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Editorial

This is the thematic issue of the academic journal Economic Themes. The papers included in this issue have been selected from the large number of submissions presented at the International Scientific Conference **The Global Economic Crisis and the Future of European Integration**, held in Niš on 18th October 2013. The conference is organized by the Faculty of Economics, University of Niš and sponsored by the Republic of Serbia Ministry of Education, Science and Technological Development.

The papers in this issue cover a number of topics related to the global economic crisis and the process of economic and political integration across Europe. The content may look non-homogeneous, but it is because the main theme of the conference need to be addressed from different angles. Under the umbrella theme of the conference authors managed to find their research niche. The content of the proceedings fully portrays diversity of research interests of our contributors.

Editor-in-Chief

Prof. dr Srđan Marinković

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THE ROLE OF FINANCIAL REGULATORS IN THE CONTEXT OF THE GLOBAL FINANCIAL CRISIS

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Abstract: The financial sector is one of the main driving forces of a country's economic development and essentially important factor of its overall economic stability. However, when exposed to inadequate regulation, unstable market and underdeveloped institutions, the financial sector might become a root cause of financial crises and one of the main factors that contribute to destabilization of a national economy as a whole. As the global financial crisis set in, it became evident that a stronger role of the state and its institutions became necessity in order to restrain more efficiently the observed internal deficiencies in the market itself. In the aftermath of first wave of the financial crisis, many countries initiated legislative reforms, abandoning the then prevailing principle of financial deregulation. One of the main directions the reforms took was the establishment of new regulatory authorities and delegation of enhanced supervisory powers to existing market regulators.

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Without any doubt, the financial sector of every national economy is one of the main driving forces of a country's economic development and an essential factor of its economic stability. However, when exposed to inappropriate regulations, unstable market and underdeveloped institutions, the financial sector, instead of being one of the main pillars of stability, might even become the root cause of financial crises and one of the main factors undermining the national economy.

Maintaining stability and reinforcing performance of the financial system, i.e. financial markets as one of its most significant and at the same time most vulnerable parts, depend on a number of institutional factors and market participants. The legislator, regulators, licensed firms and investors – all have an important role to play in developing the financial market. Still, it is noteworthy that here the state has the essential function and role.

Ten years ago, the opinion of the economic experts was rather unanimous considering what the role of the state should be in the financial sector. The common belief was that the state and often its regulators posed a hindrance to the economic development, and that the direct government interference, primarily through state ownership of financial institutions and direct subsidies were the complete opposite of the idea of a free market economy. The general standpoint was that a market should rest on its own regularities and that in such conditions capital and risks are the most efficiently distributed. The proponents of the free market theory believe that any kind of state interference in the market is not only unnecessary, but, what is more, could have damaging and numerous adverse effects. When it comes to market economy it is on the state to ensure that the laissez-fair principle is applied. It should merely establish the general rules for economic activities and ensure efficient enforcement of laws. It would be impossible to dwell on the champions of this theory, without mentioning the originator of the free market theory, Milton Friedman. When assessing the optimal role of state in national economy, he was far blunter than his followers, later on. In the middle of the last century, he argued that any interference of the state and any attempt at control of the free market violated not only the natural, free development of capitalism, but resulted in restricting the freedom of citizens as well. The following quote from Friedman is a great example illustrating this standpoint: “If you put the federal government in charge of the Sahara desert, in five years there’d be a shortage of sand.” He identified the cause of the gravest economic crisis of the time as excessive government intervention in economy: “The Great Depression, like most other periods of severe unemployment, was produced by government mismanagement rather than by any inherent instability of private economy.”

However, the new century faced the economic thought with new challenges. To be more precise, at the beginning of the last century, a new financial crisis arose, showing all the weaknesses of financial markets. As a consequence, the then generally accepted principles and the prevailing standpoints of economic experts that a market should rest on its own regularities were to be re-examined. As the crisis set in, in addition to the climate of mistrust in the state which had generally stayed the same as before the crisis, the lack of confidence in the market itself appeared. The repercussions of such lack of confidence primarily among investors in the capital market brought about some acute problems seen foremost in the undermined market stability and stagnant development, especially bearing in mind that the mistrust was in the very foundations of the financial system. It became clear in such a situation that the former arrangement no longer provided a satisfactory framework that could efficiently respond to new challenges. A stronger role of the state and its institutions became a necessity in order to restrain more efficiently the observed deficiencies in the market. At the same time, it was of utmost importance to achieve the right balance between the need for creation of a stable financial system and the risks of simultaneously smothering the competitiveness and suboptimal allocation of capital, all of which are prerequisites for further growth of the market.

In this sense, it is of importance for the state to continuously and through various mechanisms promote and advance the development of its financial market, to build its financial infrastructure, educate market participants and to constantly follow, monitor and analyze impulses, reactions and practical experience feedback from the market, in order to react timely and reduce systemic risks, but also to simplify procedures, or at least reduce administrative obstacles.

When determining the scope and direction of government intervention, we should take into consideration the experience that we now have from seeing the consequences of different reactions of some states which responded to the challenges posed by the crisis of financial institutions and the crisis of global excessive indebtedness. They indicate that healthy competition, but only if paired with strong supervision by competent authorities, could boost efficiency and enhance access to financial services without undermining total stability, at the same time.

Still, it is important to distinguish between different functions of a state in the financial system and emphasize that when direct interference is not the case, new evidence keeps arising of how state participation (e.g. state banks) can really, at certain points, help mitigate the adverse effects of crises. However, in the long run, too much of state interference in this way might have significant negative effects on the financial sector and misplace allocation of resources. On the other hand, the role of a state as a regulator that lays down rules and enforces them efficiently is of equal importance in times of a financial crisis when investor confidence needs to be restored and in time of economic prosperity, when it should prevent any potential threats to financial stability.

Speaking about the role of the state in setting general business rules and conditions through a legislative framework that should provide the optimum conditions for further development, it is important to bear in mind that the financial sector is specific, due to its dynamics and varying conditions. Therefore, it is extremely important to balance between the state interference and deregulation, and also be quick in reacting when the measures applied start showing their weaknesses or deficiencies.

Once the legislation, governing behaviour of financial market participants is in force, it is necessary that the state carry out its supervisory function by establishing independent regulatory authorities that will apply capital market regulations with integrity and independently from the executive arm of government, in a consistent way.

Therefore, let us remind of the inception period of the first Commission – capital market regulator, and the then situation in the market, which was ripe for reforms. Before the Wall Street Crash[1] in 1929, the financial market state regulations practically did not even exist. In the period immediately following the First World War, at the time when the securities related activities were on the rise, all the attempts at introducing financial disclosure and preventing frauds involving securities were not taken seriously. After the Stock Market Crash of 1929, public confidence in the market fell sharply, with a far-reaching effect. One of the ramifications of the Great Depression[2] was that retail and institutional investors, including banks, lost large sums of money. In this situation, in order for the economy to recover, it was necessary to restore confidence in the capital market. Thus, the first securities commission was formed in the USA in 1934, with an aim to regain confidence in the capital market, providing investors and the market itself with more reliable information and straightforward rules. The main task of such newly-founded commission was to enforce the newly adopted regulations on the financial market, to promote stability and foremost – to safeguard investors. Moreover, the Glass-Steagall Act (The Banking Act, Pub. L. 73-66, 48 Stat. 162, enacted June 16, 1933) was adopted, introducing legislative reforms, in the wake of the Wall Street Crash of 1929. This act primarily separated the commercial from investment banking activities, and also established the Federal Deposit Insurance Corporation (FDIC). FDIC covers bank deposits, the deposit insurance coverage amount is set by the Act, requiring all banks insured by FDIC to be members of the Federal Reserve System. The introduction of this corporation was not only an attempt at restoring public confidence in banks, but also to facilitate the much needed flow of capital to banks, which were severely hit by the crisis and placed on the verge of bankruptcy. This is illustrated by the fact that only 6 months after the establishment of FDIC, in January 1934, the bank failures – characteristic of the early years of the Great Depression – came to a halt. Moreover, this piece of legislation contains a set of provisions governing prevention of speculative behaviour, especially speculative use of loans.

A similar conclusion was reached after the last global economic crisis that once more underscored the importance of the state and regulation in prevention of consequences and primarily averting new crises, by enacting laws and

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1 The Wall Street Crash of 1929 is also known as Black Tuesday and the Stock Market Crash of 1929.
2 The Great Depression is the name used for the period of severe economic depression following the US Stock Market Crash of 1929.

stronger supervisory powers. In this respect, the states hit by the crisis introduced sweeping reforms.

One of the main directions the reforms took was to redefine the role of the state in the financial industry, abandoning the principle of deregulation, establishment of new regulatory authorities and the delegation of supervisory activities to the existing market regulators. Such concepts are to be found in all the countries that faced the great financial crisis, the end of which seems yet not to be seen. However, there is no general formula for overcoming or averting a crisis, especially bearing in mind the specific features of the financial system and the fact that different states have – in addition to differing degrees of development – different tradition of development of financial markets.

The key issue in adopting the new regulatory norms is determining the level at which the relations on the financial market should be governed by state regulations or left to the market competition and the principle of autonomy of the will of market participants. Obviously, the solution lies in finding the proper balance between the state regulation and the market. Over-regulation, of course, should be avoided because it slows down financial innovation and thereby undermines economic growth in the wider economy (Report of the High-Level Group on Financial Supervision in the EU chaired by Jacques de Larosière, Brussels, 25 February 2009). However, caution should be taken not to overburden market participants with regulations. Still, insufficient regulation also warrants caution, bearing in mind the example of the latest crisis – largely fuelled by insufficient regulation of the American financial system. It is of key importance that the enforcement of existing regulation, when adequate (or improving it, where necessary), and better supervision, can be as important as creating new regulation (Report of the High-Level Group on Financial Supervision in the EU chaired by Jacques de Larosière, Brussels, 25 February 2009).

The purpose of regulation of financial markets is in the creation of assumptions for safety and adherence to adequate standards, legal safety, transparency, fair competition, liquidity and low costs of transactions carried out in the financial market. In achieving these goals, it is necessary to balance them (for example, between the maximum transparency requirements and costs related to it), the understanding of the inherited and the existing degree of development of financial markets, with the simultaneous projecting and implementation of measures essential for attaining the standards of the World Trade Organization (WTO), European Union (EU), International Organization of Securities Commissions (IOSCO) and other relevant institutions in the area.

In the aftermath of the first wave of the financial crisis, many of the countries initiated legislative reforms aimed at abandoning the then prevailing principle of deregulation. The standpoint that a market should rest on its own regularities was abandoned and general legal reforms were initiated. As a result, it is evident even today that the degree of regulation has been significantly increased.

In addition, one of the main directions the reforms took was the establishment of new regulatory authorities and the delegation of supervisory activities to the existing market regulators. Namely, an efficient system of functioning of a capital market is based primarily on complying with the prescribed rules and procedures by the capital market and its participants, laying the foundations for building confidence in the capital market. In order to create such an environment, an independent capital market regulator is required to safeguard the integrity of the market itself. For this very reason, one of the key goals of capital market regulation is maintaining independence of the market regulator to ensure a fair, efficient and transparent capital market.

To create the foundations for the regulators to perform their primary function, it is necessary for them to hold a high level of political independence. This is primarily because of the specific and unique position regulators have on the capital market. Regulators oversee a sector which is the center of capital allocation in any society, and therefore attract avid interest of political centers of power and the industry itself as active or potential participants on the market.

The adequate level of independence of a regulator is necessary in order to deter any external pressures and lobbying. On the other hand, bearing in mind the competencies of a regulator, acquiring and strengthening independence will enable the regulator to perform all the activities within its remit.

The Dodd-Frank Act and the US Securities Commission

Maybe one of the most explicit examples of a state responding to the crisis with overregulation is the United States of America with the Dodd–Frank Act adopted on 21 July 2010 (The Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub.L. 111-203, H.R. 4173). This Act introduced the most comprehensive changes in the US financial regulation since the regulatory reform that followed the Great Depression[3]. Four years after the great crash of the US stock exchange, the Banking Act, known as the Glass-Steagall Act was adopted. By comparison, it is 23 times shorter than the Dodd-Frank Act. The Dodd-Frank Act contains 1601 sections categorized in 16 titles, and requires that regulators create 243 rules, conduct 67 studies and issue 22 periodic reports. Only one section know as the Volcker Rule, is intended to restrict banks from making risky speculative investments, to reduce banks' ability to take excessive risks by restricting proprietary trading and investments in hedge funds and private equity, containing 383 questions and 1,420 sub-questions (The Economist, February 18-24, 2012, p. 8.). One of the main reasons for the

[3] The worldwide economic crisis that began 29 October 1929 with the US stock market crash.

adoption of this act was to ensure the stability of the financial market in its broad sense. With it, the American legislator tried to advance the regulatory process, enhance supervision over specific institutions and promote transparency in operations of financial intermediaries. The Dodd-Frank Act ended the "too big to fail" principle, also protecting the American taxpayer by ending bailouts. The provisions of this Act prevent banks from taking excessive risk, proprietary trading of banks is very limited, derivatives must be traded on stock exchanges and clearing and settlement is limited to clearing houses. These are only a few of the provisions of the Dodd-Frank Act reflecting its main goal – prevention of a new financial crisis.

The Act changes the regulatory infrastructure in force by introducing a large number of regulatory bodies, and by assigning additional competencies to the existing regulatory agencies.

The Dodd-Frank Act introduced, among others, the following new agencies:

- The Financial Stability Oversight Council (FSOC) – has broad authorities to identify and monitor excessive risks to the US financial system, to supervise the financial services market and issue general recommendations, to study bills and advise the Congress. FSOC has the authority to bring within the perimeter of prudential regulation any non-bank financial firm whose failure could be the source of systemic problems.
- The Office of Financial Research – provides administrative and technical support to FSOC.

The changes in powers and competencies affected almost all of the authorities that take part in the supervision of the financial system: Federal Deposit Insurance Corporation (FDIC), Securities and Exchange Commission (SEC), Office of the Comptroller of the Currency (OCC), Federal Reserve (the "Fed"), the Securities Investor Protection Corporation (SIPC), etc.

It is worth mentioning that in order to ensure that no firm is too big to fail, was the creation by Dodd-Frank of orderly liquidation authority. Under this authority, the FDIC can impose losses on a failed institution's shareholders and creditors and replace its management, while avoiding runs by short-term counterparties and preserving, to the degree feasible, the operations of sound, functioning parts of the firm.

When it comes to the SEC, the Dodd-Frank Act contains more than 90 provisions that require SEC rulemaking, and dozens of other provisions that give the SEC discretionary rulemaking authority. To date, the Commission has put in place a foundation for a framework that will support an entirely new regulatory regime designed to bring greater transparency and access to the securities-based swaps market, adopted rules that will result in increased oversight and transparency around hedge fund and other private fund advisers, gave investors a say-on-pay regarding executive compensation and established a whistleblower program which offers incentives for individuals with information regarding securities law violations to come forward. The SEC also has proposed a series of rules designed to improve the practices of credit rating agencies, including rules to limit the conflicts that may arise when NRSROs rely on client payments to drive profits and rules to monitor rating agency employees who move to new positions with rated entities.

The Dodd-Frank Act significantly reinforced and expanded the SEC powers, especially concerning its jurisdiction over hedge funds, credit rating agencies and governance of public companies. In order to enforce these powers in practice, the Act stipulates a comprehensive set of measures and options to be added to the already substantial range of SEC powers.

Law firm Gibson Dunn (http://www.gibsondunn.com/publications/pages/DoddFrankActReinforcesAndExpandsSECEnforcementPowers.aspx) points to the following changes and enhanced powers of the SEC, established by the Dodd-Frank Act:

1. New Rewards and Expanded Protection of Whistleblowers[4]

Whistleblowers who voluntarily provide information to the SEC that leads to a successful enforcement action resulting in over $1,000,000 of monetary sanctions may be awarded by the SEC an amount not less than 10% and not more than 30% of the monetary sanctions collected. The Act states that determination of the amount of the award shall be in the discretion of the SEC, taking into consideration the significance of the information provided, the degree of assistance provided, and the programmatic interest of the SEC in deterring violations of the securities laws by rewarding whistleblowers and other factors the SEC may establish (Sec. 922(a)).

2. Authority to Impose Administrative Fines on all Persons, not Merely Brokers, Investment Advisers etc.

The SEC first received broad authority to seek or impose civil money penalties in enforcement actions as a part of the Securities Remedies and Penny Stock Reform Act of 1990, perceiving that such quasi-criminal remedies should not be imposed on persons who did not voluntarily choose to subject themselves to the SEC's jurisdiction. The SEC's own authority to impose such remedies in administrative actions was limited to persons who were associated with regulated

[4] A "whistleblower" – any individual who provides, or two or more individuals acting jointly who provide, information relating to a violation of the securities laws to the Commission, in a manner established, by rule or regulation, by the Commission. Sec 21F (a)(6).

enterprises - brokerage firms, investment advisers, investment companies and other registered entities. For all other persons, the SEC was required to seek an order from a federal district court in a civil action, triable by jury.

Dodd-Frank washes away this distinction and adopts the three-tiered penalty grid already contained in the Securities Exchange Act, but raises the penalty amounts by fifty percent.

In part, the new authority codifies existing regulatory practice and it could facilitate negotiated resolutions of SEC enforcement actions. Historically, the SEC has sought civil money penalties in most of its enforcement actions. With regard to settlements of matters regarding non-registered persons, it has frequently bifurcated its settled proceedings into two different proceedings – one an administrative action imposing prospective cease and desist orders and ancillary relief; the other a civil, district court action seeking only the imposition of a civil money penalty. Because many regulatory provisions of the securities laws, such as the reporting and internal control requirements imposed on public companies, are directly applicable only to issuers, the Commission had pursued its claims for civil penalties on a theory that an individual had "aided and abetted" the violation by the public company, a theory of violation that required allegations of scienter – either intentional or reckless misconduct. Now, persons seeking to settle actions can do so in one proceeding, and, if the settlement does not involve a claim of fraud, may do so in an administrative action asserting that the settling party was a "cause" of the violation, a claim which may be premised on negligence, rather than intentional or reckless misconduct.

On the other hand, this new authority also gives the SEC and its Enforcement Division a powerful incentive to bring more cases as administrative actions.

3. Broaden Standards for the Imposition of Secondary Liability

The SEC has long relied on theories of secondary liability to enforce the federal securities laws, particularly those provisions, such as the reporting and internal controls requirements applicable to public companies, and the rules governing brokerage firms and investment advisers that were not directly applicable to individuals. To apply these provisions to individuals, the Commission commonly filed complaints alleging that an individual "aided and abetted" the violation by a company.

The Dodd-Frank Act terminated such practice by stipulating that “aiding and abetting” which is "knowing or reckless" will be a basis for an action.

4. Extraterritorial Authorities

Bearing in mind that securities markets are increasingly global with multinational companies, Act conferred some extraterritorial authorities to the SEC and to the Public Company Accounting Oversight Board (PCAOB).

The Dodd-Frank Act which restored the authority of the SEC and of the Department of Justice and confer U.S. court jurisdiction over violations of the three anti-fraud provisions involving (i) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors, or (ii) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.

Also, the Act increased the authority of the Commission and the PCAOB to compel the production to them of audit work papers of foreign private accounting firms by making such firms subject to the jurisdiction of U.S. courts for purposes of enforcing such a request; requiring US registered public accounting firms to secure the agreement of any foreign accounting firm upon which it relies in its audit to produce the work papers of that firm, and making a failure to comply a violation of law. The Act permits a foreign public accounting firm to produce work papers through alternate means, such as through foreign securities regulators.

The Act adds confidentiality provisions that are intended to overcome objections by foreign authorities to inspections by the PCAOB and other US government data requests and permit the Commission to share documents with the PCAOB and other federal and state agencies without losing the protection from disclosure, to refuse to disclose privileged information obtained from foreign securities or law enforcement authorities, and also permits the PCAOB to share its data with foreign government regulators or authorities empowered by governments to regulate auditors.

5. Increase Collateral Consequences of Securities Law Violations

Historically, bars or limitations on association imposed under one provision of the securities laws, have not extended to association with another regulated entity registered under a different provision, such as investment advisers. The Dodd-Frank Act gives the SEC the authority to bar that person found to have violated one of the securities acts from associating with a range of SEC-regulated entities, and not just entities regulated by the specific title that was violated. Specifically, the Act permits the SEC to bar a violator from association with a "broker, dealer, investment adviser, municipal securities dealer, transfer agent, municipal adviser, or nationally recognized statistical rating organization" in each case.

6. Deadline for Completing Examinations, Inspections and Enforcement Actions

One recurring criticism of the SEC has been delay in the completion of enforcement investigations. The Act require the SEC staff to, within 180 days of providing a written Wells notification to any person, either file an action against such person or notify the Director of the Division of Enforcement of its intent not to file an action. This deadline can be extended for additional 180 day periods if the Director of the Division of Enforcement or a designee of the Director decides that it is necessary because of the complexity of the case and so notifies the Chairman of the SEC.

De Larosière Report

After the crisis spread in Europe, in November 2008, the European Commission mandated a High-Level Group chaired by Jacques de Larosière to make recommendations on how to strengthen European supervisory arrangements with a view to better protecting the citizen and rebuilding trust in the financial system. In its final report presented on 25 February 2009 (the 'de Larosière Report' - Report of the High-Level Group on Financial Supervision in the EU chaired by Jacques de Larosière, Brussels, 25. February 2009), which contains 31 recommendations, the High-Level Group recommended that the supervisory framework should be strengthened to reduce the risk and severity of future financial crises. It recommended reforms to the structure of supervision of the financial sector in the Union. The group also concluded that a European System of Financial Supervisors should be created, comprising three European Supervisory Authorities, one for the banking sector (EBA - European Banking Authority), one for the securities sector (ESMA – European Securities and Markets Authority) and one for the insurance and occupational pensions sector (EIOPA - European Insurance and Occupational Pensions Authority).

Even the "de Larosière Report" has pointed to the importance of supervision and sanctions imposed by supervisory authorities. It is emphasized in the introduction to the Report that „The Group believes that the world's monetary authorities and its regulatory and supervisory financial authorities can and must do much better in the future to reduce the chances of events like this happening again."

One of the causes of the crisis is found to be in the unregulated, or insufficiently regulated, mortgage lending and complex securitization financing techniques. Insufficient oversight over US government sponsored entities

(GSEs) like Fannie Mae and Freddie Mac and strong political pressure on these GSEs to promote home ownership for low-income households aggravated the situation. The whole Report points to the significance of regulation and especially supervision and primarily the strong supervisory and sanctioning regimes. A special chapter is dedicated to the Policy and Regulatory Repair (Chapter II), and the EU Supervisory Repair (Chapter III).

One of the recommendations in the report is that competent authorities in all Member States must have sufficient supervisory powers, including sanctions, to ensure the compliance of financial institutions with the applicable rules and that competent authorities should also be equipped with strong, equivalent and deterrent sanction regimes to counter all types of financial crime.

ESMA[5]

Based on the “de Larosière Report”, and in response to the financial crisis, on 1 January 2011 ESMA replaced CESR.[6] Its establishment forms part of a wider initiative to overhaul the European financial regulatory system and establish the European System of Financial Supervision.

ESMA is an independent EU Authority that contributes to safeguarding the stability of the European Union's financial system by ensuring the integrity, transparency, efficiency and orderly functioning of securities markets, as well as enhancing investor protection. In particular, ESMA fosters supervisory convergence both amongst securities regulators and across financial sectors by working closely with the other European Supervisory Authorities.

As well as continuing the work that was formerly carried out by CESR (including, for example, monitoring market developments and issuing guidelines and recommendations on securities law issues), ESMA has new additional powers including enhanced enforcement powers and the power to draft new technical standards.

ESMA's work on securities legislation contributes to the development of a single rulebook in Europe. This serves two purposes: firstly, it ensures the consistent treatment of investors across the Union, enabling an adequate level of protection of investors through effective regulation and supervision; secondly, it promotes equal conditions of competition for financial service providers, as well as ensuring the effectiveness and cost efficiency of supervision for supervised companies. As part of its role in standard setting and reducing the scope of regulatory arbitrage, ESMA strengthens international supervisory co-operation. Where requested in European law, ESMA undertakes the supervision of certain entities with pan-European reach.

[5] The European Securities Markets Agency
[6] The Committee of European Securities Regulators

Finally, ESMA also contributes to the financial stability of the European Union, in the short, medium and long-term, through its contribution to the work of the European Systemic Risk Board, which identifies potential risks to the financial system and provides advice to diminish possible threats to the financial stability of the Union. ESMA is also responsible for coordinating actions of securities supervisors or adopting emergency measures when a crisis arises.

IOSCO[7]

In response to the crisis, IOSCO revised its Objectives and Principles, namely they added eight new principles.

