Management at the undergraduate level, as well as she is engaged at the postgraduate specialist studies at the Faculty of Law in Osijek and the Faculty of Economics in Osijek. She has published a significant number of scientific papers in domestic and international publications covering issues from the field of macroeconomics, economic policy, gender economics and entrepreneurship. In addition, she is the co-author of the book „Nobel prize in economics" – 2nd edition (2004) and the author of the university textbook „Theory of Growth" (2006). Her scientific activity has been also reflected in active participation at national and international conferences. She is currently a senior researcher of the project "Theory and Practice of Institutional Approach to the Regional Development" financed by the Croatian Ministry. In May 2006, she has become an executive editor of the Journal of Law and Social Sciences of the Faculty of Law Osijek. Since the beginning of the academic year 2007/2008, she is a Vice-Dean for Science and International Cooperation of the Faculty of Law in Osijek.

Mira Lulić was born in 1970 in Osijek. In 1993 she graduated from the Faculty of Law. She was awarded a master's degree in 1999 at the Faculty of Law of the University in Split and in May 2005 a doctoral degree at the Faculty of Law of the University in Zagreb. She is an Assistant Professor at the Department of International Law at the Faculty of Law in Osijek. She teaches the course of International Law and International Protection of Minorities. In her scientific career she has been actively participating in numerous scientific conferences in the field of International Law. She published the book "Decolonisation and Creation of Statehood" (2005) and a wide range of scientific papers in the field of International Law. Since February 2007, she is the main researcher of the project **"**Minority Rights Protection in Contemporary International Law and National Legislations**",** approved by the Croatian Ministry of Science, Education and Sports. She is a member of the Croatian Assosiation for International Law, Croatian Institute for Local Government, Croatian Society for Maritime Law, Humanitarian International Law Assembly and The National Association for Ethnic Studies and also an Associate of the Croatian Academy of Law Sciences.

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