IOSCO's Objectives and Principles were adopted in response to the Asian financial crisis in 1998, with an aim to establish a framework for regulation of securities markets, market intermediaries, issuers and investment schemes. IOSCO Principles deal with investor protection, providing conditions for fair, efficient and transparent markets and the reduction of systemic risk. Thirty-eight IOSCO principles are grouped into nine categories: regulators, self-regulation, securities regulation enforcement, cooperation in regulation, issuers, auditors, credit rating agencies and other information providers, collective investment schemes, market intermediaries and secondary markets. More than ten years after adoption, in June 2010, IOSCO added some new principles as a response to the new, but this time global financial crisis:

Principle 6 – The regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to a mandate;

Principle 7 - The regulator should have or contribute to a process to review the perimeter of regulation regularly;

Principle 27 – Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme;

Principle 28 - Regulation should ensure that hedge funds and/or hedge fund managers/advisers are subject to appropriate oversight;

Principle 30 – There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risk that the intermediaries undertake;

Principle 32 – There should be procedures for dealing with failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk;

Principle 37 – Regulation should aim to ensure the proper management of large exposures, default risk and market disruption;

[7] International Organization of Securities Regulators

Principle 38 – Securities settlement systems and central counterparties should be subject to regulatory and supervisory requirements that are designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.

In addition to the revised Objectives and Principles, in February 2011, IOSCO also published a document entitled: Mitigating Systemic Risk: A Role for Securities Regulators. This document warns that the securities regulation has traditionally focused on disclosure and business conduct oversight instead of systemic risk. The IOSCO paper analyzed the sources and transmission of systemic risks as coming from size, interconnectedness, lack of substitutes and concentration, lack of transparency, leverage, market participant behaviour, and information asymmetry and moral hazard. The Technical Committee urged regulators to be mindful of regulatory gaps and explained how these gaps can contribute to the build-up of systemic risk. Most notably, exemptions for particular market elements from regulatory oversight and the policy considerations underlying these exemptions should be considered and evaluated on an ongoing basis. Similarly, regulators should address gaps that arise from activities that are currently lightly regulated, as well as new market activities for which there are not yet regulatory responses. To address regulatory gaps arising outside of its jurisdiction, a securities regulator should conduct regular reviews of the perimeter of its regulation, coordinate with other regulators who do have the supervisory authority, and cooperate with international regulators. This analysis might seem very general, but it pinpoints several of the causes of the financial meltdown: the failure to regulate swaps and credit derivatives; the failure to regulate mortgage brokers; the failure to regulate hedge funds or credit rating agencies; the inadequate regulation of securitized products; and U.S. Securities and Exchange Commission exemptions for sophisticated investors.

The IOSCO paper on mitigating systemic risk explains the tools available to securities regulators that can reinforce the stability of the financial system. These tools are "transparency and disclosure; business conduct oversight; organizational, prudential and governance requirements; prevention of risk transmission" through rules regarding trading infrastructure; and "emergency powers." In addition, IOSCO, as an international body of regulators, stressed "intra-jurisdictional communication and exchange of information among regulators about systemic risk to help prevent the emergence of gaps in oversight and identify possible transfers of risk or cross-sectoral risks." Regulators were asked to leverage the work of other regulators and call on self-regulatory organizations to help, when applicable. On the international level, securities regulators were encouraged to continue their collaboration "through IOSCO to improve transparency and disclosure in various international securities markets" and "be active participants in international supervisory colleges" (Mitigating Systemic Risk: A Role for Securities Regulators).

The first IOSCO general meeting after the financial crisis entered its second phase in September 2008 was held in Tel Aviv, in June 2009. Ms Jane Diplock, the then Chairman of the Executive Committee said at the meeting:

"Now more than ever, IOSCO must work towards reaffirming and building confidence in the world's financial markets, and explore new mechanisms for doing that. Some constants remain of course: reducing systemic risk; encouraging efficient, well-functioning markets; and continuing to protect investors. There essentials are the heart of our mission and always will be.

We need to understand what direction to take in order to reaffirm IOSCO`s pivotal role in the international financial architecture. To do that, we must take account of the lessons every country represented here has learned from the crisis. We need to focus more on identifying risks in financial markets and addressing stability issues within the purview of securities regulators. Recent work on credit rating agencies and hedge funds are good examples of this focus.

While recovery now seems inevitable, challenges remain. The ongoing crisis highlights the importance of addressing stability concerns and reducing systemic risk while continuing to protect investors and promote the fairness, efficiency and transparency of markets."

Serbia

When it comes to Serbia, it can be said that a response to the crisis came not earlier than 2011, when a package of new laws was adopted to govern the financial market: A new Law on the Capital Market (Official Gazette of RS, No 31/2011) was adopted, Law on Takeovers (The Law amending the Law on Takeovers of Joint Stock Companies, Official Gazette of RS, No 99/2011) and the Law on Investment Funds (The Law amending the Law on Investment Funds, Official Gazette of RS, No 31/2011) were amended. However, it should be noted that the laws were adopted also because of complying with Serbia's obligation to harmonize the national legislation with the acquis communautaire in the process of EU integration.

The fundamental goal of the Law on the Capital Market (the Law) is to ensure protection of investors and a fair, efficient and transparent capital market. These are the objectives which are enforced through a series of provisions, among which there are increased capital requirements for licensed participants and significantly wider content of prospectuses. Moreover, the Law has also introduced a new institution on the capital market of the Republic of Serbia - the Investor Protection Fund. By establishment of the Investor Protection Fund the client cash claims and financial instrument claims are protected to the maximum amount of EUR 20,000 per client. The introduction of the Investor Protection Fund represents, in addition to the harmonization with the European acquis, undoubtedly a leap forward towards greater investor protection and decreasing the systemic risks in the market. Also, with the introduction of mandatory membership for licensed participants in the financial market, the Law has created legal prerequisites for more responsible and sound operations of all participants. These provisions clearly show that the legislator is trying to restore confidence in the capital market and create conditions for safer conduct of business on our market.

There is no safety in the capital market without paying special attention to supervision. The efficient system of functioning of the capital market is based on complying with the prescribed rules and procedures. In this respect, the Law on the Capital Market significantly reinforced the powers of the Securities Commission, expanding the list of supervised entities and procedures and introducing risk based supervision. Moreover, the law significantly expands measures the Commission imposes in supervisory procedures, ensuring better and more efficient implementation of the necessary activities and contributing to the preservation of the Commission integrity as a supervisory authority. In this respect, the Commission may, independently of other imposed measures declare, a fine to a supervised entity, as well as to a member of the board of directors. A relatively wide range for levying a fine was prescribed, the Commission imposes a fine on the supervised entity which cannot be less than 1% or higher than 5% of the minimum capital, the supervised entity's capital, according to the last financial statement, and it cannot be lower than one salary nor higher than the total of twelve salaries the general manager or a director received in the period of twelve months preceding the day of adopting such decision. Bearing in mind that the Law prescribes the minimum capital of the investment firm amounting to EUR 125,000, the fine cannot be lower than EUR 1,250. In this way, in some situations, sanctions are being more adapted to their purpose and to the effects intended to be achieved by the sanction.

The Law introduces three new criminal offenses: market manipulation, the use, disclosure and recommendation of inside information and unauthorized provision of investment services. Very strict prison sentences and fines are stipulated for the violators. These are the preconditions for introducing orderly functioning of the capital market in Serbia, as sanctions have a strong deterrent effect.

The Securities Commission of the Republic of Serbia was established on 16 February 1990. From the inception of the Securities Commission to the day, the state of the financial market has changed considerably, as well as the importance and the role of the regulator. It is noteworthy, that the Securities Commission became an ordinary member of the International Organization of Securities Commissions (IOSCO) in May 2002, and a full signatory to the IOSCO Multilateral Memorandum of Understanding (MMoU), on 22 October 2009.

In this way, the Securities Commission has been validated as the regulator of the Serbian capital market that adheres to the rules and principles of the highest standard. To sum up the previous considerations about the Serbian market, it can be said that, maybe a little belatedly, we have obtained a modern law of good quality which not just declares for, but essentially contributes to better investor protection, providing conditions for a fair, efficient and transparent capital market and reducing systemic risk in the market. It certainly is necessary, but not the only precondition for the development of the Serbian financial market and tackling the current economic crisis.

Conclusion

Clearly, there are sound economic reasons that a state should play an active role in its financial system, but there are some very practical indicators showing that the state often does not interfere successfully, and that its capacities to balance the right measure and form of interference oscillate with time. Such insights tell us how complex it is to operate a successful financial policy. When determining the scope and direction of such policy, it is extremely important to take into consideration the experience obtained from seeing the consequences of different reactions of states to the challenges posed by the crisis of financial markets. They indicate that promoting healthy competition, but only paired with strong supervision by independent competent authorities could boost efficiency and provide grounds for the creation of sustainable economic development, without undermining stability at the same time.

The global economic crisis has given the best example of importance of the strong and comprehensive supervision over participants, procedures and institutions on the capital market. Many of the scientists studying the global economic crisis deducted that tightened supervision might be of the same importance as creation of the new regulations itself.

As a result, in the subsequent period, Serbia and other countries affected by the economic crisis as well are to restore confidence in the financial system, so that the capital could start returning to the financial market, and this takes much more than a sound piece of legislation which can only be a good start point.

John D. Rockefeller said that “these are days when many are discouraged. In the 93 years of my life, depressions have come and gone. Prosperity has always returned and will again.”

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ULOGA REGULATORA TRŽIŠTA KAPITALA U KONTEKSTU GLOBALNE FINANSIJSKE KRIZE

Rezime: *Finansijski sektor nacionalne ekonomije je jedan od glavnih zamajaca ekonomskog razvoja zemlje i suštinski važan faktor njene ukupne ekonomske stabilnosti. Međutim, kada je izložen neodgovarajućoj regulativi, nestabilnom tržištu i nedovoljno razvijenim institucijama, finansijski sektor, može postati glavni uzrok finansijskih kriza i jedan od bitnih faktora destabilizacije nacionalnih ekonomija u celini. Sa nastupanjem globalne finansijske krize, postalo je jasno da je neophodna jača uloga države i njenih institucija kako bi se na efikasniji način kontrolisali uočeni unutrašnji nedostaci samog tržišta. Nakon početnog talasa krize, mnoge države su započele zakonodavne reforme, usmerene pre svega u pravcu napuštanja do tada gotovo opšteusvojenog principa finansijske deregulacije. Jedan od glavnih pravaca u tim reformama bilo je formiranje novih nezavisnih regulatornih tela, kao i davanje pojačanih nadzornih ovlašćenja postojećim tržišnim regulatorima.*

Ključne reči: *finansijska kriza, finansijska tržišta, regulatori na tržištu kapitala, regulacija, post krizne reforme*

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AN EMPIRICAL RESEARCH FOR THE APPROACH AND UNDERSTANDING OF CORPORATE SOCIAL RESPONSIBILITY IN THE GREEK BANKING SECTOR

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Abstract: Corporate Social Responsibility is referred to as a concept in which companies voluntarily join, as part of their business operations, activities of social and environmental nature beyond mandatory by law actions. They concern both the internal environment of the company (employees) and the external environment (shareholders, suppliers, partners, customers, local authorities, community where the company operates, etc.). This paper aims to investigate the banks' customers' opinion regarding the Corporate Social Responsibility programs. In order to achieve this we have conducted an empirical research in the city of Kavala, Greece. Results are presented and conclusions are indicated.

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Keywords: Corporate Social Responsibility, banking sector, customers' perception.

1. Introduction

The first reference of Corporate Social Responsibility (CSR) in Europe could be considered that it was mentioned in 1993 by the President of the European Commission, Jacques Delors, who appealed to European companies to participate in the fight against social exclusion. This appeal resulted in an increased mobilization and development of European business networks. A few years later, in March 2000, the Lisbon European Council made a call for the implementation of best practices in terms of lifelong learning, the work management, equal opportunities in the workplace, social inclusion of vulnerable groups and sustainable development. A year later, in July 2001, the European Commission adopted the Green Paper on promoting a European framework for CSR. This is the first organized effort that recognizes that CSR can contribute positively to the strategic goal agreed in Lisbon, which aims to make the EU the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion. In March 2006, the European Commission (COM, 2006, 136 final, p.7) supported the creation of a European alliance calling it CSR. This alliance is general in nature and calls on European businesses, regardless of size and scope of their business, to express their support on a voluntary basis. The Commission also expressed the view that CSR can contribute to sustainable development, while enhancing Europe's capacity and European companies for innovation and competitiveness, results may therefore contribute to employability and job creation (Caroll, 1999).

In this paper, we indicate CSR policies in the banking sector in Greece and we study the banks' customers' perceptions regarding their banks' CSR policies. We present the biggest banks in Greece and we indicate the charitable programs and sponsoring that they offer in general during the last years in Greece. The present study empirically investigates the customers' perception regarding CSR policies of banks; we study if they have really understood the meaning of CSR. Specifically, it is estimated whether customers believe that banks really wish to help society and the environment or they just wish to improve their sales and increase their profits.

2. CSR and Banks in Greece

Because of the globalized environment and rapid changes, economic crisis helped to establish the social responsibility more easily and in the banking sector; most banks perceive the environmental and social issues as an opportunity that will allow them to reap economic benefits and deter them from future risks as well. The value of CSR is recognized by the Greek banking industry increasingly; banks that function in Greece integrate the concept of social responsibility in their strategic choices, as reported in a recent study of Greek Banks Association. CSR is not a single program that implements a bank but is connected to the management style, values and principles that govern the overall operation of the bank, like any business. In this direction, banks have extensive social contribution programs supporting important educational, cultural, sporting, environmental initiatives and implementing many sponsorship activities for vulnerable groups and charitable nonprofit organizations. The effects of CSR are divided into two major categories. In actions in the house, i.e. staff and those that relate to the external environment, i.e. the society in which they operate. The actions of the staff, related to the actions that need to make a business - bank, to improve the working conditions of workers (education programs offered by companies to their employees, extras health care programs, etc.). Actions relating to the external business environment are divided into four major categories, social, cultural, sports and environmental. These actions are the programs related to awareness of employees to the community, donations in cash and kind, volunteer programs, recycling, establishment of cultural institutions, participation in programs to strengthen the Greek language, scholarships, investments in renewable energy, promotion of electronic banking with obvious corresponding environmental benefits and more.

Despite the perceived weaknesses and problems of the past, the banking sector implements CSR policies that can become the power to encourage integration and implementation of responsible strategies in all aspects of Greek economy. This must be used as a vehicle for economic uplift through sustainable investment and development opportunities for investment in new lucrative sectors of the economy. The charitable programs and sponsoring that the biggest Greek banks offer are indicated.

Piraeus Bank (Piraeus Bank, 2013): In the last year, as part of the restructuring of the Greek banking system, Piraeus Bank made four major business acts, significantly upgrading the position and presence of the Group's banking operations in Greece: In July 2012, the bank acquired the 'healthy' part of the Agricultural Bank, while in December it acquired General Bank. In March 2013, Piraeus Bank acquired the banking operations in Greece of Cyprus Bank, Cyprus Popular Bank and the Greek Bank. Finally, in April 2013, Piraeus Bank has agreed to acquire Millennium Bank of Greece; the transaction was completed in June 2013. Due to the relatively recent nature of these business initiatives of the bank, the issues related to CSR have not yet fully settled. Presently, valid programs and actions implemented by the bank in advance of mergers with the above mentioned banks. The bank is developing CSR activities focusing on the environment, culture and society. Environment: Piraeus bank is a pioneer in managing operational environmental impact in creating and promoting green banking products with an emphasis on renewable energy and bioclimatic buildings. The bank runs the first green store Green Banking in the Balkans. More specifically, Piraeus bank supports investments in renewable energy sources, saving energy and green building, farming, green chemistry products, green transport, waste management - waste – water. Society: Working with charities driven by the triptych "Child, Family, Health" which is a strategic choice for targeted social assistance (assist families in Thrace; support young drug-addicts educating them and helping them reintegrate into society, supporting organizations that support the elders) etc. Culture: The Piraeus Bank Group Cultural Foundation organizes and manages a network of thematic museums studies, preserves and promotes the Greek heritage and cultural identity of our country.

National Bank (National Bank, 2013): Values governing the operation of the National Bank are as follows: respect for human rights, respect for the environment, social contribution and contribution to the arts, culture and education, independence (from the individual interests of customers, shareholders and third parties). Within the framework of CSR, the National Bank has developed activities in the field of action, people, culture and environment. More specifically: Man: The main objective of the sponsorship program of the National Bank is the social contribution. Further, indicative actions, donations and sponsorships in hospitals, support centers and associations concerning the child. Sports: Sponsorship contribution in organizing the World Games "Special Olympics Athens 2011". That is, continuation of co-sponsorship as an exclusive 'Sponsor' - the Greek Gymnastics Federation; continuation of the multiannual program for support, preparation and participation of individual athletes in the London Olympics (2012). Science - Research - Education: Funding for sponsored prizes, scholarships and research programs with Greek and foreign universities; supporting scientific work, especially conferences that cover the entire spectrum of science. Responsibility for the Environment: The bank offers every year a significant amount to support actions, stakeholders and environmental organizations in a structured program. Respecting Culture: Among the major sponsorships that began to be implemented in previous years, and those who started in 2011 and will be completed in the years to come, mainly include grants for archaeological excavations, with the National Museum of Contemporary Art for presentation of Fairs.

Alpha bank (ALPHABANK, 2013): The bank, as part of CSR, acts in the following sectors: Environmental Protection: Employee information and enhance their ecological consciousness, the smoking ban, saving energy and reducing pollutant emissions, water conservation, recycling paper. Care to enhance the ecological and social conscience of staff through voluntary participation in related programs. The bank cooperates with the Greek Society for the Protection of Nature and maintains the exclusive sponsor international program to protect the Greeks coasts 'Blue Flag'; contribution to society and culture. Since 2009, the last Sunday of May every year, has established itself as "Employee Volunteer Day Alpha Bank". On that date, in Greece and abroad (e.g., Serbia, 200 volunteers Alpha Bank Srbija with faith in the voluntary offer, they spent an afternoon with children without parental care), voluntary groups in all countries in which the bank operates, conduct social or environmental acts in collaboration with relevant agencies, promoting teamwork and cooperation, i.e. collection of food and other essential supplies, medicines. Also carries sponsorship programs through which it supports various entities for the organization and execution of cultural events mainly. Particularly important is the contribution to the sport, which continues after the Olympic Games in Athens, the presence of the "Sports Panorama Alfa Bank" sponsoring the Classic Marathon Athletics Federation and the National Athletic Teams.

EFG Eurobank Ergasias (Eurobank EFG, 2013): Supports programs relating to education is a priority for all Eurobank's groups. Already, in three countries, where the group has a presence, major initiatives in the field of education have been developed in the recent years. Under this program, the Group awards every year high-school graduates who achieve the highest grades in national exams. Each award is accompanied by an amount of 1000 euro. In Greece, the "Great Moment for Education", a program that began in 2003 and continues to run, has awarded a total of 10,663 young men and women so far. The "Great time for Culture", the involvement of the Eurobank in the support and promotion of culture is a tradition since its founding in 1994. Sunday morning in Concert: On Sunday mornings in room "Christos Lambrakis" concerts with popular projects to familiarize children and young people with the wonderful world of music. It offers free tickets for all performances in schools of the province. Actions culture abroad: In Serbia, the bank continued to support the Atelige 212 in 2011, one of the major theaters of the country. Sports: renewing their collaboration until 2014, Eurobank announced the continuation of a highly successful sponsorship of the Greek National Basketball Team. Solidarity: The Group contributes each year with donations and volunteer work, the work of a significant number of non-profit organizations and foundations, which are activated mainly on issues related to children and health (e.g., concentration and offer school supplies to needy children in large families region of Attica). Strengthened in 2011 the form of corporate volunteering, programs and organizations chosen by the employees themselves was introduced (e.g., the strengthening of the Center for the Homeless of Athens, offering drugs to "Medecins du Monde" etc.). Environment: Eurobank has remained since 2004, the first and only banking group in Greece and one of the few in Europe that has been certified by the International Standard ISO 14001 for Environmental Management System. The Bank won the National Award in the section entitled "Green Procurement" in

2009 and the National Award in the section entitled “Resource Efficiency” in 2010. Greater recognition of the Bank, however, came with the European Environmental Management Award which was awarded in 2011 in the section entitled “Participation of stakeholders in improving their environmental performance” where stood first among all the major private sector companies that participated in the contest. The action “100 parks and cultural venues” protects the four green islands of the country. In Bulgaria, Postbank since 2008, has implemented a program for the maintenance of the lake Pancharevo outskirts of Sofia, titled “Crystal Purity of Pancharevo Lake”.

Post Bank (Post Bank, 2013): Once established, the Postal Savings Bank, helped significantly to development and realization of the idea. Loans to utilities such as water supply, road construction, etc. are recorded to its activities. The bank continues the charitable activity to finance NPDD, IKA, PPC, OA, OAS and OTE. In the above, loans to groups with major social problems, such as earthquake victims can be added. Today, the bank has become S.A. and according to the law, up to 3% of its annual profits will be available for charitable, educational and development purposes. For this reason, they have allocated funds to Foundation of the Hellenic World in hospitals to purchase medical equipment and tools to Municipalities enhancing programs like Help Elderly at Home, sports clubs, cultural associations and churches in Greece (soup kitchen for needy, charitable bazaar, etc). It supported many athletes on their way to the Olympic Games in London, mostly of cycling, rowing and athletics. It must be noted that on 30/09/2013, the Boards of Directors of Eurobank and New Postbank, decided to begin the process of a merger between the two banks.

Attiki Bank (Attiki Bank, 2013): It has developed programs and sponsorships in order to assist in the development and progress of society-sports, culture, education, charitable initiatives, environmental protection and sponsorship conferences. The Attica Bank, strengthens institutions with activities, humanitarian, aimed primarily at protecting children. Sports: Attica Bank, supports various sporting clubs, mountaineering etc. Education: It has held grants to universities and institutions to carry out conferences and events, scholarships in university students as well as scholarships for graduate programs, strengthened all public and municipal libraries in Greece. Charitable Initiatives and Environmental Protection: Showed interest in the victims of the quake regions, prefectures of Achaia and Ilia, after the disasters and fires. Specifically, opened accounts for the families of firefighters who lost their lives in the fires, and it took special measures to facilitate transactions with the bank by extending their debts and reduce interest rates. In 2011, activities of the Foundation for Mediterranean Studies Culture: Gives various cultural events, published in History - Pictorial entitled “Illustrated History of the Greek

Nation". Sponsorship Conference: Attica Bank subsidizes annually conferences organized by various sectors of business activity.

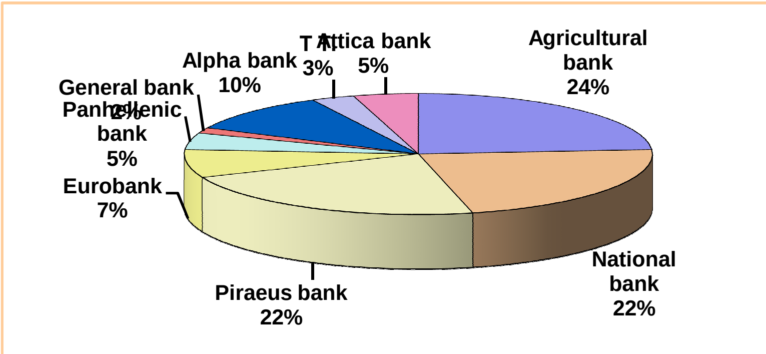
Panhellenic Bank (Panhellenic Bank, 2013): The bank acts as a custodian and coordinator of a network of 16 cooperative banks and one commercial bank. Most of these banks focus on the triptych Society - Culture -Environment. Society: Offer food to needy families, strengthening Greek police providing special equipment, annual awards honors, donations in special schools, provision and/or personal computers in schools at remote areas, support to unemployed partners, organizing educational seminars and continuous updating their workforce. Culture - Sports: General measures of cultural content mainly at local level sponsor in national exhibitions, events to support institutions of society, collective exhibitions of paintings of children, newspaper edition club donor aid sports clubs. Environment: Grant products photovoltaic systems and buying green appliances (green loans), plant more trees, strengthening local associations and club sponsorships.

3. Empirical Research

The study was conducted in Greece from June to August 2013 by the Department of Accountancy and Finance of the Eastern Macedonia and Thrace Institute of Technology. The aim of the study is to capture the opinion of bank clients regarding CSR; whether banks really wish to help and improve society and the environment or they just wish to increase their sales and profits. The data were collected using a structured questionnaire containing 34 questions. The questionnaires were distributed randomly to people who were asked to complete them anonymously and return them back. It must be noted that at the begging of the questionnaire the definition of the CSR was given, as well as examples of it in the banking sector, in order for the respondents to understand the meaning of it. The 34 questions were divided in to two sections. Section 1 consisted of six questions related to demographic data. Section 2 consisted of twenty eight questions regarding the perception of banks' clients of the CSR. The questions were of closed type, meaning the respondents had to choose specific answers. The collected data were analysed using descriptive statistics and the program SPSS v17.l

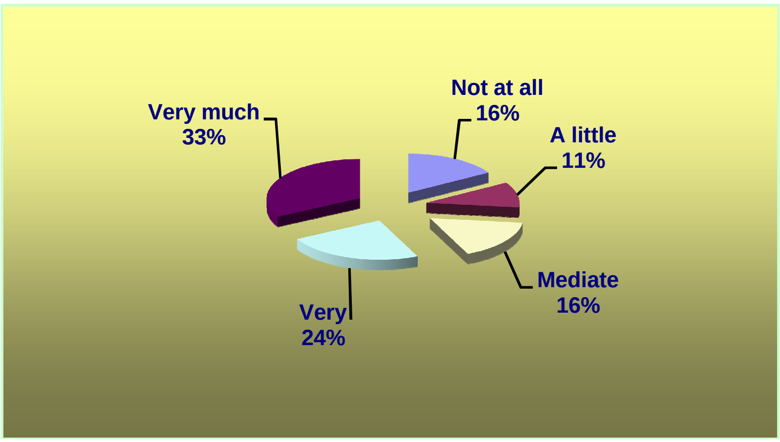
The number of respondents was 67 from Kavala region; 38 of the respondents were women and 29 men. Furthermore, 10 of the sample are 18 to 25, 18 are 26 to 35 years old, 16 are 36 to 45, 12 are 46 to 55 and 11 are more than 56 years old. The majority of our sample have academic education (52.2%) and 37.3% have secondary education. Regarding the occupation of our sample, 38 are employees, 12 are freelances, 9 are unemployed, 4 are retired, 1 is farmer and 3 do domestic tasks. Regarding the monthly income of our sample, the majority of them have monthly income 501-1000€ (54%), less than 500€ (19%), 12% have income 1001-1500€, 8% have income 1501-2000€ and 7% have income more than 2001€ per month. Figure 1 presents the primary bank of our sample, since most of them are clients of more than one bank. So, 16 are clients of Agricultural bank, 15 of the National Bank and 15 of Piraeus bank which represents the reality.

Figure 1: Primary Bank



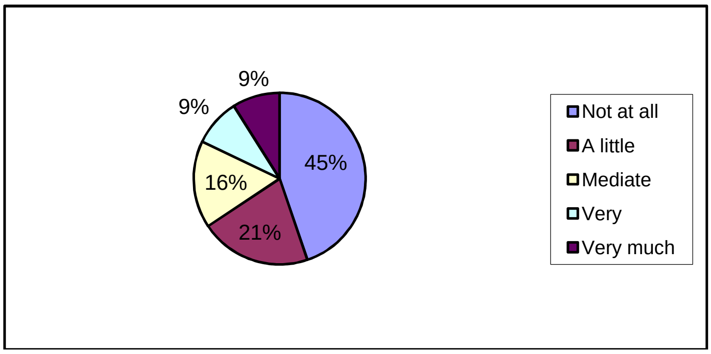
The respondents (18 of them) admitted that they did not know or knew a little about the meaning of CSR before replying the questionnaire. However, 16 knew enough of the meaning of CSR and 22 knew it very well, as it is shown in Figure 2.

Figure 2: Did you Know the Meaning of CSR?



It is remarkable that 30 did not know the CSR program of their bank and only 12 knew it very and very much (Figure 3).

Figure 3: Knowledge of the Bank's CSR Program



There is a balance at the interest of the course of the CSR program of the respondents' primary bank, since 22 didn't know at all or a little, 22 knew it mediate and 23 very and very much. The majority have positive opinion regarding CSR, since 48 have responded very and very much at the relative question. Almost all, 50 respondents, believe that CSR programs are important. More than half believe that CSR programs are remarkable (43 respondents), useful (46 respondents) and necessary (45 respondents). Almost half believe that they have nothing to gain from the CSR, since 29 respond not at all or a little, 21 mediate and 17 very and very much. The majority believes that they contribute to society via CSR (35.8% mediate and 41.8% very and very much), but quite enough (22.4%) are not convinced. The majority believes that banks use CSR for their reputation and image (76.1% respondents) and to attract customers (79.1% respondents). It is notable that respondents are not convinced about the interest of the banks for the society and the environment as it is shown in Table 1.

Table 1 Perception of Bank Clients for the Bank's Interest in Society/Environment

	Do you believe that banks use CSR out of interest for the society?	Do you believe that banks use CSR out of interest for the environment?
Not at all	14	14
A little	12	13
Mediate	24	22
Very	10	10
Very much	7	8

Bank clients are not very satisfied with the CSR program of their bank and they believe that it is not ideal (see, Table 2). However, they are satisfied with the services of their bank regardless of CSR (68.7% respondents). Most of them believe that they did not choose the bank with the best CSR program (73.1% respondents), but they would not change their bank because of the CSR program. They stress this out since they reply that they would continue to be clients of their bank even without a CSR program (see Table 3).

Table 2 Satisfaction with the CSR Program

	Are you satisfied with the CSR program of your bank?	Do you believe that the CSR program of your bank is ideal?
Not at all	14	13
A little	9	11
Mediate	27	32
Very	12	5
Very much	5	6

Table 3: Satisfaction with the CSR program

	Would you change your bank because of the CSR program?	Would you continue to be a client of your bank even if it abolishes the CSR?
Not at all	18	5
A little	13	10
Mediate	20	16
Very	12	22
Very much	4	14

4. Conclusions

From the analysis of the results, some important conclusions are raised. Age groups between 18 and 45 knew the meaning of CSR and showed more interest for the program of their bank. Most of the respondents learnt the meaning of CSR through the questionnaire. The majority believes that the CSR programs are important, useful and necessary for the society and the environment. Banks are interested in their profitability, so they use CSR fir their image and reputation. Most of the clients are not quite satisfied with the CSR program or are not quite familiar with it, but they are satisfied with the services of their bank. So, they would not change their bank easily, especially because of the CSR program. The responsibility for healthy development of society and protection of the environment concerns everybody. The means to be used depend on the CSR policy of a company. Thus, the awaking of the CSR of all companies irrespective of their economic status and the continuous action for the benefit of society and the planet is necessary.

In the future this research study could be expanded in all regions of Greece and in the area of Balkan countries as well.

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EMPIRIJSKA ISTRAŽIVANJA PRISTUPA I SHVATANJA KORPORATIVNE DRUŠTVENE ODGOVORNOSTI U GRČKOM BANKARSKOM SEKTORU

Rezime: Korporativna društvena odgovornost podrazmueva koncept za koji se kompanije dobrovoljno opredeljuju, kao deo svog poslovanja, aktivnosti socijalne i ekološke prirode, izvan obavezjućih pravnih aktivnosti. Oni se tiču kako unutrašnjeg okruženja kompanije (zaposlenih) tako i spoljašnjeg ambijenta (akcionari, dobavljači, partneri, potrošači, lokalna vlast, zajednica u kojoj kompanija posluje, itd). Ovaj rad ima za cilj da istraži mišljenje klijenata banaka vezano za programe korporativne društvene odgovornosti. Da bi se ovo postiglo sproveli smo empirijsko istraživanje u gradu Kavala, Grčka. Predstavljeni su rezultati i istaknuti zaključci.

Ključne reči: Korporativna društvena odgovornost, bankarski sektor, percepcije klijenata.

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MORTGAGE MARKET, SPECULATIVE BUBBLES AND THE GLOBAL FINANCIAL CRISIS

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Abstract: The intensive development of technology and the trend of financial globalization contributed to the fact that the volume of transactions in the financial market surpasses by several times over the volume of transactions in the real sector, which has identified a growing trend of separating financial from the real economy. In the race for ever-increasing profit, financial institutions have succeeded to, due to the so-called informal deregulation, acquire through a variety of financial innovation greater de facto freedom of action in the financial markets. Securitization is seen as the biggest financial innovation of the 20th century, which, based on the contractual assignment of receivables, transformed the less liquid claims (based on loans, credit cards, etc.) into more liquid forms, the so-called mortgage-backed securities. Thereby, issuers of securities are coming to liquidity at a lower cost and the risk of holding long-term bank loans (mainly mortgage) passes to the buyers of mortgage securities. Despite the indisputable benefits of this financial innovation, the need for performing a number of iterative actions and involvement of a number of institutions makes this a very complex mechanism. The crisis that hit US mortgage market in 2007 was initiated just by securitization of “bad mortgages”. Therefore, the securitization of loans has been distinguished as a mechanism for the formation of “speculative bubble”, thus causing the financial crisis of global proportions. In this sense, the question is whether the solution should be sought in the re-regulation of securitization of loans or it will only delay solving the problem?

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Introduction

The intensive development of technology and the trend of financial globalization contributed to the volume of transactions in the financial market to exceed the volume of transactions in the real sector by several times, which identified the growing trend of separating financial from the real economy. In the race for ever-increasing profit, financial institutions have managed to provide greater de facto freedom of action in the financial markets by the so-called informal deregulation, through a variety of financial innovation.

Securitization is seen as the biggest financial innovation of the 20th century. Although it was developed during the seventies and eighties of the 20th century in the US, its intensive development took place in the nineties, when it spread so much that most of the real estate financing was actually performed through mortgage-backed securities.

Securitization of loans enables the bank to obtain alternative sources of funding through the transformation of previously approved loans into marketable securities. Owing to the securitization of loans, bank balances become more liquid. In the process of securitization, the risk of financing mortgages is transferred from the original institution to specialized agents and the owners of mortgage securities. Transferring risk from the institution that provides the loan makes sense, because the market also includes many other participants that are able to withstand the risk better (they have longer investment horizons and are not sensitive to interest rate risk and similar). Moreover, securitization enables diversification of the risk of mortgage loans payment (Hellwig, 2009).

However, despite its indisputable advantages, securitization is increasingly identified as the crucial cause of the current financial crisis. Securitization was performed without a clear regulatory framework, including the lack of transparency and the over-reliance on reviews of rating agencies that have proved unreliable. Real estate market “overheating” in the US, encouraged by low interest rates and new financial instruments, led to the formation of a price “bubble”. When artificially constructed foundations of the pyramid of risky mortgage loans began to crumble, there was a burst of the “bubble” and the collapse of the loan securitization system. A mortgage crisis emerged, which has shaken the whole world since the middle of 2007.

I Regulatory and De-Regulatory Processes in a Globalized Financial Sector

Late seventies and early eighties of the last century were marked by a wave of the financial sector deregulation stimulated by numerous financial innovations. In fact, in an environment of strict financial regulations, when the ability of financial intermediaries to mobilize additional resources through traditional financial instruments is significantly reduced, the need for financial innovation in the function of mobilizing additional resources increases (Krstić, 2003). In this context, financial institutions strived, through the so-called informal deregulation, to ensure greater actual freedom of operation in the financial market than allowed by the existing regulations. Thereby, the informal deregulation occurred as an introduction to the subsequent formal deregulation of the financial sector.

Formal deregulation in the globalized financial sector has been achieved by adopting a set of laws in the US banking:

- Depository Institutions Deregulation and Monetary Control Act of 1980 - DIDMCA), which allowed performance of mergers between banks and a higher degree of freedom in the conduct of business, primarily interest rate policy of banks;
- Garn–St. Germain Depository Institutions Act, enacted two years later, whose main purpose was to revitalize residential development by strengthening the financial stability of the savings and credit associations for housing and by securing loans for housing construction (GSGDIA, 1982);
- Community Reinvestment ACT - CRA, adopted in 1997, aimed to resolve housing problems of customers with medium and low income by departing from standard credit-standing assessment criteria in the process of approving mortgage loans;
- Further deregulation of the US banking was carried out in November 1999, by adopting the Gramm-Leach-Bliley Act, which repealed the Glass-Steagall Act of 1933, thus officially terminating separation of American investment and commercial banking, as well as lifting the ban on non-banking activities for bank holding companies.

In such an environment, securitization has found its place as a mechanism by which indirect credit relationship gets increasingly replaced by direct credit relationship. With this, through the securitization of loans, primarily mortgage securitization, banks attempted to prevent a wave of disintermediation that proceeded simultaneously with deregulation and marked the reduced participation of banks in financial intermediation (Krstić, 2003, p. 493). Although it has brought considerable benefits to many participants in the process, securitization of loans in a deregulated environment was the subject of much abuse, which eventually resulted in the mass of unrepaid mortgage loans, worthless mortgages and huge losses suffered by financial institutions and the economy as a whole.

The global financial crisis revealed fundamental weaknesses in risk management, inadequate regulations and low quality of supervision of the financial systems, particularly in the USA, EU, and in other countries around the world, as well. In this regard, the financial crisis is accompanied by increased regulatory activity. At the global level, there is the ongoing process of regulatory reform that aims to set a new framework in which financial institutions and financial markets can function freely and thereby reduce the likelihood of a new financial crisis.

II Securitization of Loans and Formation of a "Speculative Bubble"

Securitization is the process of converting debts (based on loans, credit cards, leasing, etc.) as less liquid forms of assets into securities, by which intermediary relationship is replaced by direct credit relationship between the owners and users of financial surpluses. Securitization of bank loans is a narrower term, given that it involves the transformation of bank loans, most often mortgage loans, to bonds issued on the basis of pooled mortgages (Lowell, 1991, quoted from Juhas, 2011, p. 13). In this regard, securitization of loans offers the bank a possibility to obtain alternative sources of funding through the transformation of previously approved loans into marketable securities. However, despite the rather simple approach to define securitization of loans, the necessity for performing a number of iterative actions and involving a number of institutions, makes this a very complex mechanism.

The mechanism of securitization involves several groups of activities: approval of loans in the primary mortgage market and their sale; repackaging of cash flows; issue risk reduction; issuing securities and selling them to investors; and service. The process begins in the primary mortgage market through the approval of mortgage loans. Since this is a long-term loan which is characterized by a long payback period and, finally, a high degree of uncertainty regarding the collection of the loan in full, its sale is carried out. Thus, getting clear of the illiquid form of assets, the bank replenishes its previously cut credit potential and places it, thereby increasing the turnover ratio, and ultimately the bank's profit. On the basis of a pool of mortgages, securities are issued with which the bank obtains necessary funds and the investor realizes certain return. This is a case of the securities of high credit rating, close to that of the government bonds, with a yield slightly higher than the government bond yields. In addition, liabilities for issued securities are serviced from mortgage loan installments.

Key institutions in the securitization process are: the issuer of the loan (loan originator), special purpose legal entity (Special Purpose Vehicle or Special Purpose Trust, or SPV), rating agencies, investment banks and investors.

The issuer of the loan or the creditor is in most cases also the loan servicer who, in addition to the initial approval of the loan that is the subject of securitization, takes the obligation to receive payments of debtors as the loan repayment and forward them to the investors.

SPV is a special purpose legal entity which, based on securitized assets, issues securities, controls the pledged assets, supervises or performs the collection of payments of interest and principal by the debtor and transfers these cash flows to investors (Šoškić, Živković, 2007, p. 292).

Rating agencies play a key role in assessing credit rating of the issued securities, so that the measures can be taken to reduce the emission risk in a situation of excessive risk, thereby adjusting securities to the special requirements of potential investors.

Risk reduction can be achieved in several ways: by internal warranty, i.e. guarantee of the original creditor, and by the establishment of a special reserve fund based on the difference between the interest paid on the basis of collateral group of loans and the interest paid on dividend-warrants; by external guarantee, i.e. guarantee of another person, bank, insurance company or specialized state and para-state organizations; as well as by a specific technique by which the credit risk of the pledged portfolio is relocated from the priority tranches and transferred to a subordinate, that is, subservient tranche (Marinković, 2011, pp. 138-140).

In addition to its role of a distributor of issued securities, the investment bank often takes the role of an underwriter of the issue, guaranteeing the purchase of securities that, possibly, remain unsold. Furthermore, the investment bank regularly performs an advisory function, thus informing the issuer of the price, type and structure of the securities that are issued. In this sense, the investment bank is a key institution in the securitization process, from the formation of pools of mortgage loans, over mortgage securities issuance, up to their primary sales to interested investors (Juhas, 2011, p. 16). Naturally, the investment bank earning will be the largest in a situation where it assumes the greatest risk, i.e. when it acts as the underwriter of the issue.

Finally, investors, by their preferences in relation to the essential characteristics of issued securities (financial reliability, maturity date, cash flow structure, denomination, etc.), substantially determine the success of the process of securitization. High financial reliability of securitized bonds has contributed to the fact that the most frequent buyers of these securities are institutional investors, such as investment funds and contractual savings institutions, due to their conservative investment policy (Šoškić, Živković, 2007, p. 294).

The roots of securitization may be found in the US, where it started with the securitization of mortgage loans during the 1970s of the 20th century. In fact, it is a so-called straight or off-balance sheet securitization, in which the securitized assets are derecognized from the bank balance sheet, allowing the bank to release claims relating to capital adequacy and to provision for risky placements, and only up to the amount of the loan (Šoškić, Živković, 2007, p. 292). This way the entire credit risk is transferred to investors, while credit rating of asset-backed securities is determined by the rating of the underlying assets (Juhas, 2011). Although, historically, first to be securitized were residential mortgage loans, everything is securitized today: from current and future inflows from tolls, to the government loans. In Europe, on the other hand, there is the so-called on balance sheet securitization, in which the loans representing security of mortgage bonds are not derecognized from the balance sheet of the bank that is issuing mortgage bonds, which offers potential investors a safer form of investment.

Traditionally, banks have funded long term placements in mortgage loans from long-term deposits. This, of course, highly restricted the scope of these loans, since resources were limited and placements were fixed on many years. The limitation of traditional sources of financing mortgage loans forced banks to take an active role in the financial market in order to provide greater financial potentials. Banks have adopted a new model of financing (more precisely, refinancing) mortgage loans, in which they continue to have primary contact with the customer (at the conclusion of the contract and in most cases in loan servicing), but their funds are not the primary source of financing for these loans. This qualifies the bank as just one of the mediators in the process of securitization, in which it does not have available funds prior to granting loans, but it specifically mobilize them in order to approve the loan (Vujović, 2008).

An important change has also occurred in the assessment of the credit standing of a real estate value buyer and the risk of trends in real estate market. The transfer of credit risk from the creditor to a third party changes the profiles of risk and return. If the creditor transferred the partial or total risk, it can cause weakening of the supervisory measures of credit risk. The existence of institutions to which banks can transfer credit risks has induced that the banks, in a race for new potential clients, disregard basic principles of credit analysis. As a result, most borrowers were clients of dubious credit rating[1].

The essence of the idea was to approve, on the basis of relatively lower-cost funding sources, mortgage loans that will enable purchase of houses and apartments to the so-called middle class. This way, banks and other financial intermediaries can quickly and easily earn commissions, while transferring

[1] Bank clients have become the following: borrowers with insufficient documentation (low doc loans), without the necessary documentation (No doc loans), those who lied about their income and assets (Liar loans) and finally the borrowers with no income, no job and no assets (NINJA loans).

substantial risks to new niche markets of securities based on real assets (asset-backed securities). It was necessary to process the application for loan as soon as possible, to approve a mortgage loan and to provide refinancing in order to repeat the process with the next client.

However, numerous potential real estate buyers were unable to provide the participation and were not financially reliable to obtain classical mortgage loans. To overcome this problem, it was necessary to relax the restrictions on debt and participation amounts and to lower the cost of servicing mortgage loans. The so-called subprime mortgages appeared to be a solution. Such mortgage loans allowed for clients to borrow more easily and in bigger sizes in relation to their income. They are characterized by a very low fixed interest rate in the first couple of years, after which the interest rate forms freely, according to market conditions. At the beginning of 2007, these loans already accounted for one-fifth of all active mortgage loans (Vujović, 2008).

Banks were selling mortgage loans to investment banks, which then “packaged” and forwarded them to rating agencies that analyzed their risk level. These packages (which included: asset-backed securities - ABS, residential mortgage-backed securities - RMBS, commercial mortgage-backed securities - CMBS, collateralized-debt obligations - CDOs and collateralized mortgage obligations - CMOs) were attributed AAA rating by rating agencies, although their complexity was not very clear to them (O'Quinn, 2008). In addition, the rating agencies were in a conflict of interest because they were paid by the issuers to whom, besides the rating evaluation, they also gave advice. The issuer was able to address the rating agency to model for him/her the assets that would later receive the best rating of the same agency. Payment to rating agencies, made by those investment banks to whose instruments they assign ratings, enabled the so-called “rating shopping”. Issuers could opt for the rating agency which offers them the most favorable rating conditions, that is, which will provide the highest rating. On the other hand, the profits of rating agencies depend on whether investment banks are satisfied with their operation. For example, in 2005 more than 40% of the Moody's Agency revenue was generated through assigning ratings to securitized bonds (Spasojević, 2011, p. 100).

The three leading rating agencies in the area of determining the credit rating of issuers worldwide, Moody's Investors Service, Standard & Poor's and Fitch Ratings, gave the highest rating estimates to the financial instruments created in the process of securitization of low-quality mortgage loans. High rating of risky securities created conditions for investment in bad securities by major financial institutions.

Despite the obvious risks, securitization of loans has been experiencing rise. Apart from the benefits for financial intermediaries, securitization led to an increase in private saving, a boom in housing and a growth of employment.

The multiannual boom in residential construction and real estate market was fueled by the interest rate policy in the United States in that period. Interest rates were kept at very low level in order to overcome the recession of 2001-2002. Low interest rates raised the demand for real estate, which had dual effects in the sense of growing prices of real estate and of construction of new apartments and houses. Artificially increased demand led to an unsustainable rise in real estate prices, that is, to the creation of price "bubble" in the mortgage market (Vujović, 2008). The average price growth in this market, which was only 0.67% until 1998, went up to 10.4% in the period from 1998 to 2006 (O'Quinn, 2008). The price growth overrates the expectation of return, which in turn stimulates further growth of real estate prices, until the "speculative bubble" bursts (Hellwig, 2009).

The pyramid of risky mortgage placements was growing until investors realized that in their portfolios they possess much riskier securities than they first thought, and then they started with their massive sales[2]. In such an environment, the Fed began since 2004 with a more restrictive monetary policy, through the progressive increase in the interest rate (from 1% in 2004 to over 5% in early 2007). In June 2006, real estate prices started to decline, at first slowly, and then, in the period from 2007 to 2008, quite dramatically, by over 15% (Hellwig, 2009, p. 156). With the rise in interest rates and a decline in real estate prices, the number of clients unable to fulfill the obligations to banks increased.

In mid 2007, rating agencies cut the ratings of many mortgage securities, where the majority of shares received a rating lower not by one, but by three or more notches. It turned out that the risk models on which the rating is based were too optimistic about the risk of mortgage repayment and about the correlations between the different mortgages and various mortgage-backed securities.

With the burst of price “bubble”, investors were trying, by assuming the “short sale” position, to free themselves of worthless securities held in their portfolios, having thereby additionally accelerated the depreciation trend. The problem of liquidity in the markets of securitized mortgage portfolios also pointed to certain shortcomings in the valuation of securities at fair value accounting. If the market value of the securities or the fair value below its fundamental value (below the expected present value of its future cash flow), the system causes a write-off, which is a favorable scenario for the bank only in a situation where it wants to liquidate the bond, but not in the situation of holding it until maturity. In times of crisis, reliance on fair value accounting has not appeared as an optimal concept because it forces financial institutions to quickly admit negative trends and take corrective measures without undue delay. These actions have created additional pressure on the market and contributed to reducing the price of the asset (Hellwig, 2009).

[2] Instead in verified AAA securities, investments were made in contaminated, high-risk securities (junk bonds).

Due to the rapid decline in the value of mortgage securities, banks registered huge losses on securities that they possessed. Although, it was believed that securitization does not expose banks to risk because they are selling their loans in this process, the situation was somewhat different. Namely, banks have often retained the riskiest part (the so-called toxic assets) in order to convince potential investors that these securities are safe. Also, the flow rate of these securities in banks was high and the time from the receipt of the mortgage to the sale of these securities was long enough, so that the banks hold significant amounts of these securities at any moment. With the decline in demand for mortgage securities, banks had enormous amounts of bonds secured by real estate, which they could not sell (Spasojević, 2011).

When the market prices of securities began to fall in mid 2007, the application of fair value accounting required this to be admitted in the bank business ledgers. In a situation where bank capital is not sufficient to absorb the shock, the price decline is converted into a write-off and sale of assets. The amounts of own capital in many banks did not provide an adequate response to the problems created, which could be proved by the following facts:

- relative decline in capital adequacy rate in the nineties, partly because of the option provided by the amendment of the Basel Accords of 1996, which relates to the determination of regulatory capital for market risks based on their own quantitative models of risk assessment;
- Small size of the equity capital buffer in excess of regulatory requirements, allowing banks to increase the level of financial leverage in an attempt to ensure the highest possible rate of return on their own capital;
- According to Basel II, an investment in securities with AAA rating may be supported by a moderate level of capital. Namely, a high rating of these securities allows for a lower level of regulatory capital and a higher level of financial leverage.

The problem was further illuminated by multiple interventions of the monetary authorities which, even after repeated pumping of liquidity, failed to establish stability of the financial system. After these failed interventions of the central bank, it became crystal clear that the main problem of this crisis was not a short-term disproportion of cash inflows and outflows, but the solvency of financial institutions.

In early 2008, the crisis shifted from the mortgage market to the stock and bond market, which already in September 2008 caused an escalation of the financial crisis and the collapse of American giants. From the US market, against the domino effect principle, the crisis spread not only to countries that had a similar mechanism of mortgage lending but also to all the world's stock markets. In this respect, the securitization of mortgage loans was designated as a factor of international credit risk. Stock market panic was replaced by banking panic, followed by accelerated withdrawal of deposits and a growth of interest rates, which ultimately led to the freezing of the inter-bank market. The rise in cash prices has further destabilized the investment activities in the real sector and thus resulted in a global economic crisis.

III Re-regulation of the Securitization of Loans

Many believe that the key focus of the current crisis is in the weak institutional and regulatory framework of the US financial sector that has created a favorable environment for banks and other financial institutions to access numerous financial innovations. In an effort to find alternative ways to refinance long-term mortgage loans, securitization of mortgage loans was singled out as a suitable mechanism. The lack of an appropriate system of prevention and intervention, as well as the fact that a significant segment of the participants in this process has remained outside the regulations, the so-called shadow banking, became an international credit risk factor that has contributed to the spread of the crisis to other economies. The crisis thus assumed global dimensions (Vujović, 2008, pp. 8-12).

Regulatory weaknesses played a major role in the emergence and spread of the crisis because they encouraged market players to take excessive risks. These problems have forced various regulatory initiatives in many countries, of which the most important ones occurred in the United States and the European Union.

Regulatory initiatives are aimed at preventing systemic risk and ensuring the stability of both the national and the global financial system. In support of this primary purpose, a repeated regulation, i.e. re-regulation is undertaken, directed to the following segments:

- Development of regulatory and supervisory framework that will provide information that gives insight to the overall risk exposure of the financial system;
- Regulation and supervision of various types of institutions should be adapted to their specific positions in the financial system;
- A systematic approach to assess the risk exposure of individual institutions.

Regulatory rules are revised towards better capitalization of banks and alleviation of the pro-cyclicality of the banking business (Basel III), creation of safe and stable systems of deposit insurance, establishment of adequate regulation of systemically important institutions and the like. Since the beginning of the crisis is associated with the sub-prime mortgage market in the USA, the redefinition of the rules is also related precisely to the area of securitization of loans.

In the United States all regulatory changes are directed toward a higher level of consumer protection from hidden fees, abuse and possible deception with which they are faced in the process of trading. For this purpose, the Dodd-Frank Wall Street Reform and Consumer Protection Act was enacted in mid 2010, which provides for the establishment of a special independent authority for consumer protection in order for them to receive timely and accurate information in the process of application for mortgage loans, credit cards and other financial products. New solutions are trying to repeal the practice of rescuing institutions designated in the system as ”too big to fail”, so that the taxpayers’ money would not end up in financing their losses. Such institutions are anticipated for liquidation, and during their business operations they are obliged to honor strict capital requirements, thereby controlling the level of financial leverage.

In addition, the so-called Volcker Rule was enacted, which requires from the regulator to secure that banks, their affiliations and holding companies may not trade for their own account (proprietary trading), or enter into any form of partnership with hedge funds and venture capital funds. The adoption of this rule was the result of the discussion, conducted in the USA about a possible separation of low-risk business practices (such as deposit and credit operations) from high-risk activities (such as investment banking). The discussion was prompted by the opinion of some regulators that the global crisis would not have assumed such proportions if the Glass-Steagal Act had not been abolished in the USA (the law which, after the Great Depression of the 1930s of the 20th century, introduced the prohibition of business practices of investment and commercial banking within the same financial institution). The Dodd-Frank Act on financial reform from 2010 still did not restore the separation of commercial and investment banking, but the Volcker Rule was brought to limit the possibility for the banks that receive deposits with state guaranty to be engaged in high-risk investments.

The global financial crisis has highlighted the problem of inadequate regulation of the activities of rating agencies. Rating agencies have played an important role in the promotion of new financial products globally, while unrealistic evaluation of issued securities contributed to the development of the global financial crisis (McVea, H., 2010). In order to protect investors, new stricter rules are introduced to increase transparency and responsibility of the operations of credit rating agencies. New rules are related to the licensing and enhanced regulation and supervision of rating agencies. To reduce the conflict of interests of rating agencies, the regulatory agency SEC (Securities and Exchange Commission) shall have the authority, according to the Dodd-Frank Act, to determine the eligibility of a rating agency to assess the standing of an issue. This potentially reduces the possibility of the issuers to select an agency that suits them best, i.e. that is most permissive and that will offer the highest rating.

The European Commission has adopted a set of measures focused on the work of rating agencies. These measures make sure that the services of establishing a credit rating stay incompatible with advisory services. Also, rating agencies are obliged to publicly announce models and prerequisites for determining credit ratings, annual reports on transparency and the like. (Pavković, Vedriš, 2011).

To solve the problem of "buying" a rating, which is especially apparent in the securitization instruments, the following is proposed: greater involvement of investors when paying fees to rating agencies, limitation of the number of ratings assigned per issuer, introduction of subscription payment by the user of services, restriction of the number of years of service delivery and the like. (Pavković, Vedriš, 2011).

The introduction of greater transparency in the securitization process is amended by the requirement for the initiators of securitization to retain risky exposure to the tranche that bears the greatest risk. Regulatory changes involved also the change of the principles of preliminary credit analysis in terms of their aggravation, especially when it comes to approving mortgage loans.

In addition, it should be noted that the introduction of fair value accounting for loans and mortgages increased the scope of systemic risk. Due to the weaknesses discovered in accounting methods of evaluation of financial assets at fair value, there has been a change in the relevant international accounting standards and in financial reporting on financial instruments (Kikanović, Milošević, 2012). Changes opened up the possibility that financial institutions do not recognize the decline in market value of financial assets as a real loss in the conditions of crisis, given that this decline may be caused by temporary panic of market participants.

Conclusion

The global economic crisis began in 2007 in the US real estate market. From the mortgage market, in early 2008 crisis shifted to the stock and bond market, which already in September 2008 caused an escalation of the financial crisis and the collapse of American giants. From the US market, by the principle of domino effect, the crisis spread not only to countries that had a similar mechanism of mortgage lending but also to all the stock markets in the world. In this respect, the securitization of mortgage loans was designated as a factor of international credit risk. Stock market panic was replaced by banking panic, followed by accelerated withdrawal of deposits and a growth of interest rates, which finally led to the freezing of the inter-bank market. The rise in cash prices further destabilized the investment activities in the real sector and thus induced a global economic crisis.

Securitization of loans, as one of the biggest financial innovations of the 20th century, apart from its undisputed benefits, is also identified as the main cause of the current financial crisis. In fact, securitization, increased use of complex financial products and financing through linked global financial markets constituting the major channel for the spread of the crisis.

The financial crisis emerged as a consequence of excessive deregulation of business operations of financial institutions and of abusing the securitization mechanism in the absence of clearly defined rules to regulate this area in the American mortgage market. In this regard, the need arose for redefining the existing concepts underlying the process of securitization of mortgage loans, so that it would not become the cause of future financial crises.

Regulators have recognized the problem and focused especially on the protection of consumers in terms of their better information, on the process of securitization in terms of its greater transparency, as well as on the work of rating agencies. Particular need arose for a stricter and more precise regulation of rating agencies because, by assigning extremely high ratings to nontransparent and structured financial instruments, these institutions contributed significantly to the emergence and development of the financial crisis.

Appropriate regulation should allow the introduction of greater transparency in the securitization mechanism and prevent excessive risk-taking in financial markets. On the other hand, the tendency of the regulator to limit as much as possible the likelihood of a repeated “abuse” of securitization of loans would lead to maybe excessive “bureaucratization” in some of its segments, thus raising the question of the quality of these regulatory changes that could only be answered in time to come.

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HIPOTEKARNO TRŽIŠTE, SPEKULATIVNI MEHUROVI I GLOBALNA FINANSIJSKA KRIZA

Apstrakt: *Intenzivan razvoj tehnologije i trend finansijske globalizacije doprineli su da volumen transakcija na finansijskom tržištu višestruko prevaziđe volumen transakcija u realnom sektoru, čime je identifikovan rastući trend odvajanja finansijske od realne ekonomije. U trci za sve većim profitom finansijske institucije su uspele da tzv. neformalnom deregulacijom, kroz razne finansijske inovacije, osiguraju veću faktičku slobodu delovanja na finansijskom tržištu. Sekjuritizacija se ocenjuje kao najveća finansijska inovacija 20. veka koja, zasnovana na ugovornom ustupanju potraživanja, doprinosi pretvaranju manje likvidnih potraživanja (po osnovu kredita, kreditnih kartica, i dr.) u likvidnije oblike, tzv. hipotekarne hartije od vrednosti. Ovim putem izdavaoci hartija od vrednosti dolaze do likvidnih sredstava po nižim troškovima a rizik držanja dugoročnih bankarskih kredita (najčešće hipotekarnih) prelazi na kupce hipotekarnih hartija od vrednosti. Uprkos nespornim prednostima ove finansijske inovacije, potreba za obavljanjem brojnih iterativnih radnji i uključenjem niza institucija, čini ovaj mehanizam izuzetno kompleksnim. Kriza, koja je 2007. godine pogodila američko hipotekarno tržište, inicirana je upravo sekjuritizacijom „loših hipotekarnih kredita“. Time se sekjuritizacija kredita izdvojila kao mehanizam formiranja „spekulativnog mehura“ i pokretanja finansijske krize globalnih razmera. U tom smislu postavlja se pitanje da li rešenje treba tražiti u re-regulaciji sekjuritizacije kredita ili će se ovim putem rešavanje problema samo odložiti.*

Ključne reči: *sekjuritizacija, spekulativni mehur, finansijska kriza, re-regulacija*

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MODERN PORTFOLIO THEORY ON THE CAPITAL MARKET IN SERBIA

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Abstract: Modern Portfolio Theory is one of the most important innovations in the field of investments and securities portfolio management. The paper analyzes possibilities of using methods of portfolio analysis on the stock market traded at the Belgrade Stock Exchange. The aim of the paper is to select stocks on the Belgrade Stock Exchange which have had the best performance in the analyzed period, and by the application of portfolio analysis find out the optimal portfolio that will have better performance than BELEXline stock index at a lower risk rate. It should be noted that this method is limited in many ways on the stock markets similar to the stock market in Serbia, but in spite of that a portfolio has been obtained which gave better performance than BELEXline stock index.

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Introduction

Investing in any kind of financial assets is motivated by the expectation of investors to get some return. However, the return is not always certain and every investor faces a certain risk related to their investment. Therefore, the task of the investors is to quantify the extent of the expected return and risk associated with the investment. Various statistical models and risk evaluation models attempt to specify the level of risk faced by the investors. With the help of the expected return and risk which such return bears, different options can be compared in terms of financial assets portfolio formation managed by the risk-return relation.

Causality of risk and return in the investment process is expressed through the ability of the investor to assess the level of acceptable risk in the expected return. His/her goal is to construct a portfolio that will bring him/her the maximum return with an acceptable risk level. Incorrect assessment of risk can lead to the absence of expected returns or even losing the invested capital.

Rarely are found investors who invest their whole capital in one type of securities. Instead, they invest in diversified portfolios. One of the main decisions is how much money to invest in risk-free, and how much in risk-bearing assets. In contrast to the risk-free assets (e.g. short-term Treasury bills) where the yield can be determined with high certainty, the return on risky assets (equities) bears a much higher risk in terms of uncertainty of return.

Portfolio theory provides an investor with the opportunity to decide which combination of financial instruments provides the highest return for a given risk. In this context, capital allocation line (CAL) is significant which shows all possible combinations of risk and return as a result of the distribution of the entire portfolio of the risk-bearing and risk-free assets. Based on CAL, the investor has to choose the optimal combination of a number of possible choices. This decision is related to the degree of rejection or institutional constraints of the investors towards risk. Investors who are less inclined to risk will choose a smaller portion of risky assets, and a higher proportion of risk-free instruments. There is no doubt that investors will hold efficient portfolio, that is, a portfolio that brings the highest return under the given risk. Since the effective portfolio is a personal choice of the investor, the number of efficient portfolios depends on the number of investors.

In order to understand the importance of portfolio theory, the paper will discuss the general settings of modern portfolio theory and its contribution to practical use in the modern world of finance. Statistics makes an important element in the portfolio theory by which we try to quantify the level of risk and expected returns of the very investments. Research part of the paper refers to the construction of an internationally diversified portfolio on the capital market in Serbia.

Modern Portfolio Theory – Theoretical Basis

The portfolio is a collection of various types of financial instruments and characteristics, i.e. a set of investments in different types of financial assets, mostly in various securities held by an individual or institutional investor (Mirjanić, 2009).

Before the foundation of portfolio theory, investors made portfolios by selecting stocks with the best performance, considering that this technique maximizes the expected return of portfolios. Although aware of the risk, investors evaluated portfolio performance on the basis of the rate of return. Risk measures have not been developed, and the concept of risk has not been explicitly considered. However, the goal of the investors is not only to maximize the expected return. If it were the only goal, investors would allocate total assets in securities that carry the highest returns regardless of the risk.

The emergence of the modern financial economics is associated with the name of Harry Markowitz who presented his article on 'Portfolio Selection' in the *Journal of Finance* in 1952 and in the book titled "Portfolio Selection: Efficient Diversification of Investment" in 1959. Modern portfolio theory helps investors to select the package of securities, which gives higher return along with the desired level of risk (Markowitz, 1991). Development of portfolio theory in the early 1960s suggested a way of measuring risk as the observed variability of return. At that time, neither measure combined both return and risk, but these factors were observed individually. Researchers would group portfolios based on the measure of risk (e.g, variances of return) into classes with similar risk, in order to compare the rates of return of portfolios of different risk classes.

When selecting a portfolio, a rational investor, according to Markowitz uses two basic parameters: the profit and risk. Profit is measured by the average rate of return and risk as the deviation from the mean rate of return. The greater deviation is, the riskier portfolio would be. When they decide to make a portfolio, investors are trying to reduce this deviation by diversification of investments-investments in financial assets whose return rates fluctuate in different directions.

The investor is interested in the risk of an individual investment. However, the investor is not only interested in the variance of the investment, but rather for the covariance with other financial instruments in the composition of the portfolio.

Markowitz's model is used by the portfolio investors to construct the efficient borders respecting the trade-off of the return and risk. For a rational investor who maximizes the expected benefits, the selected portfolio is optimal taking into account the expected return as a criterion of profitability of the portfolio and variance of return as a measure of risk. The model assumes that the investor is risk-averse, and when deciding on the selection of the portfolio, pays attention to the expected return and variance of return in a period of investment. Portfolio with the highest expected return for a given level of risk or the one bearing the lowest risk is an efficient portfolio.

Contribution of Modern Portfolio Theory to Financial - Economic Theory and Investment Practice

Modern portfolio theory can be observed through three postulates. The first postulate which was set by Markovitz refers to the relationship and the balance of the assumed risk and the expected return, which depends on diversification. The second one is attributed to William Sharp includes a simplified model of portfolio analysis in relation to the Markowitz's model, i.e. CAPM – Capital Asset Pricing Model and beta coefficient. Finally, the third postulate is the hypothesis on efficient market (EMH) by Eugene Fame (Alihodžić, 2010).

Prior to the development of Markowitz´s model, the financial risk was considered corrective factor of the expected return. Markowitz's model of the mean value and variance was the first attempt to quantify risk, and the measurement of the interdependence of the structure of return by calculating the correlation was undoubtedly something new. The structure of interdependence is represented by the variance-covariance matrix, which measures the impact of the selection of portfolio of each asset in comparison with the others, which explains the importance of diversification. In other words, the most significant contribution of the Markowitz theory is the distinction of the variability of return of individual securities and risk-bearing portfolio.

Long before Markowitz it was clear that individuals seek to increase their wealth and minimize the risk of potential return. However, Markowitz rejected the idea of the existence of the portfolio which would bring the investor the maximum expected return and minimum risk, by showing that a portfolio which has the maximum expected return does not need to have a minimum amount of variance.

Modern portfolio theory has eliminated the drawbacks of diversification, which is manifested in a decrease of efficiency with increasing number of elements of the portfolio. Markowitz pointed out that if we wanted to reduce the variance, it was not enough just to invest in many different securities, it was necessary to avoid investing in securities that had a high covariance. The model suggests not only the importance of diversification of investments to reduce overall portfolio risk, but also an effective way of carrying out diversification. It is also shown that, instead of random selection and random outcomes in the process of forming the portfolio, there is an optimal choice and the outcome - the optimal portfolio. It is possible to establish a set of portfolios that provide the highest possible expected return for a given level of risk or the lowest risk for any given level of expected return. Such a set of portfolios creats an efficient limit and each portfolio that is on that line is economically efficient trade-off between return and risk.

Reviews of Modern Portfolio Theory

The most serious problems the investors face with in practical application of Markowitz's portfolio optimization can be summarized in the following points.

(1) Estimation errors of the input optimization parameters

Empirical studies have shown that the procedure for portfolio optimization proposed by Markowitz leads to financial irrelevant or even wrong "optimal" portfolios, and poor allocation of resources. Michaud (1989) found that the main problem of Markowitz's optimization is its tendency to maximize the effects of input parameters estimation errors so that the portfolio with equal ponder values was often superior to the portfolio constituted by application of Markowitz's optimization procedure.

The most important limitation of the model arises because of the assumption that all input data in the process of optimization are 100% accurate, which is never the case in practice. The basic problem is the selection of input parameters, particularily in terms of risk assessment and expected returns containing prediction errors. The selection of an optimal portfolio for the input parameters requires information about the expected return of each security, variance and covariance with the returns of other securities. However, in practice, the expected returns, variance and covariance are unknown and have to be estimated from the available historical data or subjective judgments.

(2) Neglecting factors of liquidity and volatility of the portfolio

Markowitz's optimization ignores factors that are fundamental in the investment management such as as the liquidity factor, or the percentage of the market capitalization of company represented in the possessed portfolios. The impact of liquidity on the set of efficient portfolios indicates that compared with the classical efficient border, imposing liquidity constraints, results in a small increase of return and/or lower risk reduction.

In some cases, in portfolio optimization the problem of portfolio instability arises, when the shares of individual securities are extremely sensitive to variations in the expected return. The problem of instability occurs when small changes in the estimate of input parameters lead to large changes in the resulting ponders (Jorion, 1986). One of the main reasons for the described behavior is the existence of errors in the covariance matrix. Markowitz's optimization involves the inversion of covariance matrix and errors in covariance matrix lead to instability of ponders. The input parameters that do not reflect financially significant forecasts or use estimates of the parameters based on insufficient historical data often lead to instability (Latković, Barac, 1999).

(3) The lack of normal distribution of return

Using Markowitz's analysis is based on the assumption of normal distribution of return, that is the assumption that the utility function is the function of the first two moments. In the case of normal distribution, there is the central tendency of the data (the farthest, extreme data have the lowest probability of occurrence) and there is a symmetrical dispersion of data around the mean value. Contrary to that, most financial returns do not have normal distribution, which is particularly evident in emerging capital markets. Classical portfolio selection does not take into account the higher-order moments (asymmetry and roundness). Asymmetry of the return curve is a kind of risk measure or probability of occurrence of high returns, whether positive or negative, while the roundness indicates a probability of unexpected positive or negative big movements in terms of return.

Instead of random values, which move independently of each other, the prices and returns show a strong tendency of dependance. Historical data on the movement of prices and returns show that the emerging markets have the statistical property of autocorrelation (movement of prices and returns in one period is best described by movement of prices and returns earlier). Great autocorrelation of financial time series indicates periods of high and low volatility known as clustering. Clustering implies that big changes in the price of financial assets are followed by periods of great changes, while small changes in the price of financial assets are followed by periods of small changes (Knight, Satchell, 2007), which suggests that the change in the price of financial assets in the following period are associated with a change in current prices.

(4) Limitations on markets in transition

The main limitations of emerging markets, including the Serbian market, are primarily reflected in low liquidity, shalow market, the problem of reliability of information and financial reports, functioning of the rule of law, transparency of markets, unanticipated oscilation of returns, currency and interest rate risks and, above all, political risks that significantly affect the downgrade of the country and withdrawal of foreign investors and their hesitation to invest (Jeremić, Terzić, 2010).

Application of Modern Portfolio Theory on the Capital Market in Serbia

Previously in the paper theoretical concepts have beed presented in the process of securities portfolio formation. In this section, we will try to apply these concepts to the Serbian capital market. The study covers a period of 90 days from the July 9, 2012 till October 5, 2012. The survey was followed by a lot of obstacles in the direct application of modern portfolio theory. If we take into account the situation in the Serbian capital market, in forming portfolios it is recommended to involve in it only securities that meet certain criteria. The criteria are as follows:

1. There must be liquid securities whose market capitalization is above the median1 (according to liquidity ratio, average annual turnover relative to market capitalization)
2. There must be securities which are traded on a continuous basis in order to avoid interruption caused by irregular trading
3. There must be securities which have been listed on the stock exchange for more than 3 years.

Of course, due to pre-defined criteria for the selection of securities, slightly modified modern portfolio theory would be presented in this paper.

In accordance with the criteria, the following securities have been selected:

Table 1 Issuers and Their Market Capitalization

Issuer	Symbol	Capitalization
Nikola Tesla Airport joint stock company Belgrade	AERO	14.367.237.650
NIS joint stock company. Novi Sad	NIIS	102.564.991.600
AIK banka joint stock company Niš	AIKB	12.051.641.360
Komercijalna banka joint stock company Belgrade	KMBN	8.273.844.500
Tigar joint stock company Pirot	TIGR	376.342.740
Metalac joint stock company Gornji Milanovac	MTLC	1.698.300.000
Soja protein joint stock company Bečej	SJPT	6.837.045.516
Galenika Fitofarmacija joint stock company Zemun	FITO	2.904.000.000
Alfa plam joint stock company Vranje	ALFA	935.593.824
Philip Morris Operations joint stock company Niš	DINNBP	2.647.014.400

Source: Belgrade stock Exchange

[1] Median – the number that divides the upper half of the sample from the lower half

During the formation of the portfolio, we considered 10 securities because numerous studies, primarily by Evans and Archer (1968), questioned the economic feasibility of constructing a portfolio of more than 10 securities. Also, Elton and Gruber (1977) have investigated the relation between risk and the number of shares in the portfolio and came to the following conclusions: 51% of the standard deviation is eliminated by increasing number of stocks from 1 to 10; adding 10 more shares eliminates only additional 5%; increasing to 30 shares eliminates only additional 2%.

In order to create a portfolio, it is necessary to have longer continuous time series of daily rates of return. Here the problem arises because some stocks are not traded every day. Although we took into consideration the most liquid securities in the market, the problem still occurs. For the purpose of this research the problem is solved by using the assumption that there was no change in the price and the last known closing price for the day was taken. It is important to mention that such filling of data may give a distorted picture of reality. It is because of this phenomenon that we introduced the criteria for selecting shares to reduce the level of error in the research.

On the basis of the daily price changes standard deviations are calculated along with average returns of shares included in the portfolio:

Table 2 Average Returns on Shares and Their Standard Deviations in the Observed Period

ISSUER	**Average return**	**Standard Deviation**
AERO	-0,18%	1,43%
NIIS	0,00%	0,82%
AIKB	0,13%	5,41%
KMBN	0,70%	3,57%
TIGR	-0,37%	1,42%
MTLC	0,05%	1,16%
SJPT	0,16%	2,47%
FITO	-0,01%	2,19%
ALFA	0,20%	2,07%
DINNBP	0,25%	3,45%

Source: Calculations by authors

Based on these data, a matrix of correlation coefficients has been made as follows:

Table 3 Matrix of Correlation Coefficients of Shares Included in the Optimal Portfolio in the Observed Period

	AERO	NIIS	AIKB	KMBN	TIGR	MTLC	SJPT	FITO	ALFA	DINNBP
AERO	100,00%	-13,61%	1,20%	3,15%	-2,90%	-3,32%	-29,98%	-17,54%	26,58%	-0,33%
NIIS		100,00%	-3,70%	-4,72%	3,20%	13,96%	8,73%	-4,44%	0,86%	12,35%
AIKB			100,00%	-3,69%	-5,07%	-20,51%	9,52%	-2,09%	3,23%	-3,24%
KMBN				100,00%	1,16%	1,24%	-17,54%	0,96%	17,59%	1,80%
TIGR					100,00%	-19,86%	11,94%	3,81%	-5,46%	30,77%
MTLC						100,00%	-0,61%	2,29%	-0,19%	-9,30%
SJPT							100,00%	-14,78%	-18,50%	-0,12%
FITO								100,00%	-20,50%	8,24%
ALFA									100,00%	-2,94%
DINNBP										100,00%

Source: Calculations by authors

Note: Analysis used software “Softonic”

From the matrix we can see that there is a sufficient number of shares which are negatively correlated which provides a good basis for portfolio diversification. During the observed period the highest positive correlation was between Philip Morris Operations joint stock company Nis and Tigar joint stock company Pirot, while the highest negative correlation was between Soja protein joint stock company Bečej and Nikola Tesla Airport joint stock company Belgrade.

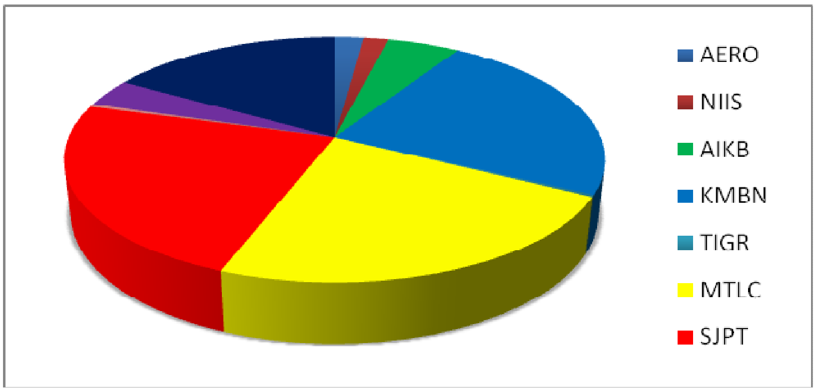
The aim of the research is to form a portfolio from the offered shares which has the best ratio of risk and return. Based on the data from Table 3, we got the optimal portfolio in which the portion of shares is allocated as follows:

Table 4 Securities and Their Stakes in Portfolio

Issuer	**AERO**	**NIIS**	**AIKB**	**KMBN**	**TIGR**	**MTLC**	**SJPT**	**FITO**	**ALFA**	**DINNBP**
Stake	2,07%	1,76%	5,15%	23,36%	0,28%	23,16%	23,55%	0,38%	3,69%	16,60%

Source: Calculations by authors

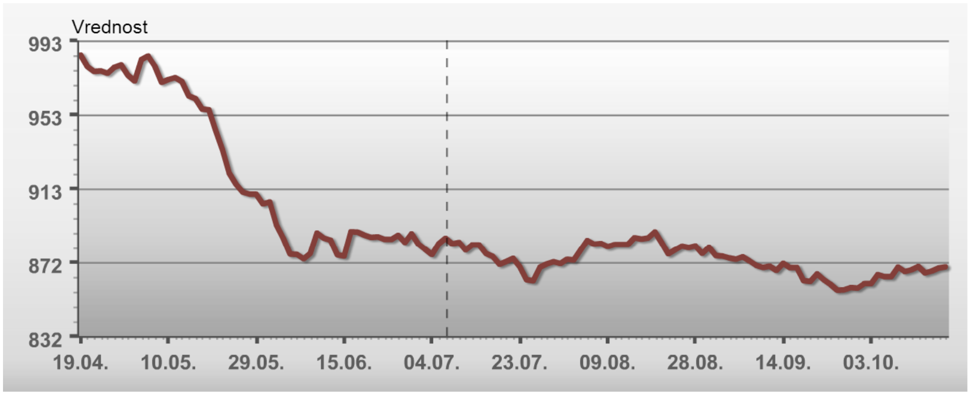
Figure 1 Portfolio Structure



Source: Calculations by authors

Of course the optimal portfolio return has to be compared with the benchmark index which is represented on the Belgrade Stock Exchange by BELEXLINE. Optimal portfolio rate of return has to be higher than the Belexline rate of return.

Figure 2 BELEXline Fluctuation



Source: Belgrade Stock Exchange

In the observed period, the BELEXline had return of 0.9 which is much lower than the optimal portfolio which had return rate of 22.5%. However, return is not the only measure which shows which investment was more successful. The goal of portfolio optimization is to optimize the relationship between expected return and its risk. For that purpose, Sharpe index or ratio will be used in this paper.[2]

Sharpe ratio is taken, because it is not necessary to calculate the beta coefficient for it, which in our conditions would beextremely difficult and invalid.

The article by Nikola Radivojević (2009), states the following limitations in calculating the beta coefficient: a large number of extreme values which create the illusion of high variability of the rate of return, the choice of the referential index and the impact of non-synchronized trading. And, what is specific in terms of this paper, a short period of time of the research (90 days). Sharpe ratio formula is as follows:

$$S = \frac{Er - rf}{\sigma}$$

We see that for the calculation of this index, it is necesarry to determine the risk-free rate of return. On the Serbian capital market Treasury bills are available. The average rate of return from the last two issuings will be taken into consideration, which amounts to 0.031% on a daily basis. The period of 90 days has beed taken for the purpose of this paper, so that the rate of return amounts to 2.79% on Treasury bills.

Sharpe ratio for the optimal portfolio is 17.28, while for the BELEXline it amounts -4.39. The higher amount of Sharpe ratio shows that the optimal portfolio achieved a much higher return per unit of risk than the Belexline. By obtaining such result, modern portfolio theory was successfully applied in the Serbian capital market

Jeremic and Terzic (2010) presented the modern portfolio theory applied to the Belgrade Stock Exchange in the period January - December 2007. The portfolio also included 10 securities listed on the Belgrade Stock Exchange, with a difference in that the return of the portfolio was compared with the Belex15. It is interesting to note that the optimal portfolio in 2007 and our optimal portfolio in 2012 has 5 out of 10 listed securities in common, which confirms the attitude that the market is shallow.

Conclusion

The paper illustrates that the modern portfolio theory can be applied in the Serbian capital market, but its implementation is accompanied with numerous

[2] Sharpe ratio is the measure of the additional rate of return (Risk Premium) of some means (or portfolio) above the non-risk rate in relation to its risk.

limitations. It can be concluded that the application of this theory in the shallow and underdeveloped markets, such as the Serbian market, requires a selection of a narrow group of securities that comply with the criteria of liquidity and frequent trading in the stock market. Because of these difficulties, the paper presents a slightly modified modern portfolio theory in the sense that only previously determined shares have been used in the process of optimization.

Using Excell the optimal portfolio has been obtained which is more efficient than a comparable BELEXline, which was indeed the subject of this research. However, some empirical studies have shown that investors in the Serbian capital market have suffered significantly greater losses in the case of the declining market from those expected using the classical portfolio theory.

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MODERNA PORTFOLIO TEORIJA NA TRŽIŠTU KAPITALA U SRBIJI

Apstrakt: Savremena portfolio teorija predstavlja jednu od najznačajnijih inovacija na području investiranja i upravljanja portfoliom hartija od vrednosti. Rad se bavi ispitivanjem mogućnosti korišćenja metoda portfolio analize na tržištu akcija kojima se trguje na Beogradskoj berzi. Cilj rada je da se izaberu akcije sa Beogradske berze koje su u analiziranom periodu imale najbolje performanse, te da se primenom portfolio analize dođe do optimalnog portfolia koji će imati bolje performanse od berzanskog indeksa BELEXline uz manju stopu rizika. Treba napomenuti da na tržištu akcija kakvo je tržište akcija u Srbiji, postoje brojna ograničenja primene ovog metoda, ali je uprkos tome dobijen portfolio koji je dao bolje performanse od berzanskog indeksa BELEXline.

Ključne reči: portfolio analiza, optimalni portfolio

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EFFECTS OF THE EUROPEAN MONETARY UNION ON MEMBER STATES

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Abstract: Although founded as an experiment of the twentieth century, without a political union and non-compliance with the agreed basic principles of integration, the European Monetary Union will definitely mark the new millennium. Divided politically and monetarily integrated Europe withstood many challenges and pressures, but the problems that existed from the very beginning not only did not solve, but there are created and new. Despite the efforts of the EU member states to join the EMU, it is necessary to analyze the level of development of the EMU countries' ex ante and ex post accession to the EMU. This paper is devoted to the analysis of problems and changes in key economic parameters of the Member States, 12 years after joining the EMU.

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Keywords: EMU, monetary integration, convergence criteria, problems in the EMU

1. Problems in the EMU

The need to create some form of universal payments dating back to ancient times, and usually various political and economic reasons make countries joining together to some form of monetary union. Given that the monetary union cannot avoid a heterogeneous impact of different Member States, State governed by the logic of the economic benefits of unification, which are numerous, but they are not easy to measure and difficult to understand their nature and importance.

European Economic and Monetary Union was an experiment of the twentieth century, as established without a political union. This is particularly important due to the fact that countries in the EMU differ in size, commissioned by power, the geopolitical situation, different economic and political structures, history, social heritage, political ideology, and so on. Because of the large differences between EU member states, Mundell`s optimal currency area criteria (Mundell 1961, 509-517) is not met, it is therefore necessary to create a viable currency area, which in addition to the monetary union requires political union (Kenen, Meade 2008, 14).

If we look at the level of political integration, it is necessary to analyze the institutional and functional structure of political unification. Despite the large number of common institutions, the problem arises from a functional point of view, because the EU in some areas is over the sovereignty of national governments (agricultural and trade) in the areas of taxation, social security, incomes policy, defense and foreign policy of the national government retained the right to making. Disparities also occur because of the structural reform process, which has remained in national jurisdictions. Political integration is essential to national budgets to centralize and redistributing income countries provided by asymmetric shocks. Also, the political union can reduce asymmetric shocks, because the separation of spending and taxation by the national government creates asymmetry. Non-harmonized wage policies lead divergent trends, leading to a domino effect where each country tries to ensure competitiveness folding rigid wages. In the case of a political union, France could not arbitrarily reduce the workweek to 35 hours, which created a negative supply shock in France and EMU GDP decline. In the event that there was a harmonized incomes policy, Germany would not be able to adapt their tight wage policy to reduce wages by 10% and thus increase the competitiveness of their products. This has had negative consequences for the entire EMU, because all the other members were forced to modify their wage policies, create recessionary tendencies with a reduction in employment and low growth in consumption and investment (Talani 2009, 50-89).

The lack of political integration is just one of many flaws of EMU, in which errors were made by the foundation. Although the Maastricht Treaty, which created the European Monetary Union, stipulates that the move towards monetary union, in addition to the principle of convergence is based on the principle of gradualism, EU leaders have significantly accelerated the start of the third stage (start functioning EMU) and some states have made a number of concessions and exemptions (Furtula 2011, 202). States have had the biggest problem with the fiscal convergence criteria, in conjunction with the budget deficit and public debt. Gradualism that is required, replaces the urgency, and the mistakes that were made can be seen in the case of Greece. Greece was admitted to the EMU 2001 without the actual convergence criteria, and then the problem of public debt and deficit escalated in 2010 and threatened to jeopardize the entire EMU project. In December in 1997, only Finland, Luxembourg and Portugal have fully met the convergence criteria, and in 1999 it was decided that all EU member states become part of the EMU.

Accelerated creation of the European Monetary Union, with a number of concessions and under-defined rules, cannot be rationally explained, but presumably the result of an effort to create a zone of monetary stability in Europe, as a counterpart to the United States, and to annul the effects of turbulence on the dollar in Europe economy. In fact, some European countries (Germany, Austria, Belgium, Netherlands, Luxembourg ...) feared that a devaluation of the dollar affect the dollar will be replaced by their currencies, which will lead to an appreciation of their currencies and make it difficult to export. Joining the EMU and euro adoption does not automatically mean better economic performance. To make progress in the euro zone, the state should implement appropriate policies. By joining EMU, they lose their national instrument of adjustment of nominal exchange rate. This provides greater flexibility to the domestic economy and increased responsibility for the harmonization of national economic policies of the Member States, because they have to compensate for the loss of this channel of adjustment. Because of a common monetary policy and exchange rate policy, the states in the fight against asymmetric shocks are available fiscal policy, labor mobility and price flexibility. With regard to fiscal policy have redistributive and stabilizing role that economic analysis suggests little correlation between labor migration and asymmetric shocks, as the only response to asymmetric shocks, the state is the flexibility of prices. The problem of the inability to respond to asymmetric shocks is reduced because of the dynamics of functioning of EMU, as the ten-functioning state largely harmonized business cycles and growth rates.

Due to the dominant influence of the German Bundesbank and the constitution of the ECB as an explicit objective of the monetary policy of the European Central Bank was established price stability, which was the primary goal of the Bundesbank. But unlike the primary objective of the Bundesbank, which is supported by the German government, the ECB has met with opposition from many governments, especially France. Inflation has been a problem in 1980 of the last century, and many state officials are expected to target the single central bank is focused on production and employment. Also, in addition to the dominant objective of price stability, the problem is far too low a certain limit to the growth rate of 2% per year, especially if we consider the fact that 11 of the 17 EMU countries never achieved the required rate of inflation.

The insistence on the sole purpose of price stability, unemployment is put into the background, leaving its implementation to national governments. In the case of low employment, national officials will be dismissed, even though monetary instruments as a key to solving this problem, is not in their jurisdiction. Also, the anti-inflation Maastricht convergence criteria and the Stability and Growth Pact, created a hysteresis in unemployment. It is a phenomenon in which the temporary shock of unemployment, such as during recession, transformed into a permanent shock. Since the ECB acting as a conservative bank with a focus solely on price stability, hysteresis problem has become more difficult, as in the case of not solving the problem of unemployment, temporary rise in unemployment would become too large and led to persistent unemployment, i.e. it would increase the natural rate of unemployment.

Monetary policy is an instrument of economic policy and the objectives of monetary and economic policies must be identical, but the EMU versus independent European Central Bank and a single monetary policy, there is a lack of policy integration and harmonization of economic policies. The Member States in addition to the loss of monetary sovereignty retained the right to manage fiscal policy, which is the problem of lack of coordination of economic policies even more pressing importance.

In order to eliminate these shortcomings the Stability and Growth Pact, was passed which with its controversial name (it is impossible to simultaneously achieve price stability and economic growth, as the main intention of the Pact, the agreement with the primary objective of the ECB, which automatically implies inability to increase economic growth) due to the numerous concessions, modifications and sanctions ceased to exist. Stability and Growth Pact is built on a weak institutional base, and putting government spending and taxation in the domain of national governments, is only an advisory role and not the regulator. Also, the lack of Stability and Growth Pact is the emphasis on the budget deficit rather than on a problem of public debt, which has a much greater impact in the long term. If we observe the attitude of the Member States relating to the Stability and Growth Pact, it can be concluded that small and open states correspond to the rules, and the rules and large opposed the primacy given discretion in decision-making. Fiscal stimulus in a small and open country in the absence of rules is being poured into greater exports and developed countries, while developed countries are less open and fiscal stimulus remains within national borders.

Coordination of monetary and fiscal policy is necessary because the fiscal policy could jeopardize and limit the effects of monetary policy. In the case of large deficits and public debt EMU countries, the European Central Bank will be under pressure from financial debts of member states. In the EMU, it is impossible for a single monetary policy of the ECB to eliminate the negative effects of fiscal policy in each country individually, because in some countries expansionary fiscal and other restrictive policies are pursued. In case that one country enters the budget deficit by increasing government spending, monetary policy has to respond by raising interest rates. The increase in interest rates affects the reduction of economic growth in all Member States, which will cause the individual states still have budget deficits, and the ECB will be forced to raise interest rates again (Goodfriend, McCallum 1997, 1480-1057).

Single monetary policy, prevents the response to asymmetric shocks in demand because it is impossible that all were at the same stage of economic growth. In some countries it is necessary to increase and the other to reduce the interest rate. The problem arises because in all analyzes that consider EMU monitors the performance only EMU, which is logical, but it does not pay attention to the particular country in which there are significant discrepancies. EMU members differ sharply on inflation rates, growth rates, the debt, deficit and surplus, relative to GDP, unemployment rates. The only thing is present at the level of harmonization of the EMU are interest rates, which recorded average reduction of 20% compared to the level of the 2000 (except Greece, Portugal and Ireland). However, we should distinguish between the nominal interest rate that does not affect the economy and the real interest rate, which is the difference between nominal interest rates and inflation. Due to differences in the rates of inflation and real interest rates are significantly different, which is a definite asymmetry was confirmed as the main feature of the EMU.

Despite all the problems, it is evident that the EMU withstood many pressures and relatively successfully functioned in the past decade, and its influence has changed and the economic environment in Europe. The EMU not only affects the 17 Member States, but also all the countries of Europe. Even countries that have not adopted the single currency (the United Kingdom, Sweden, Denmark), will not escape the impact of the EMU, because most of their trading partners and neighbors are in the process of or within the EMU. In an effort to become members as soon as the EMU, countries often do not perform a cost-benefit analysis of entry, so it is necessary to analyze whether the member states gain or lose by joining the EMU.

2. EMU Founding States - In the Period before and after the Joining EMU

Accelerated creation of the EMU had another opposite effect. The cost-benefit analysis is not performed in the long-run. In the all theoretical analysis, impact of the global financial crisis is not included (Blanchard, Faruquee, Das 2010, 33). Therefore, in order to determine the final effects of monetary integration, it is necessary to analyze the basic economic parameters (Taylor 2009, 16) in the EMU founding states (convergence criteria, GDP and unemployment), including the states in regime of exemptions, in the period before and after the joining EMU. Review of basic economic parameters before and after the joining EMU is given in Table 1

Table 1 Percentage Changing in Basic Economic Parameters in 2011 (twelve years after joining the EMU), Compared to 1999 (before joining the EMU)

	GDP	Budget/GDP	Debt/GDP	Inflation	Interest rate	Unemployment
Euro zone	46	-2.83	72.65	125	-19	14
Belgium	54	-1.35	96.11	219	-24	-15
Germany	29	-2.26	68.16	317	-50	-31
Ireland	71	-4.5	45.73	-52	74	157
Greece	59	-7.36	114.25	48	158	47
Spain	85	-2.5	50.48	41	-2	64
France	46	-3.73	67.55	283	-38	-8
Italy	39	-3.34	108.68	70	-3	64
Luxembourg	115	1.62	9.71	270	-47	104
Netherlands	56	-1.63	54.28	25	-45	26
Austria	51	-2.04	66.11	620	-40	8
Portugal	44	-5.1	70.23	64	83	158
Finland	57	2.68	42.3	154	-45	-24
GreatBritain	47	-4.06	51.34	246	-46	36
Denmark	47	1.48	42	28	-52	46
Sweden	62	1.13	46.49	180	-51	12

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

Remark: GDP column represents the percentage of increase in nominal amount of the GDP, in 2011 compared to 1999. Budget/GDP column refers to the average budget surplus or deficit as the percentage of GDP from 2000-2011. Debt/ GDP column refers to the average value of debt as a percentage of the GDP from 2000-2011. Inflation column representing the percentage increasing/decreasing of inflation rate in 2011 compared to 1999. Interest rate column representing the percentage increasing/decreasing of long term interest rate in 2011 compared to 2000. Unemployment rate column representing the percentage increasing/decreasing of unemployment rate in 2011, compared to 1999.

1. If we observe the average percentage increase in GDP, it is evident that the EMU Member States got different benefits from joining the EMU, during the time period 1999-2011. Luxembourg (115%), Spain (85%), Greece (71%) and Ireland (59%) recorded the highest increase in this parameter. From the other hand, Germany (29%), Italy (39%) and France (46%)

recorded the lowest increase. Great Britain and Denmark, which are in the regime of exceptions, recorded similar level of increase as the average of Euro zone (approximately 50%). Sweden recorded increase by 62%.

2. The data also illustrate the average value of surplus and budget deficit as a percentage of GDP during the period from 2000-2011, it can be concluded that all EMU Member States except Luxembourg and Finland realized an average budget deficit, while Greece, Portugal, Ireland, France and Italy exceeded permitted level of this ratio determined by the Stability and Growth Pact of by 145%, 70%, 50%, 24% and 11%, respectively. Great Britain has exceeded level of this ratio required by the Stability and Growth Pact by 35%, while Sweden and Denmark recorded an average budget surplus during this period.
3. If we consider the ratio debt/GDP, we can see that the Eurozone has exceeded permitted level (60%) of this ratio by 20%, namely, the Eurozone recorded an average of this ratio at 72.65%. Ireland, Spain, the Netherlands and Luxembourg are the countries which did not exceeded permitted level of this ratio. From point of view of this parameter, Greece and Italy recorded the most alarming average, and they have exceeded permitted level of this ratio by approximately 100%. Great Britain, Denmark and Sweden are within the permissible limits.
4. If we consider an average change of inflation rate during the time period 1999-2011, we observe three very important facts. Firstly, 8 of 15 countries which are analyzed, they recorded three digit increase of the inflation rate. Secondly, only Ireland of the Eurozone Member States recorded decrease in the inflation rate. And thirdly, the Eurozone realized an average increase in inflation rate by 125%. Finland recorded increase by over 150%, Belgium, Germany, France and Luxembourg recorded increase of inflation rate in range of 220-320%, while Austria is “recorder” with amazing 620% of increase. Great Britain and Sweden, which did not join the EMU, realized increase of 246% and 180%.
5. The percentage change in the level of the long-term interest rates during the time period 2000-2011 had following features: Greece, Portugal and Ireland recorded increase of interest rate by 158%, 83%,74%, respectively. Other Eurozone Member States realized decrease of interest rates. They can be divided into 3 groups. The first group consists of countries which recorded decrease to 20% (Spain), the second group comprises the countries which recorded decrease in range of 20-40% (Belgium, France and Austria) and the third group consists countries which recorded decrease in the level of the interest rate in range of 40-50% (remaining countries in table). Great Britain, Sweden and Denmark, which did not participate in the third phase of the Maastricht Treaty, recorded decrease of interest rate by approximately 50%.

6. Percentage change of the unemployment rate in the EMU shows large disparities between countries during the time period 1999-2011. Negative unemployment rate, namely the increase in employment rate was recorded in Belgium, Germany and France, while the increase of unemployment rate by more than 50% was recorded in Spain, Italy (both of them 64%), Ireland, Luxembourg and Portugal (third of them over the 100%). Denmark recorded increasing by 50% compared to non-Euro zone Member States in the EU.

7. Conclusion

Unlike various positions, considering absence or presence asymmetric shocks in the EMU, most economists agree that the survival of the EMU just depends on the possibility of eliminating the crises. It can be concluded that the problems and solutions for asymmetric shocks are embedded into the idea of the EMU, while the financial crisis are exceptional circumstances, outside of European asymmetries, and EMU leaders did not design predefined solutions.

The first serious challenge for the EMU was precisely the global financial crisis, which imposed the issue of the possibility of the EMU's survival. Although started in the U.S. unexpectedly, the crisis spread to the European continent soon, and seriously damaged the EMU. The emergence of the global financial crisis in the U.S. in August 2007, nobody could predict, and definitely no economist could determine the speed of diffusion of the global financial crisis on the whole world economy. Another important problem related to the global financial crisis is the fact that everybody analyzed the reasons of crisis, and no negative effects caused by the financial crisis and how to prevent these negative effects, and thus the crisis was rapidly spreading through the global financial system.

The growing differences between the member states contributed to the unexpected negative impact of the global financial crisis (Feldstein 1997, 61-62). The gap between developed and lower developed countries of the EMU, escalated ahead of the global financial crisis, multiplying the differences in borrowing capacity. For example, the interest rate on the long-term government securities in Greece was five times higher than the interest rates on the German government securities. Borrowing costs increased in countries outside the EMU, as well, but that countries had monetary sovereignty and operational capacity of national monetary policy, which could, ultimately print national money and eliminate differences.

The global financial crisis has raised another problem in the EMU. Solving the crisis situation is usually at the level of the monetary union, while at the national level, there was no over activity of the problem. The absence of a unified European response is the result of heterogeneous national plans and fiscal policies, which in turn implies the conclusion that EMU is a unique creation. It is notable that in the EMU, there is a lack of crisis management and a higher level of coordination and cooperation between national governments, national central banks and the European Central Bank.

As a final conclusion regarding euro winners and euro losers, we must point out that there is no harmonized action of certain factors and criteria in the EMU. Although the EMU is defined as a harmonized entity, only the interest rate shows a correlation between the Member States, but if we look at the real interest rates correlations is negative. This can be explained by large asymmetries and differences between countries. Ireland, Greece and Spain, on the one hand, and Germany, Portugal, Luxemburg and the Netherlands, on the other, have diametrically opposed economic cycle. The tables above could rather represent the states from different continents than the EMU states with a single monetary policy.

Analyzing the time period before and after 2008, and 12 years of functioning of the EMU, it can be pointed out that euro winner is Finland, and followed by the Netherlands, Belgium and Germany. It have to be concluded, if we observe inflation rate which is the primary aim of ECB, that all countries have lost after the joining the EMU. The biggest looser is definitely Greece, and behind Greece is Portugal. In addition to the unstable financial markets and fiscal challenges, the recovery of the EU economy is faced with another challenge: the uneven nature of economic recovery. Different countries are facing different challenges to establish and maintain sustainable economic growth.

Surely the most important question of all European countries is whether the European monetary union can create a supranational European monetary union or to collapse and thereby bring down the entire European project. Is the EMU “steel” or “glass” design? The future is difficult to predict, even when things are certain, than it can be concluded that the existence and successful functioning of the EMU in the long term it will lead to the formation of European Republic or the United States of Europe (after the United States). Imaginary such terms and conditions cause imaginary EMU, which will definitely be at the crossroads in the next downward phase of the cycle and in the next world crisis. Meanwhile, the EMU will survive in a given form, with the new member states, only if there is no abandonment of certain states.

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EFEKTI EVROPSKE MONETARNE UNIJE NA DRŽAVE ČLANICE

Apstrakt: Fomirana kao svojevrsni eksperiment XX veka, bez prethodnog političkog ujedinjenja i nepoštovanja osnovnih dogovorenih principa integracije, Evropska monetarna unija definitivno će obeležiti i novi milenijum. Politički podeljena a monetarno integrisana Evropa, odolela je brojnim izazovima i pritiscima, ali problemi koji su postojali od samog osnivanja ne samo da nisu rešeni, već su kreirani i novi. Pored nastojanja država članica EU da pristupe EMU, interesantnim se nameće analiza nivoa razvijenosti država članica EMU ex ante i ex post pristupanja EMU. Ovaj rad posvećen je analizi problema i promena ključnih ekonomskih parametara država članica, 12 godina nakon pristupanja EMU.

Ključne reči: EMU, monetarna integracija, kriterijumi konvergencije, problemi u EMU

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FULFILLING THE GOALS OF EUROPE 2020 STRATEGY IN THE CONTEXT OF COMPETITIVENESS GROWTH

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Abstract: Competitive economy is the economy that is able to create a high and sustainable level of living standards, enabling all the members of society to contribute and to benefit from the level reached in prosperity. In the context of competitiveness analysis on a global level, The World Economic Forum has been studying Europe's competitiveness for more than three decades. Over the years, the WEF has carried out a number of Europe-specific competitiveness reports covering Member States and enlargement countries that assess overall Europe's progress in accomplishing its competitiveness agenda. The recent WEF publication: "The Europe 2020 Competitiveness Report: Building a More Competitive Europe"(2012) has focused attention upon creation of The Europe 2020 Competitiveness index following proposed development goals from new European competitiveness agenda adopted in 2010. This paper provides an analysis and evaluation of the approach taken by the WEF in measuring level of competitiveness of the EU, its Member States and selected enlargement countries. All countries of the region, including Montenegro, by fulfilling the overall institutional conditions for EU accession, especially economic criteria of readiness for membership, i.e. dealing with competition coming from the large market - are required to define the vision of socio-economic development, its development directions through which they would harmonize with the framework Europe 2020 strategy.

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1. Introduction

High level of the EU economic prosperity cannot be sustained without high level of competitiveness. Therefore, defining a comprehensive reform agenda that identifies key measures to address the main competitiveness weaknesses of the EU is needed. The recent World Economic Forum publication: "The Europe 2020 Competitiveness Report: Building a More Competitive Europe"(2013) has focused on creation of The Europe 2020 Competitiveness index following proposed development goals from ten-year growth strategy – The Europe 2020 adopted in 2010. Following the well-established methodology the Forum uses to analyse and measure competitiveness, this Report researches and monitors to what extent the EU is making progress to achieve the competitiveness goals set in its "Europe 2020" Strategy to achieve "smart, sustainable and inclusive growth". Therefore, this paper provides an analysis and evaluation of the approach taken by the WEF in measuring level of competitiveness of the EU, its Member States and selected enlargement countries. The aim of this paper is to look more closely to the Europe 2020 strategic goals, priorities and initiatives in Section 2, the WEF report on the Europe 2020 competitiveness index in Section 3 and Montenegro development direction 2013 – 2016 in Section 4 as case of a national development strategy. Section 5 provides concluding comments.

2. Europe 2020 as Development Strategy for the EU Member States and Countries of Enlargement

The European Commission in March 2010 prepared and the Council in June 2010 adopted the European Union's ten-year growth strategy – Europe 2020. It is a development vision of the EU, which also should be a strategic framework for the next decade development of a potential candidate and candidate countries for the EU membership. Therefore, the development framework of the EU and its Member States at the same time is a development framework of Montenegro and other Western Balkans countries (Đurović 2012, 277).

Europe 2020 sets out a vision of Europe's social market economy for the 21st century that will deliver high levels of employment, productivity and social cohesion. Europe 2020 defined three priorities, five goals and seven initiatives for the next decade focused on long-term growth of the Union's competitiveness. Three mutually reinforcing priorities to deliver comprehensive growth are the following: a) smart growth as development of an economy based on knowledge and innovation (more effective investments in education, research and innovation); b) sustainable growth as promotion of a more resource efficient, greener and more competitive economy (towards so-called low carbon economy); and c) inclusive growth as fostering of a high employment economy delivering economic, social and territorial cohesion (job creation and poverty reduction). In order to measure progress in meeting the Europe 2020 goals, the document is focused on five ambitious **headline targets** agreed for the whole EU and each Member State in the areas of employment, innovation, education, poverty reduction and climate/energy:

1. The employment rate of the population aged 20-64 should increase from the current 69% to at least 75%, including the greater involvement of women, older workers and the better integration of migrants in the work force (this indicator for US and Japan is over 70%);
2. 3% of the EU's GDP should be invested in R&D with focus on improvement of conditions for private R&D investment and development of an indicator which would reflect R&D and innovation intensity (R&D spending in Europe is below 2%, compared to 2.6% in the US and 3.4% in Japan, mainly as a result of lower levels of private investment);
3. Reduce greenhouse gas emissions by at least 20% compared to 1990 levels or by 30%, if the conditions are right; increase the share of renewable energy sources in our final energy consumption to 20%; and a 20% increase in energy efficiency (so-called "20/20/20" climate/energy targets);
4. A target on educational attainment which tackles the problem of early school leavers by reducing the drop out rate to 10% from the current 15%, whilst increasing the share of the population aged 30-34 having completed tertiary education from 31% to at least 40% in 2020 (this indicator in US is 40% and over 50% in Japan);
5. The number of Europeans living below the national poverty lines should be reduced by 25%, lifting over 20 million people out of poverty (80 million people were at risk of poverty prior to the crisis, 19 million of them are children; 8% of people in work do not earn enough to make it above the poverty threshold); related to this indicator, unemployed people are particularly exposed including problems with fast-growing youth unemployment (Europe 2020, 2010, pp. 8-10);

Above-mentioned set of the EU-level targets is translated into **national targets** in each EU country, reflecting different situations and circumstances. Despite disparities in levels of development and standards of living, the Commission considers that the proposed targets are relevant to all Member States, old and newer alike, so that each Member State can check its own progress towards these goals. Achieving the EU-level targets through proposed national targets is the common goal, which has to be pursued through a mix of national and EU action. Finally, the strategy includes seven "**flagship initiatives**" providing a framework through which the EU and national authorities mutually reinforce their efforts in areas supporting the Europe 2020 priorities such as innovation, the digital economy, employment, youth, industrial policy, poverty, and resource efficiency.

Table 1 Europe 2020: An Overview of Priorities and Initiatives

SMART GROWTH	SUSTAINABLE GROWTH	INCLUSIVE GROWTH
INNOVATION EU flagship initiative "**Innovation Union**" to improve framework conditions and access to finance for research and innovation to strengthen the innovation chain and boost levels of investment throughout the Union	***CLIMATE, ENERGY AND MOBILITY*** EU flagship initiative "**Resource efficient Europe**" to help decouple economic growth from the use of resources, by decarbonising our economy, increasing the use of renewable sources, modernizing our transport sector and promoting energy efficiency.	***EMPLOYMENT AND SKILLS*** EU flagship initiative "**An agenda for new skills and jobs**" to modernise labour markets by facilitating labour mobility and the development of skills throughout the lifecycle with a view to increase labour participation and better match labour supply and demand.
EDUCATION EU flagship initiative "**Youth on the move**" to enhance the performance of education systems and to reinforce the international attractiveness of Europe's higher education	***COMPETITIVENESS*** EU flagship initiative "**An industrial policy for the globalization era**" to improve the business environment, especially for SMEs, and to support the development of a strong and sustainable industrial base able to compete globally.	***FIGHTING POVERTY*** EU flagship initiative "**European platform against poverty**" to ensure social and territorial cohesion such that the benefits of growth and jobs are widely shared and people experiencing poverty and social exclusion are enabled to live in dignity and take an active part in society.
DIGITAL SOCIETY EU flagship initiative "**A digital agenda for Europe**" to speed up the roll-out of high-speed internet and reap the benefits of a digital single market for households and firms.		

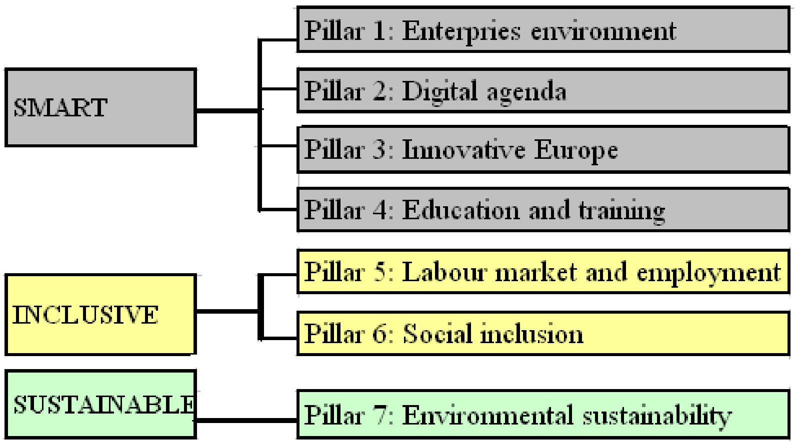
Source: Europe 2020, EC, 2010, p. 30.

3. WEF's Europe 2020 Competitiveness Report

Further analysis related to the Europe 2020 strategy implementation leads us to the analysis of the EU competitiveness, i.e. competitiveness of the EU member states including candidate countries from group of the so-called enlargement countries (Milović 2012, 237). Recently published analysis of the World Economic Forum: "The Europe 2020 Competitiveness Report: Building a More Competitive Europe" (hereinafter WEF Competitiveness report) is the first in a series that will assess Europe's competitiveness progress based on the Europe 2020 Strategy every two years until the end of the present decade. The goal of this Report is to provide a platform for ongoing dialogue between business, civil society, governments and European institutions in the areas requiring attention in order to improve Europe's competitiveness. The aim is to encourage positive policy reform and the necessary investments required to further Europe's economic and social progress. In the following part of this paper, we will present main findings and recommendation from this analysis, including estimation of Europe 2020 Competitiveness Index.

According to WEF Competitiveness report, the seven key dimensions of the Europe 2020 Strategy, described above as flagship initiatives, with some adjustments for presentational purposes, can be presented in a seven-pillar framework, as follows in the figure below.

Figure 1 "Europe 2020" Competitiveness Report Framework



Source: WEF Competitiveness report 2012

Each pillar is populated by a number of variables that helps measure Europe's progress along this key dimension. Combined, these seven pillars create the Europe 2020 Competitiveness Index. The Index is organized around three sub-indexes that monitor Europe's progress towards becoming an increasingly (1) smart, (2) inclusive, and (3) sustainable economy. Each of these sub-indexes is composed of a number of pillars that reflect the spirit of the seven flagship initiatives (WEF Competitiveness report, 2012, p. 9).

Smart Europe

The Smart Europe sub-index aims to measure the extent to which European countries are developing economies based on knowledge and innovation. It is made up of four pillars that capture various aspects of Europe's ability to develop smart economies: the enterprise environment, digital agenda, innovative Europe and education and training. Each is described below.

***Pillar 1: Enterprise environment* -** A prerequisite for improving the prospects of growth and employment in the EU is improving the overall enterprise environment. Critical to achieving this goal is enhancing competition through channels such as effective antitrust policy and appropriate regulation. Another key objective is to stimulate entrepreneurship and facilitate business creation by improving the business start-up environment. This can be achieved by reducing the administrative impediments to doing business in the EU and reducing burdensome taxes, as well as by making it cheaper and easier to start a business and ensuring access to capital for new and growing businesses. The EU has taken an important step in this area by making it possible to start a business within a week in most EU countries, and facilitating the process through a one-stop shop. Yet, the enterprise environments vary greatly across member countries and much remains to be achieved in this area.

***Pillar 2: Digital agenda* -** This dimension measures the extent to which an economy has harnessed information and communication technologies (ICT) to share knowledge, and enhance the productivity of its industries. ICT has evolved into the "general purpose technology" of our time, given the critical spill-over to other economic sectors, their capacity to transform business practices and economic activities, and their role as efficient infrastructure for commercial transactions. Countries with companies that aggressively integrate these new technologies into their production processes tend to see better productivity improvements than others. Further, countries with governments that strongly prioritize the adoption of ICTs have often leapfrogged in this direction. To create a true information society that ensures maximum productivity gains from ICT adoption, all stakeholders in the economy (individuals, businesses and governments) must use these tools. This dimension of the Europe 2020 Strategy offers an excellent opportunity for exchange in information and experience between the strong and weaker performers.

***Pillar 3: Innovative Europe* -** Innovation is critical, especially for those countries that have moved very close to the technology frontier, as is the case of most EU economies. As well as making maximum use of existing technologies, as discussed in the pillar above, these countries must have the necessary framework to ensure that they are at the forefront of innovation. Firms in these countries must design and develop cutting-edge products and processes to maintain a competitive edge. This progression requires an environment that is conducive to innovative activity, supported by both the public and the private sectors. In particular, it entails sufficient investment in research and development (R&D), especially by the private sector; the presence of high-quality scientific research institutions; extensive collaboration in research between universities and industry; and sophisticated business practices. In light of the recent sluggish recovery and rising fiscal pressures faced by advanced economies, it is important that public and private sectors resist pressures to cut back on the R&D spending and other innovation-driven activities that will be so critical for sustainable growth going into the future.

Pillar 4: Education and training - Quality higher education and training is crucial for economies that want to move up the value chain beyond simple production processes and products. In particular, today's globalizing economy requires countries to nurture pools of well-educated workers who are able to adapt rapidly to their changing environment and the evolving needs of the production system. This pillar measures secondary and tertiary enrolment rates as well as the quality of education provided. The extent of staff training is also taken into consideration because of the importance of vocational and continuous on-the-job training—which is neglected in many economies—to ensuring a constant upgrading of worker skills.

While the Report portrays the results for these four dimensions separately for presentational purposes, it has to be noted that they are closely interconnected. The capacity of an economy to shift towards more knowledge intensive, higher value added activities, will depend on its capacity to generate new knowledge through better performing innovation and educational systems and the effective use of technologies, including ICT, as much as on the business conditions that facilitate or hinder the ability to bring this new knowledge into the market in a timely and effective manner.

Inclusive Europe

The Inclusive Europe sub-index captures the extent to which every member of society can contribute to and benefit from Europe's growth and development. This is captured through two pillars, one measuring the labour market and employment conditions, and the second measuring social inclusion more generally.

Pillar 5: Labour market and employment - This pillar gauges the capacity of an economy to mobilize all human resources to contribute to the economic growth of a society. The efficiency and flexibility of the labour market are critical to ensuring that workers are allocated to their most efficient use in the economy and provided with incentives to give their best effort in their jobs. Labour markets must therefore have the flexibility to shift workers from one economic activity to another rapidly and at low cost, and to allow for wage fluctuations without much social disruption. The importance of the latter has been dramatically highlighted by the recent events in some southern European countries, where rigid labour markets are an important cause of high youth and long-term unemployment, the root cause of the recent unrest. Efficient labour markets must also ensure a clear relationship between worker incentives and their efforts to promote meritocracy in the workplace, and they must provide gender equality in the business environment.

Pillar 6: Social inclusion - This pillar aims to capture the extent to which all members of society have the opportunity to benefit from economic growth in their country. This is critical because higher median disposable incomes create demand and savings pools for investment, and inclusive societies, which allow opportunities for all, will tend to be more stable and thus more conducive to economic activity and prosperity. It is measured here by the extent of inequality in the economy as reflected by the Gini coefficient, the government's efforts to reduce poverty and inequality, including the existence of effective social safety net protection, as well as access to healthcare services within the country. Largely, this sub-index reflects the capacity of an economy to provide security of employment rather than security of jobs and is closely associated with the concept of "flexicurity" that several Nordic countries have been successfully promoting in the past years.

Sustainable Europe

The sustainable Europe sub-index is made up of just one pillar, measuring the extent to which the natural environment is contributing to overall national competitiveness and the preservation of a pollution-free environment.

Pillar 7: Environmental sustainability - A high quality and well-managed physical environment, through a variety of channels, is important for competitiveness. The efficient use of energy and other resources lowers costs and directly boosts productivity by virtue of making better use of inputs. Further, a high-quality natural environment supports a healthy workforce, avoiding the illness and lower human capital productivity that can be brought about by pollution and other environmental degradation. Finally, related to the last point, environmental degradation can also directly reduce the productivity of sectors such as agriculture, which in turn lowers output and potentially the ability for a country to meet the food needs of the population. In the index this dimension is assessed by taking into account the share of renewable energy consumption, the enforcement of environmental legislation, the ratification of international environmental treaties and the quality of the natural environment, including through the level of air pollution as measured through CO2 intensity and PM25 emissions (WEF Competitiveness report, 2012, pp. 7-9).

3.1. Europe 2020 Competitiveness index: Member States and Comparator Countries

The assessment of Europe's competitiveness is based on publicly available hard data from respected institutions (The World Bank, UN, ITU, ILO, etc.) and data ranged from 1 to 7 from the World Economic Forum's Executive Opinion Survey, EOS (survey of business leaders, conducted annually in over 140 countries, that provides data for a variety of qualitative issues). The overall scores for each country are calculated as non-weighted average of the individual scores in the seven pillars (65 individual components divided in 7 pillars). Each pillar has the same weight (1/7). The sores are calculated for 2010 and 2012. Considering the fact that the Europe 2020 is defined as a new competitiveness strategy, calculation of the Europe 2020 competitiveness index represents continuation of measuring competitiveness after the Lisbon strategy (Lisbon Review series). Therefore, this index has become very important analytical instrument for measuring of competitiveness and defining economic policy measures at the EU and national level.

Performances of EU 27 according to the Europe 2020 Competitiveness Index are compared among each other to assess which countries are leading in achieving the goals, and which are trailing behind. EU 27 is also compared with other advanced economies such as US, Japan and Canada, and large emerging economics, i.e. Brazil, The Russian Federation, India and China (BRICs). In addition, Croatia as candidate country in 2012 (today 28th EU member), such as Montenegro, FYROM, Iceland, Turkey and Serbia are involved in analysis and calculation of the Europe 2020 Competitiveness Index. It is important for these countries to measure and compare their level of competitiveness as they may become full members at some point (by the end of this decade in optimistic scenario) and must then abide to the EU's overall goals.

Calculation of the Europe 2020 Competitiveness Index for 2010 and 2012 is presented bellow. All the scores are presented on a scale from one to seven, where higher values indicate stronger performance. According to calculated scores, the EU is not a homogeneous entity in terms of competitiveness. The fact is that while some European economies are among the most competitive in the world, the weaker performance of others is negatively affecting the bloc as a whole. If global market confidence in Europe is to return, then top priority must be given to supporting the weaker performers through their reform and investment programmes.

Calculated differences in competitiveness performance across Member states divide them in four groups: a) Nordic Europe (SE, FI, DK), b) Western Europe and Estonia (NL, AT, DE, UK, LU, BE, FR, EE, IE), c) Southern and Eastern Europe (SI, PT, ES, CZ, ZY, MT, LV, LT, IT, SK, PL, HU), and d) Southeast Europe (EL, RO, BG). The Nordic countries hold the top three place in the index, with Sweden market first, maintaining the lead also held in 2010. Score of five countries is slightly improved in 2012 (AT, EE, PT, ES, and LV).

With an average value of 4, 94 on the Competitiveness Index (also slightly improved in 2012), the EU fares better than BRICs (3, 95), almost the same as US (4, 95), although it performs not that well as Japan (5, 04) and especially Canada (5, 22). At the same time, Sweden holds the first place in total calculation, in comparison with mentioned advanced economies (CA, US, JP) and BRICs.

Table 2 Europe 2020 Competitiveness Index: Ranking and Scores of the EU Member States 2010-2012

Country	Code	2012		2010		Change
		Rank 2010	Score	Rank 2010	Score	
Sweden	SE	1	5.77	1	5.77	→
Finland	FI	2	5.71	2	5.61	→
Denmark	DK	3	5.60	3	5.52	→
Nederland	NL	4	5.46	4	5.34	→
Austria	AT	5	5.33	6	5.25	↑
Germany	DE	6	5.28	5	5.25	↓
Great Britain	GB	7	5.23	7	5.10	→
Luxembourg	LU	8	5.13	8	5.05	→
Belgium	BE	9	5.04	9	5.02	→
France	FR	10	4.98	10	5.00	→
Estonia	EE	11	4.74	13	4.67	↑
Ireland	IE	12	4.66	11	4.71	↓
Slovenia	SI	13	4.59	12	4.69	↓
Portugal	PT	14	4.59	15	4.52	↑
Spain	ES	15	4.52	16	4.50	↑
Czech Republic	CZ	16	4.49	14	4.54	↓
Cyprus	CY	17	4.40	17	4.47	→
Malta	MT	18	4.39	18	4.38	→
Latvia	LV	19	4.36	21	4.20	↑
Lithuania	LT	20	4.31	20	4.22	→
Italy	IT	21	4.30	19	4.23	↓
Slovakia	SK	22	4.13	22	4.17	→
Poland	PL	23	4.08	23	4.06	→
Hungary	HU	24	4.06	24	4.04	→
Greece	EL	25	3.95	25	3.92	→
Romania	RO	26	3.79	26	3.84	→
Bulgaria	BG	27	3.76	27	3.79	→
	EU	**4.94**		**4.88**		↑

Source: WEF Competitiveness report 2012, p. 12.

3.2. Europe 2020 Competitiveness Index: Acceding Country Croatia and Candidate Countries (IS, ME, MK, RS, TR)

Are the acceding country Croatia (member since 1 July 2013) and other candidate countries getting ready to join the Union in terms of competitiveness? Answer on this question is presented in the following analysis and table below.

Table 3 Europe 2020 Competitiveness Index: Ranking of Croatia and Other Candidate Countries 2010-2012

Country	Code	2012 Score	2010 Score	Change
Iceland	IS	5.34	5.38	↓
Montenegro	ME	4.39	4.24	↑
Croatia	HR	4.01	4.01	→
Turkey	TR	3,75	3.63	↑
Macedonia, FYR	MK	3.60	3.67	↑
Serbia	RS	3.53	3.48	↑
EU 27	**EU**	**4.94**	**4.88**	↑

Source: WEF Competitiveness report 2012, p. 12.

According to WEF Europe 2020 Competitiveness index, Croatia and mentioned candidate countries, with the exception of Iceland (above EU average level of competitiveness), mostly depict a competitiveness profile that is similar to that of the least competitive countries in Europe. However, the competitiveness profile of each of these countries is quite different. Excluding Iceland, we can notice a significant leg in all observed areas, i.e. seven pillars of competitiveness as it is presented in the following table.

Table 4 The Europe 2020 Competitiveness Index: Seven Pillars of Competitiveness in 2012

Country / score per pillars	Enterprise Environment	Digital Agenda	Innovative Europe	Education and Training	Labour Market and Employment	Social Inclusion	Environmental Sustainability
Croatia	3.30	4.72	3.14	4.27	3.55	4.24	4.83
Iceland	3.82	5.31	5.43	5.56	5.54	5.55	6.15
FYRoM	3.70	4.17	2.72	3.84	3.98	3.36	3.47
Montenegro	**3.95**	**4.74**	**3.62**	**4.37**	**4.67**	**4.79**	**4.60**
Serbia	3.12	4.10	2.79	3.81	3.53	3.85	3.49
Turkey	3.90	4.27	3.29	4.01	3.42	4.01	3.32
EU-27	4.26	5.44	4.90	5.30	4.33	5.43	4.90

Source: WEF Competitiveness report 2012, pp. 13-15.

The competitiveness profile of each of these countries is shortly described below.

An official candidate country since 2010, **Iceland** distinguishes itself from the other candidate countries through its membership in the European Economic Area, through which the country has been participating in the European single market since 1994. As a result, a large number of community laws have already been incorporated into the country's legislation. The score of Iceland for 2012 is **5.34**. Since the official start of the negotiation meetings in June 2011, 27 chapters of the EU *Acquis* have been opened, out of which 11 are officially closed (Iceland, EC, 2012). In spite of excellent European integration dynamic, Iceland decided in June 2013 to slow down accession negotiation with the EU. The new euro-sceptic government in Iceland has announced a halt to the country's EU accession talks, until Icelanders vote in a referendum within the next four years on whether they want membership negotiations to continue (Iceland, 2013).

In a customs union with the EU since 1995, **Turkey** holds strong trade ties with the EU: half of its trade takes place with the EU and there is already some alignment with EU policies, especially in areas of competition and intellectual property law. Since the beginning of the accession negotiations in October 2005, 12 chapters have been opened, including those on company law, enterprise and industry, and one – Science and Research has been closed. In terms of the Europe 2020 strategy, the score for Turkey in 2012 is **3.75**. Turkey performs close to the EU average in the area of enterprise environment, driven by intense local competition and low barriers to the creation of new businesses, as evidenced by a low number of procedures and limited amount of time it takes to start a business. The country has also experienced a notable improvement in its digital agenda since 2010, driven by increased government prioritization of ICT as further reflected in its progress in the use of government online services since 2010. However, important steps remain to be taken to catch up with the EU average. Turkey needs to build its human resource base by advancing its education and training system as well as improving its labour market efficiency and raising opportunities for its citizens to participate in the labour market, particularly for women and youth. In parallel, additional efforts with regard to environmental sustainability are critical, particularly the ratification of environmental treaties as well as lowering its CO2 emissions and improving its air quality in order to converge to the EU average (WEF Competitiveness report, 2012, p. 28).

Croatia is the 28th member state since 1 July 2013 after six years of negotiations. The score of Croatia in 2012 is **4.01** (the same as in 2010). While the country's performance is close to the EU average in terms of environmental sustainability, it faces many challenges to strengthen its competitive environment and to converge towards the EU along all other pillars. This holds particularly true for the smart Europe sub-index. Increased competition is particularly hampered by a weak enterprise environment that is characterized by difficulties in obtaining finance and weak competition in the local market. The private sector considers cumbersome government regulation and an inefficient tax system and labour market as among the many impediments, indicative of the myriad reform efforts that will be needed to increase Croatia's competitiveness. The education and training system will also require reforms in order to develop the country's human resources base. As well as addressing inefficiencies in the labour market, as evidenced by the high level of youth unemployment and low overall participation rate, Croatia must work towards improving its overall accessibility to healthcare services and ramp up its social safety net in order to achieve not only smart, but also inclusive growth (WEF Competitiveness report, 2012, p. 29).

Montenegro has been a candidate country since December 2010. Since the negotiations were open in June 2012, two chapters of the EU Acquis, related to science and research, and education and culture, have been opened and temporarily closed (Montenegro, EC, 2013). In terms of its performance along the Europe 2020 Competitiveness Index, Montenegro performs on par with Malta and Cyprus and ahead of most members of the EU12 with score of **4,39** in 2012. Its economy is characterized by an enterprise environment almost at par with the EU average and well ahead of other candidate countries, fostered by few administrative procedures and little time required to start a business. The country has also advanced its digital agenda, along all sub-dimensions compared with 2010, and has performed slightly above the EU average in the labour market and employment pillar. Going forward, further steps towards building its knowledge-base economy would be needed, including improvements captured by the "innovative Europe" pillar, where it registers the largest difference to the EU average, as well as the education and training pillar (WEF Competitiveness report, 2012, p. 29). EU financial assistance achieved 1, 1% of GDP at annual level and focused mostly on institutional capacity and co-financing of some infrastructural projects in environment and transport (Đurović, Jaćimović, 2012, pp. 122-123).

Serbia is the most recent candidate country as of March 2010. On 28 June 2013, the European Council endorsed the Council's conclusions and recommendations of 25 June 2013 and decided to open accession negotiations with Serbia. The first intergovernmental conference will be held in January 2014, at the very latest. Prior to this, the negotiation framework will be adopted by the Council, and confirmed by the European Council at its usual session on enlargement (The European Council conclusions, 2013, p. 12). Related to increase its competitiveness, significant efforts along all pillars of the Europe 2020 Competitiveness Index will be needed. Serbia scores lower than its neighbouring peers (**3.53**), including the member states of Bulgaria and Romania, in all areas captured by the index. While the country made notable improvements in its digital agenda compared to 2010, raising its performance to a level comparable to those of Bulgaria and Romania, comprehensive reform efforts are required to improve the enterprise environment and education and training as a basis for smarter growth. Nonetheless, a first priority will be to build the institutional capacity in the country, an area to which the largest part of EU financial aid is being allocated. Considerable room for improvement also remains along the “inclusive Europe” dimension in view of severe rigidities in the labour market (characterized by a mismatch between productivity and pay, weak labour-employer relations and a high youth unemployment rate) as well as within the environmental sustainability pillar.

For **Macedonia**, FYR, a candidate country since 2005, accession negotiations have yet to be opened. Similar to its neighbouring peers, the country’s most imminent challenge will be to advance its institutional capacity as a basis towards a knowledge-based economy. The country achieves scores similar to its candidate peers for its enterprise environment, where the private sector has seen slight improvements in obtaining financial resources since 2010. Improvements in ICT infrastructure, such as mobile phones and Internet bandwidth and use, have helped the country advance its digital agenda. However, Macedonia faces multiple challenges in the areas of education and training, innovation and environmental sustainability. It is also notable that Macedonia registered deterioration along the inclusive Europe sub-index, driven by a dramatic rise in youth unemployment and the business sector perceiving a worsening in labour-employer relations and pay and productivity alignment since 2010 (WEF Competitiveness report, 2012, p. 29).

4. Montenegro Development Direction 2013-2016 as a Response to the Europe 2020 Strategy

Montenegrin government prepared, in March 2013, and following the Europe 2020 Strategy, Montenegro Development Directions (MDD). As an EU membership candidate country, Montenegro is to establish a vision of socio-economic development, including specific required investments and development measures for their implementation. The Development directions together with specific projects and financial structure will be the base for programme budgeting and establishing of a direct connection between the funds and development priorities. It will enable efficient use of IPA funds in the mentioned period. An overview of main goals, priorities and directions of MDD is given in the following table.

In view of increasing employment and competitiveness of a national economy, it is necessary to resort to structural reforms, observe fiscal responsibility principles and enhance business environment. Only this can create the assumptions for increase of potential growth rates and ensure good life quality for all its citizens. Following the concept of the Europe 2020 Strategy, the MDD is structured in three directions: smart growth, sustainable growth and inclusive growth. The principles of the three growth directions in the Europe 2020 Strategy were the guidelines for selection of development investments and measures of Montenegro in the coming four-year period.

Table 5 Montenegro Development Directions 2013-2016: An Overview

<table>
<tr><td colspan="3">MDD Objectives</td><td colspan="9">1. Detailed assessment of the existing economic, social and environmental situation in Montenegro in the context of the strategy of EU development and specificity of Montenegro;
2. Formulation of strategic and operational development objectives;
3. Identification of key policy areas for accomplishment of strategic objectives;
4. Creation of a consistent matrix of measures and investments within financial possibilities harmonized with macroeconomic and fiscal scenarios.</td></tr>
<tr><td colspan="3">MDD Contribution to Economic Performance</td><td colspan="9">1. Recovery of economic growth above the potential growth rate, i.e. the real growth of GDP by 3-4%;
2. Decrease in public finance deficit and achievement of balanced budget by 2016; and
3. Decrease in the share of informal economy.</td></tr>
<tr><td colspan="3">MDD are Basically Grounded on</td><td colspan="9">• The concept of “green economy“
• Four development priorities (priority development sectors) with relevant sectoral strategies, and
• Macroeconomic and fiscal framework 2013-2016</td></tr>
<tr><td colspan="12">PRIORITY DEVELOPMENT SECTORS</td></tr>
<tr><td colspan="3">1. Tourism</td><td colspan="3">2. Energy</td><td colspan="3">3. Agriculture and Rural Development</td><td colspan="3">4. Industry</td></tr>
<tr><td colspan="12">DEVELOPMENT DIRECTIONS</td></tr>
<tr><td colspan="4">Smart Growth</td><td colspan="4">Sustainable Growth</td><td colspan="4">Inclusive Growth</td></tr>
<tr><td colspan="4">Policy Areas</td><td colspan="4">Policy Areas</td><td colspan="4">Policy Areas</td></tr>
<tr><td colspan="4">1. Business Environment</td><td colspan="4">8. Agriculture, rural development</td><td colspan="4">14. Labour Market</td></tr>
<tr><td colspan="4">2. SMEs</td><td colspan="4">9. Forestry</td><td colspan="4">15. Education</td></tr>
<tr><td colspan="4">3. Competitiveness</td><td colspan="4">10. Energy</td><td colspan="4">16. Sports</td></tr>
<tr><td colspan="4">4. Science</td><td colspan="4">11. Environment</td><td colspan="4">17. Social Protection</td></tr>
<tr><td colspan="4">5. Higher Education</td><td colspan="4">12. Transport</td><td colspan="4">18. Healthcare</td></tr>
<tr><td colspan="4">6. Information Technologies</td><td colspan="4">13. Housing and Construction</td><td colspan="4"></td></tr>
<tr><td colspan="4">7. Tourism</td><td colspan="4"></td><td colspan="4"></td></tr>
<tr><td colspan="12">Three development directions, 18 policy areas of MDD with 72 specific and necessary investments/development measures</td></tr>
</table>

Within this framework, the MDD identify **18 policy areas** for investments and public sector reform. Within these policy areas, there were identified **72** specific and necessary investments/development measures. Those measures are connected to policy fields of smart, sustainable and inclusive growth in line with the Europe 2020 Strategy.

The objective of MDD is to establish a consolidated midterm investment and development plan, and thus launch the implementation of development priorities, which would stimulate economic growth in the country. MDD financial plan is presented in the table 6.

Table 6 Sources of Funding of Required Investments/Development Measures in the Period 2013 – 2016 (in million €)

Economic Growth Area	**Total mil. €**	**Share in %**	**State Budget**	**Donation**	**Loans**	**EU/IPA**
Smart Growth	27,93	**2,4**	14,39	2,61	8,70	2,23
Sustainable growth	1085,69	**93,2**	272,0	24,18	751,	38,38
Inclusive Growth	51,09	**4,4**	36,60	1,14	10,00	3,35
Total Investment/ Measures	**1164,71**		**323,02**	**27,93**	**769,80**	**43,96**
Share in %	100,00		**27,70**	**2,40**	**66,10**	**3,80**

Source: Montenegro Development Directions, 2013, pp. 6-7.

Table 6 shows that nearly 93% of all required investments/development measures are identified in the area of sustainable development. Out of this, 80% of the amount of all required investments/development measures of the country is related only to two infrastructure sectors – transport and environment in the period 2013 – 2016. In the area of smart development – with the share of 2.4% of all required investments/development measures, most required investments/development measures are identified in the science sector. Identified required investments/development measures in the area of inclusive growth make 4.4% of all required investments/development measures.

The total available public funds of Montenegro for financing 1164.71million € of investments/development measures proposed in MDD in the period 2013 – 2016 are estimated to 599.33 million €. Financial gap between the required investments in MDD and available public funds for the entire period 2013 – 2016 is estimated to 565.38 million €, which on average annual level amounts to 141.34 million € or 3.7% of average projected GDP. This means that required investments/development measures identified in the Development Directions are on the level that is more than two times higher than envisaged scope of available public funds of Montenegro in the following four-year period. In other words, financial gap actually indicates the difference between the wishes for investments/development measures and actual financial potential, and the requirement to adjust to the same. We can conclude that financial gap could be the key limiting factor for implementation of required investments/development measures in the area of sustainable growth.

5. Concluding Remarks

The European Union (EU) is going through one of the most difficult periods since its establishment, with multiple challenges facing the Union's policy-makers in order to make European economies more competitive on a global scene. For **better economic governance,** the EU adopted a new development strategy (Europe 2020) for smart, sustainable and inclusive growth in next decade. Smart growth refers to innovation, digitalization and mobility of young people. Sustainable growth refers to improved efficiency of using resources and industrial policy, while inclusive growth is aimed at better employment and poverty reduction. Following the well-established methodology in analysis of competitiveness level, the WEF continue to measure the Europe 2020 development results through creation of **the Europe 2020 Competitiveness Index** for Member States and selected candidate countries including Croatia.

Based on a country-specific analyses that points out individual competitiveness strengths and weaknesses for all 27 Member States and six acceding and candidate countries in 2012, the Report finds that **large disparities** exist among Member States in terms of competitiveness, with some countries performing much better than others and well above the EU average or other advanced economies. Based on the competiveness analysis presented in this Report, a number of considerations can be highlighted going forward:

- The EU continues to lag behind in terms of creating a **smarter economy**. Further resources should be considered for those areas that aim to bridge this gap at the European level and create important European benefit by generating intra-European spillover effects. Education and training policies, research and innovation, the three corners of the knowledge triangle, fall under this category.
- **Regional policies**, including cohesion and structural funds, aimed at reducing the disparities across Member States and regions within the European Union **should follow a competitiveness agenda** in order to ensure sustained economic convergence. More emphasis on addressing the strong knowledge lag of these countries and regions by further supporting efficient investments in education and training, research and innovation should be considered.
- **Enlargement policy** aiming to facilitate accession of selected candidate countries should also be centered around addressing their competitiveness weaknesses, including institutional build-up, thus setting their economies on a more solid footing that can better facilitate their integration. Following mentioned recommendation, candidate countries are also obliged to define their own competitiveness agenda (**national Europe 2020 strategies**) and to participate in joint monitoring organized by the Commission.

Finally, in this paper, the case of **Montenegro** is presented as a case of candidate country which is obliged to create national development strategy as national Europe 2020 strategy. Montenegro development directions 2013-2016 are created to identify development measures and investments in Montenegrin economy in mentioned period adjusted to the EU 2020 Strategy.

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ISPUNJAVANJE CILJEVA STRATEGIJE EVROPA 2020 U KONTEKSTU RASTA KONKURENTNOSTI

Apstrakt: *Konkurentne ekonomije su one koje su u mogućnosti da stvore visok i održiv nivo životnog standarda, dozvoljavajući svim članovima društva da doprinesu i da imaju koristi od tog dostignutog nivoa prosperiteta. U kontekstu analize konkurentnosti na globalnom nivou, Svjetski ekonomski forum istražuje konkurentnost evropskih zemalja više od tri decenije. U tom periodu WEF je sproveo više izvještaja o konkurentnosti koje se odnose na Uniju i zemlje proširenja koji su ocjenjivali sveukupni progres evropskih zemalja u ostvarivanju svoje agende konkurentnosti. Nedavna WEF publikacija "Izvještaj o konkurentnosti Evropa 2020: građenje konkurentnije Evrope (2012) fokusira se na kreiranje Indeksa konkurentnosti Evopa 2020 u skladu sa predloženim razvojnim ciljevima iz nove agende konkurentnosti Evrope definisane 2010 godine. Ovaj rad analizira i ocjenjuje pristup Svjetskog ekonomskog foruma u mjerenju nivoa konkurentnosti EU, njenih država članica i izabranih zemalja proširenja. Sve zemlje regiona, uključujući Crnu Goru, kroz ispunjavanje sveukupnih institucionalnih uslova za pristupanje EU, posebno ekonomskih kriterijuma spremnosti za članstvo u odnosu na konkurenciju koja dolazi sa velikog EU tržišta – pozvane su da definišu svoje vizije socio-ekonomskog razvoja, svoje razvojne smjernice pomoću kojih će se uskladiti sa okvirom strategije Evropa 2020.*

Ključne riječi: *Evropa 2020, Indeks konkurentnosti Evropa 2020, EU, zemlje kandidati za članstvo, Razvojne smjernice Crne Gore*

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ECONOMIC GROWTH, RECESSION AND PUBLIC DEBT IN THE WESTERN BALKANS AND REPUBLIC OF MACEDONIA

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Abstract: Initially the question is raised what economic theory tells us about the relationship between public debt and economic growth. However, causality is hard to establish and, in our reading of the empirical evidence, there is no paper that can make a strong case for a causal relationship going from public debt to economic growth. In several countries debt refinancing, especially of short-term issues, will contribute considerably to gross financing requirements. So far, SEE6 countries have been able to roll over their debt, but whether they can continue to do so depends on market confidence. In this sense, the task is to identify the reasons not to fall of the Macedonian economy during the global crisis, but more importantly, the role of government and monetary authorities in the design of measures and incentives by economic growth in the state of recession creating effective aggregate demand through investment financing in the public sector.

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Keywords: public debt, recession, economic growth.

1. Introduction

The literature shows that debt has a negative impact on growth through a standard crowding out effect, but back-of-the-envelope calculations indicate that this effect is quantitatively small. While uncertainty and policy credibility may amplify the negative effect of crowding out, hysteresis can lead to a situation in which expansionary fiscal policies have positive effect on the long-run growth.

However, causality is hard to establish and, in our reading of the empirical evidence, there is no paper that can make a strong case for a causal relationship going from public debt to economic growth.

Our finding that there is no evidence of a causal negative relationship going from debt to economic growth does not mean that debt does not matter, and that countries should run profligate fiscal policies. First, saying that there is no evidence that debt is bad for growth is different from saying that there is evidence that debt does not matter for growth. Second, we think that the relationship between debt and growth is heterogeneous across countries and time periods and that future research should focus on these sources of heterogeneity.

Sovereign debt can help developing countries. It enables their governments to facilitate growth take-offs by investing in a critical mass of infrastructure projects and in the social sectors when taxation capacity is limited, or when the alternative would be to print money and compromise macroeconomic stability. Debt also facilitates tax smoothing and counter-cyclical fiscal policies, essential for reducing output volatility; and it permits an equitable alignment of benefits and costs for long-gestation projects by shifting taxation away from current generations

The growth of the global economy slowed in 2012, with achieved growth of 3.2%, if we exclude the crisis period, the lowest growth seen in the last ten years. Given these trends in advanced economies, emerging economies and developing countries were again the main driver of growth, although their economic activity was visibly slowed compared with the previous two post-crisis years. The slower growth of these countries generally due to their reduced export activity in terms of negative global environment, as well as delayed (lagged) effects of monetary tightening are evident in these countries in 2011.

In such a global environment, foreign effective demand for the first time in 2009, dropped from 1.7%, which reflected the realized negative economic growth in most of the major trade partners of the Republic of Macedonia. Analyzed in more detail, Greece Italy and Serbia had the largest negative contribution to the annual rate of change foreign effective demand in 2012, and only Germany and Bulgaria had a positive contribution due to increasing economic resilience. After two years of relatively stable economic growth of about 3% in 2012 Macedonian economy had a slight decline of 0.3%. Further uncertainty in the external environment and reduced economic activity most important trading partners, as a result of the European debt crisis and in 2012 was a major limiting factor to growth the domestic economy. The economy gradually began to recover in the second half of the 2012, and in conditions of still unfavorable external environment, the growth in domestic activity in the second half of the year was entirely due to domestic factors. The state capital investments and the high amount of construction works by private investors were the main drivers of growth in domestic economic activity in the second half of the year (0.2% on average).

In this sense, the task is to identify the reasons avoid the fall of the Macedonian economy in the condition of global crisis, but more importantly, the role of government and monetary authorities in the design of measures and incentives by economic growth in the state of recession creating effective aggregate demand through investment financing in the public sector. Furthermore, it can be done either by changing the structure of public revenues and expenditures or by increasing the public debt which may have positive or negative effects on economic growth in the future.

2. The Theory Approach

Initially the question is raised what economic theory can tell us about the relationship between public debt and economic growth. If we assume that government spending on goods and services is fixed and we can examine what happens if the government decided to temporarily reduce taxes and financing costs by issuing debt. According to some views for public debt, (Elmendorf and Mankiw, 1999), in the short-run output is demand-determined and fiscal deficits (or higher public debts) have a positive effect on disposable income, aggregate demand, and overall output. This positive short-run effect of budget deficits (and higher debt) is likely to be large when the output is far from capacity. But things are different in the long-run. If Ricardian Equivalence does not hold, the decrease in public savings brought about by a higher budget deficit will not be fully compensated by an increase in private savings. As a consequence, national savings will decrease, resulting in lower total investment, either at home or abroad. Lower investment at home will have a negative effect on GDP, as it will lead to a smaller capital stock, higher interest rate, lower labor productivity and wages. Lower foreign investment (or higher foreign inflows), instead, will have a negative effect on foreign capital income and will thus lower the country's future GNP. This negative effect of an increase in public debt on future GDP (or GNP) can be amplified by the presence of distortionary taxes.

Growth seldom enters the picture explicitly; indeed, most theoretical models do not include a direct link between government debt and growth. Long-run growth is typically taken as exogenous and, with insolvency ruled out, the problem becomes one of allocating taxes over time to minimize deadweight losses from taxation given initial debt. However, unsustainable debt levels can lower growth by raising real interest rates and crowding out the private sector. And sovereign debt can facilitate the achievement of growth, for example, by enabling the optimal social provision of public goods such as education and infrastructure when taxation capacity is limited today but expected to be higher in the future. It also helps when public investments spur private investment through complementarities. But this critically assumes that only those public projects with economic returns exceeding the cost of borrowing are selected;

and that the government subsidizes such projects when their financial return is lower than the cost of funds through redistributive taxation (as opposed to further borrowing): in other words, that governments play their assigned role.

The only explicit debt-growth theoretical link is that between external borrowing (public or private) and growth, the assumption being that if the marginal product of capital is higher than the world interest rate for developing countries, then such countries would benefit from external borrowing. But even here, external debt helps to exploit the existing growth potential of the country; it does not enhance it. Theoretically, therefore, the only guideline one finds is that the rate of return on spending should exceed the marginal cost of borrowing on the assumption that debt is eventually repaid.

According to Elmendorf and Mankiw's (1999) back-of-the-envelope calculations, each additional dollar of government debt reduces steady-state gross output by about 10 cents (9 cents are due to the lower capital stock and one cent to future tax distortion). If we assume that annual real GDP growth is 3 percent and convergence speed is 2 percent, we find that this change in steady-state output has a fairly small growth effect. In particular, our calculations indicate that increasing debt by 100 per cent of GDP would reduce annual GDP growth by approximately 20 basis points in the first twenty years.

The negative effect of public debt could be much larger if high public debt increases uncertainty or leads to expectations of future confiscation, possibly through inflation and financial repression (Cochrane, 2011a,b) for a discussion of these issues). In this case, higher debt could have a negative effect even in the short-run.

The conventional split between the short and long-run effects of debt disregards the fact that protracted recessions may reduce future potential output (as they increase the number of discouraged worker, with the associated loss of skills, and have a negative effect on organizational capital and investment on new activities). In this case, running fiscal deficits (and increasing debt) may have a positive effect on output in both the short and long-run. In fact, at some authors argue that, in a low interest rate environment, expansionary fiscal policy is likely to be self-financing (DeLong and Summers (2012). They mention that the US Congressional Budget Office recognizes this fact and reduces its estimates of future potential output when output falls below potential for at least one year. There is, in fact, evidence that recessions have a permanent effect on the level of future GDP.

Theoretical model in which, over the business cycle, debt can only be issued to finance public investment and the optimal level of public debt is determined by the public to private capital ratio that maximizes economic growth (Checherita-Westphal, Hughes Hallett, and Rother (2012)). With such a set-up, it is clear that the level of debt that maximizes economic growth is a function of the output elasticity of the capital stock. Given model is used to estimate optimal debt ratios for various subsamples of OECD countries and find values that range between 43 and 63 percent of GDP. The results are driven by their assumption that the deficit is equal to public investment at each point in time. According to other author (Greiner (2012a)), in such a set-up, debt is completely irrelevant and the non-linear relationship between debt and growth is given by the growth-maximizing tax rate. He then shows that allowing for a more general debt policy leads to a monotone and negative relationship between public debt and steady-state growth. He also argues that the effect of debt on growth depends on the presence of rigidities in the economy. In particular, he shows that, in a model with no rigidities and elastic labor supply, public debt has a negative effect on labor supply, investment, and economic growth. In the presence of wage rigidities and unemployment, instead, public debt has no effect on the allocation of resources and can even have a positive effect if it is used to finance productive investment. Conclusion is that there is no well-specified model that can generate an inverted U-shaped relationship between debt and growth.

Non-linearities may arise if there is a tipping point above which public debt suddenly become unsustainable. (Ghosh, Kim, Mendoza,Ostry, and Qureshi, 2012, provide a formal model). However, we are not aware of any theoretical model that includes such tipping points in a growth framework.

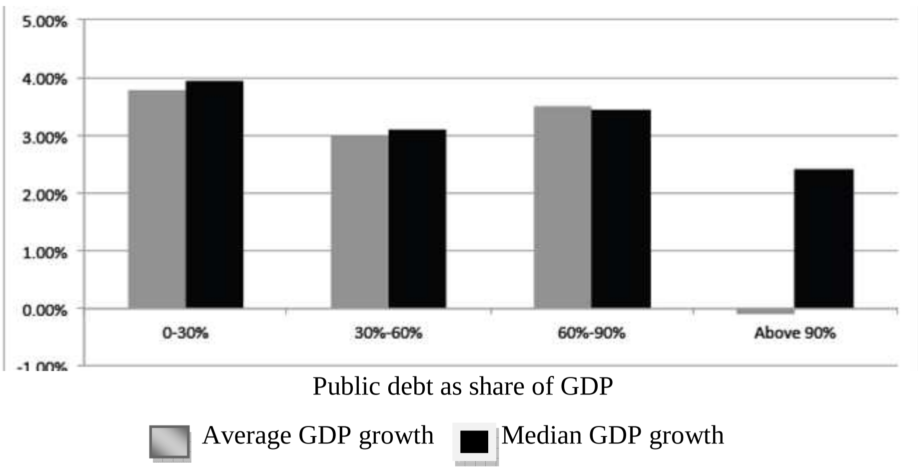
It is also possible that high levels of debt pose constraints on a country’s ability to conduct countercyclical policies, and thus increase output volatility and reduce economic growth (for the relationship between volatility and growth, (Ramey and Ramey (1995). However, the relationship between debt and the ability of conduct countercyclical policies is more likely to depend on the composition of public debt than on the level of public debt. This suggests that countries with different debt structures and monetary arrangements are likely to start facing problems at the very different levels of debt.

Summing up, simple back-of- the- envelope calculations suggest that debt may have a negative effect on growth, but the effect is likely to be small. More sophisticated models yield uncertain results on the relationship between debt and growth and show that the link between debt and growth depends on many cyclical and structural factors. These considerations suggest that trying to estimate a single debt coefficient that holds for all countries and all periods may be mission impossible.

A good starting point for discussing the relationship between public debt and economic growth in advanced economies is Reinhart and Rogoff’s (Reinhart and Rogoff (2010b) finding that high levels of debt are negatively correlated with economic growth, but that there is no link between debt and growth when public debt is below 90 percent of GDP. Reinhart and Rogoff

(2010b) illustrate this threshold effect by collecting annual data on debt and output growth for 20 advanced economies over 1946-2009 and splitting their sample into four groups: (i) country-years for which public debt is below 30 percent of GDP (443 observations); (ii) country-years for which public debt is between 30 and 60 percent of GDP (442 observations); (iii) country-years for which public debt is between 60 and 90 percent of GDP (199 observations); and (iv) country-years for which public debt is above 90 percent of GDP (96 observations). Next, they compute median and average GDP growth for each group and show that there are no large differences among the first three groups, but that average and median GDP growth are substantially lower in the fourth group. In particular, they show that in the high debt group median growth is approximately 1 percentage point lower and average growth is nearly 4 percentage points lower than in other groups (see Figure 1).

Figure 1 The Non-Linearity of the Debt-Growth Relationship



In this way influential paper sparked a new literature aimed at assessing whether their findings were robust to allowing for non-arbitrary debt brackets, to controlling for other variables in a proper regression set-up, and to instrumenting public debt to assess its causal effect on economic growth. In this section, we review this new empirical literature.

3. Economic Growth, Recession and Fiscal Policy in SEE6[1]

After average annual growth of just 2 percent in 2010 and 2011, and mirroring Eurozone developments, in the first half of 2012 SEE6 countries again entered recession**.** Led by Serbia, which accounts for almost half of SEE6

[1] SEE6 are Albania, Bosnia and Herzegovina, Kosovo, Macedonia, Montenegro and Serbia

GDP, regional economic activity faltered in part because of the severe winter but also because of severely shrinking demand, both external and domestic (Table 1).

Table 1 South East Europe Six: Real Economic Growth, 2009-2012

	2009	2010	2011	2012 H1	2012 H2 (proj.)	2012 (proj.)
ALB	3.3	3.5	3.0	1.0	0.6	0.8
BIH	-2.9	0.7	1.3	-0.2	0.2	0.0
KOS	2.9	3.9	5.0	3.6	3.6	3.6
MKD	-0.9	2.9	2.8	-1.1	1.0	0.0
MNE	-5.7	2.5	3.2	-0.9	1.0	0.2
SRB	-3.5	1.0	1.6	-1.6	-2.3	-2.0
SEE6	**-1.8**	**1.8**	**2.2**	**-0.6**	**-0.5**	**-0.6**
EU11	...	2.0	3.1	1.3	...	0.9

Source: SEE6 country statistics offices and World Bank staff (2013). Averages are GDP weighted

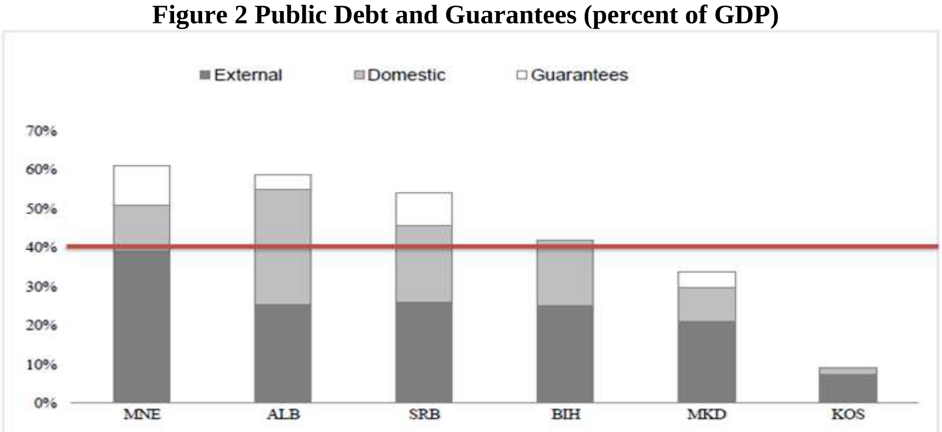
General recession notwithstanding, growth in individual SEE6 countries varied widely. Serbia and Macedonia contracted most, by about 1.6 and 1.1 percent, respectively, in the first half of 2012. Kosovo is an outlier whose real output continues to be propelled by remittances from the diaspora as well as high public investments, and Albania's economy grew 1 percent on the heels of domestic demand. Lower exports and investments drove these developments; high unemployment keeps the lid on consumption. Even with the expected gradual recovery in the second half of the year, the SEE6 as a group will remain in recession for the year as a whole. Unemployment **-** the highest regional unemployment in Europe, averaging about 25 percent (excluding Kosovo whose unemployment exceeds 40 percent, partly offset by informal employment) **-** will keep rising.

After looking better in 2010 and 2011, the fiscal situation in SEE6 countries weakened considerably in the first half of 2012 as the double-dip recession impacted government budgets**.** The average fiscal deficit in SEE6 countries improved from –3.9 percent of GDP in 2010 to – 3.1 percent in 2011 partly because economic growth began to revive. Expecting this trend to continue into 2012, governments proceeded with somewhat optimistic revenue assumptions. However, growth slowed across the region in the second half of 2011 and turned negative in the first half of 2012 amid continued turmoil in the Eurozone, compounded by a severe winter that significantly reduced economic activity. Between slow growth and optimistic budgeting, revenues considerably underperformed; deficits are again increasing in most countries (Table 4).

Interestingly, over a longer period SEE6 countries seem on average to have run countercyclical fiscal policies, but the surpluses were too small to provide much room for maneuver during a prolonged crisis**.** After 2000, structural fiscal balances moved generally in line with growth (Figure 30 and Figure 31). During the peak growth period (2005–07), SEE6 countries on average ran surpluses (although in retrospect not always as large as needed **-** especially in Montenegro, which experienced both the largest boom and the worst bust) and then moved into deficit in 2008 as the effects of the economic crisis hit. The problem was that countries in the region did not build up enough resources during the boom to finance prolonged deficits during the crisis. Indeed, despite average growth of about 3.8 percent in the 2000s, they ran structural deficits on average of over 1 percent of GDP. Some countercyclical fiscal policies were more successful than others. Kosovo, Montenegro, and to a lesser extent Bosnia had fiscal surpluses on a structural basis during the boom. However, despite solid economic growth Albania and Serbia had deficits (Figure 2).

In Serbia, Albania, and Montenegro the public debt is too high**.** In August, the Serbian public debt stood at 57.6 percent, well above the 45 percent ceiling set by the Law on Fiscal Responsibility. Albania also has breached its public debt threshold of 60 percent of GDP. Montenegro's public debt has risen significantly, above 59 percent of GDP, in large part because of the deficits during and after the global crisis and state guarantees. These countries will need to make special efforts to implement fiscal consolidation and ensure that they keep the confidence of lenders. BIH, Kosovo, and Macedonia all seem to be well within sustainable levels of public debt. BIH debt was about 40 percent of GDP at the end of 2011, but given the vulnerabilities, BIH debt levels should also be reduced in medium term. Kosovar public debt is now about 9 percent of GDP, although attempts to build up a domestic credit market may push this up slightly in 2013. Public debt in Macedonia is moderate.

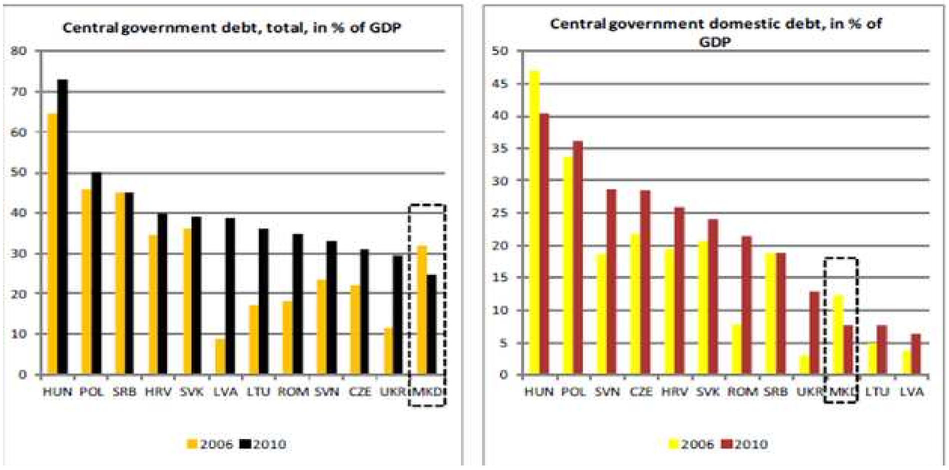
Figure 2 Public Debt and Guarantees (percent of GDP)



Source: National authorities and World Bank estimates based on latest data available

In several countries debt refinancing - especially of short-term issues - will contribute considerably to gross financing requirements. So far, SEE6 countries have been able to roll over their debt, but whether they can continue to do so depends on market confidence. Some countries also have large amounts for long-term bonds due in late 2012 and early 2013.

Figure 3 Central Government Debt in CESEE, 2006 and 2010

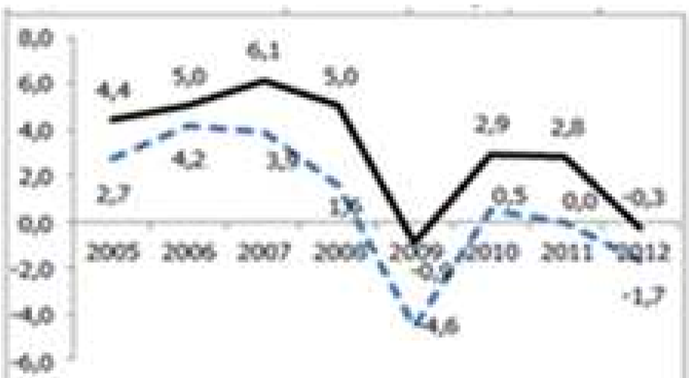


Macedonia's government debt ratio has decreased substantially over the last decade and is modest by regional standards. In contrast with most of its regional peers, Macedonia had lower government debt as a share of GDP in 2010 than in 2006, before the crisis, and the current debt level is among the lower ones in the region (Figure 3).

4. Growth Analysis and Public Finance in Macedonia

Macedonia to the financial crisis had a relatively good economic growth rates. Negative growth rates appear in 2009 and after that recorded relatively stable economic growth of about 3%, and in 2012 the Macedonian economy had a decline again of 0.3% (Figure 4). Continued uncertainty in the external environment and reduced economic activity of the most important trading partners, as a result of the European debt crisis and in 2012 was a major factor limiting the growth of the domestic economy. Adverse effects transmitted especially were felt in the first half of the year. Reemerging of the debt crisis in Eurozone affected the growth rates of our major trading partners and led to a decline in the foreign effective demand for the first time after 2009. Reduced demand for Macedonian products, and lower world export prices, followed by the effects of extremely low temperatures adversely impacted on the domestic industry and export sector. As a result of these developments the domestic economy entered negative zone growth dropped by around 0.8% on average for the first half of the year. The economy gradually began to recover in the second half of the year, and in conditions of still unfavorable external environment, growth of the domestic economy in the second half of the year was entirely due to domestic factors. The state capital investments and the high amount of construction by private investors were the main drivers of growth in domestic economic activity in the second half of the year (0.2% on average).

Figure 4 GDP and Foreign Effective Demand (annual rate of real assessment)



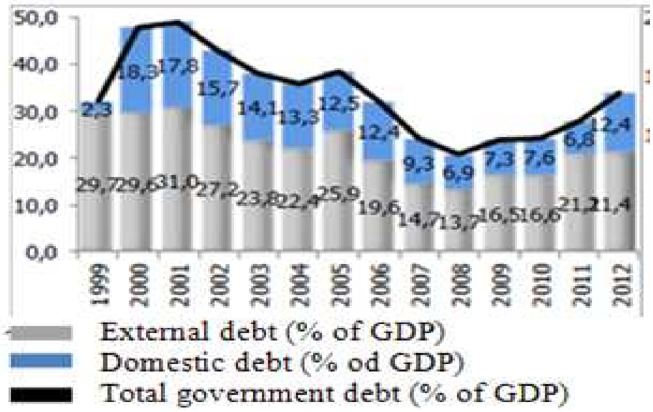
GDP foreign effective demand

Source: SSO and consensus forcast, february 2013

In the absence of growth of the domestic economy, the 2012 budget deficit increased, but fiscal policy successfully maintained cautious nature. The public finances are faced with major challenges during this period. Thus, revenues were lower than planned. Such deviations caused needs downward correction on the expenditure side to keep the budget deficit target of 2.5%. The 2012 fiscal deficit was generated from 3.8% of GDP, an increase of 1.3 percentage points compared with the previous year and is also one of the highest realized deficits.

The growing need for financing the deficit caused further growth of the public debt, which at the end of 2012 amounted to 33.8% of GDP. During this year, achieve the trend of continuously constant increasing gross external debt. Finally on 31.12.2012, it was 5163.2 million, or 68.6% of BDP or total government debt 34% of GDP, which is an annual increase of 4.1 percentage points of GDP (Figure 5). During the year, the greater contribution of about 55% of the gross external debt had increased levels of private debt, which was mostly due to higher liabilities to direct investors in the long and short term. At the same time, the debt of other sectors in the economy has increased as a result of higher short-term obligations based on other obligations and commercial loans (lending to foreign trade partners). As for the banks, the higher level of debt, was state due to increasing short-term liabilities of non-resident deposits, which were partially offset by the reduction of long-term debt to banks. Higher level of public external debt reflects the new term borrowing and the sale of state Eurobonds by residents to non-residents.

Figure 5 Structure of Public Debt



Source: Ministry of Finance and Calculation of NBRM

The analysis of indicators of external debt of the country mainly shows that the gross debt is "safe zone". Namely, according to **indicators of solvency**, measured according to the methodology of the World Bank, the Republic of Macedonia according to the level of external debt belongs the low indebted countries, with the exception of the indicator for the share of external debt to GDP, the only indicator in which belongs to the group of highly indebted countries. The observed dynamics, in almost all indicators of solvency are improvements on an annual basis, with the exception of the ratio between gross external debt to GDP ratio, which deteriorated (by 2.9 pp of GDP). In this context, it should be said that this indicator has been constantly deteriorating for six years, and the threshold is exceeded moderation since 2005. Significant improvements were seen in the ratio of gross debt to exports of goods and services and repayment of the ratio of debt to exports of goods and services (by 5.3 percentage points and 3.2 percentage points of GDP, respectively), where end-year growth trend as a result of the strong increase in exports of goods and services, in terms of lower growth in gross debt and decline in repayment of debt. At the same time, a small positive change (reduction of 0.2 percentage points of GDP) appears in the indicator of interest repayment / exports of goods and services. Liquidity indicators of the state of external indebtedness generally indicate a relatively favorable position. The coverage of short-term debt by residual maturity to foreign exchange reserves is very close to the required full coverage, although unlike last year this indicator in 2012 has seen a slight deterioration.

Yet, clearly there appeared after 2008 a decline of the dynamics of the Macedonian economy with simultaneous growth of public debt, especially domestic public debt. Of course, given the low prior indebtedness there was sufficient space to increase the effective aggregate demand through financing public investment by increasing public debt, which in recession conditions can be recommended measure. Moreover, since it was observed that the increase in the structural primary deficit in terms of a negative output gap, it can be estimated that the fiscal policy in 2012 was aimed at counter and home support demand. The increased demand for financing the deficit in unfavorable global environment conditions and difficult access to international financial markets have led to an increased presence of the state in the domestic capital market. Thus, the total realization of the primary market for government securities in 2012 equaled 24.9% of GDP, a doubling compared with previous year. In 2012, the total debt of the central government increased by 21.8% compared to 2011 and reached 2.545 million Euros. Moreover, the share of central government debt to GDP rose to 33.8% from 27.8% in previous year. Annual growth in debt was due to the growth the national debt (about 83.9%), while the external debt recorded low annual change of 1.9%. Regarding the structure of the debt, such changes caused a significant increase in the share of domestic debt to GDP (12.4% of compared to 6.8% in 2011) and a moderate increase in the share of external debt.

5. Conclusion

Our findings should not be interpreted as a suggestion that debt accumulation is not a relevant policy issue or that high debt levels are not a serious problem. First of all, stating that there is no evidence that debt has an effect on economic growth is different from stating that there is evidence that debt has no effect on economic growth. Second, there are different ways through which a large public debt may harm the economy. We suggest that a fully solvent government with a high level of debt may decide to put in place restrictive fiscal policies to reduce the probability that a sudden change in investors' sentiments would push the country towards a bad equilibrium. These policies, in turn, may reduce growth, especially if implemented during a recession. In this case, it would be true that debt reduces growth, but only because highlevels of debt lead to contractionary policies. While such an interpretation would justify longterm policies aimed at reducing debt levels, it also implies that countries should not implement restrictive policies in the middle of a crisis.

In our view, future research on the links between public debt and economic growth should focus on cross-country heterogeneity and on the mechanisms and transmission channels through which public debt may hinder economic growth.

Addressing the latter point would require a unified theory aimed at explaining under what conditions and through which mechanisms debt may reduce economic growth.

The relationship between debt and growth is characterized by large cross country heterogeneity and may also vary over time within countries. The way in which debt affects growth may depend on institutional quality, on the dimension of the public sector, on how and why debt has been accumulated, and on the structure and composition of the public debt.

After average annual growth of just 2 percent in 2010 and 2011, and mirroring Eurozone developments, in the first half of 2012 SEE6 countries again entered recession**.** Led by Serbia, which accounts for almost half of SEE6 GDP, regional economic activity faltered in part because of the severe winter but also because of severely shrinking demand, both external and domestic. Interestingly, over a longer period SEE6 countries seem on average to have run countercyclical fiscal policies, but the surpluses were too small to provide much room for maneuver during a prolonged crisis. In Serbia, Albania, and, the public debt is too high. BIH, Kosovo, and Macedonia all seem to be well within sustainable levels of public debt. In several countries debt refinancing - especially of short-term issues - will contribute considerably to gross financing requirements. So far, SEE6 countries have been able to roll over their debt, but whether they can continue to do so depends on market confidence. Some countries also have large amounts for long-term bonds due in late 2012 and early 2013.

We are finding that conservative fiscal, monetary and financial policies gave the Macedonian authorities policy space to confront spillovers from the global crisis - balance of payments pressures early on in the crisis were managed successfully, reserves were reinforced, and looser fiscal policy has supported weak domestic and external demand. As a result, Macedonia avoided large declines in output and disruptive capital outflows, and is well-positioned to return to growth when the recovery in Europe sets in.

Moderate economic growth of 2 percent in 2013 is still achievable, but subject to substantial downside risks. As the external environment remains difficult and as signs of recovery in the Macedonian economy remain fragile, policies should remain supportive in the near term, particularly since there are no exchange rate imbalances. In that respect, the 3.5 percent of GDP cash deficit target for the central government in 2013 as well as current monetary policy settings are appropriate.

As growth returns, Macedonia should aim to rebuild some fiscal space for future countercyclical responses, by gradually lowering debt levels. The debt trajectory should take into account the fact that safe debt levels depend on country specific characteristics such as low and volatile revenue ratios and low growth.

Macedonia should continue to keep a proactive policy to create aggregate demand through financing public investments during the global crisis. It as secondary indebted country still has possibility to increase the public debt but the very careful way. It means that it needs careful structuring of public debt to creditors on the one hand, and public financing of exclusively productive investments manner with the short to medium term multiplier effect on the private sector of the Macedonian economy.

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PRIVREDNI RAST, RECESIJA I JAVNI DUG U ZEMLJAMA ZAPADNOG BALKANA I MAKEDONIJI

Rezime*: Na početku se javlja pitanje šta nam ekonomska teorija govori o vezi između javnog duga i ekonomskog rasta. Međutim, uzročnost je teško uspostaviti, i u našem razmatranju empirijskih dokaza ne postoji rad koji može dokazati uzročnu vezu javnog duga i privrednog rasta. U nekoliko zemalja refinansiranje duga, posebno kratkoročno, doprineće značajno bruto zahtevima finansiranja. Zadatak je da se identifikuju razlozi da makedonska privreda ne pada za vreme globalnie krize, ali, još je bitnija uloga vlade i monetarnih vlasti u dizajniranju mera i podsticaja ekonomskog rasta u stanju recesije kroz kreiranje efikasne agregatne tražnje kroz finansiranje investicija u javnom sektoru.*

Ključne reči: *javni dug, recesija, privredni rast*

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COMPETITIVE DIALOGUE AS AN INSTRUMENT FOR THE IMPLEMENTATION OF PUBLIC-PRIVATE PARTNERSHIPS IN THE REPUBLIC OF SERBIA

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Abstract: The competitive dialogue ("CD") as a method of procurement of public-private partnership ("PPP") is relevant method of selecting a private partner in cases where the public sector knows the goal wanted to be achieved by the project, but lacks the knowledge about the means and methods necessary to be applied for its achievement. Both PPP and CD as one of the instruments for their implementation are novelties in the Republic of Serbia. Therefore, the paper analyzes legal and institutional framework for PPPs, as well as the procedures for their realization, emphasizing the procedure of CD. The aim of the research is to contribute and to encourage the public sector to use CD as complex but useful concept, particularly in countries in transition, by analyzing important legal and economic aspects as main drivers and advantages of CD.

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1. Introduction - Public Private Partnership (PPP)

What is PPP? - During the 1970s and 1980s known as a period of macroeconomic dislocation, there was a growing concern about the level of public debt which grew rapidly. At the same time, this concern triggered the awareness on methods of public procurement (spending) used traditionally as well as on necessity to reduce public spending while providing public goods and services. Governments were eager to find an alternative method of procurement, involving more and more private sector potentials. In that way, most of the projects implemented in partnership between public and private sector were negotiated individually, as one-off deals, and much of this activity began in the early 1990s. The success of the approach, known later as "Public-Private Partnerships" (PPP), spread from one country to another with variations linked mostly to the national legislation framework. However, in the EU there is no common explicit legal framework that would regulate PPP and also, there is no single definition of PPP. According to the Green Paper on PPPs and Community Law on Public Contracts and Concessions , "*… the term (PPP) refers to forms of cooperation between public authorities and the world of business which aim to ensure the funding, construction, renovation, management or maintenance of an infrastructure or the provision of a service* " (Green Paper on PPP and Concessions, 2004, p. 3).

PPP in Serbian Legislation. Serbian legislation related to PPP is based on two main pillars: the Law on Public-Private Partnership and Concessions (2011) and Law on Public Procurement (2012). The Law on Public-Private Partnership and Concessions is stipulating the definition of PPP as *"…long-term cooperation between public and private partner with aim to provide financing, construction, reconstruction, management or operation of infrastructure and other objects of public interest as well as delivery of services of public interest which may be contractual and institutional"* (Official Gazette of the Republic of Serbia, No. 88/2011). In both contractual and institutional form of PPP, before entering the process of private partner selection (public tender), public body is obliged to have a consent or positive opinion on whether the project proposal can be implemented through PPP concept or not issued by the Commission for PPP of the Republic of Serbia, the main PPP Task Force and base of the national institutional framework for PPP.

According to which procedures PPP is implemented? Serbian Legislation distinguishes two ways of procedures of PPP implementation, depending on the types of PPP:

a) If the project comprises elements of concessions, the procedure to be implemented for the award of the public contract is the one defined by the Law on Public Private Partnerships and Concessions.

b) If the project does not have elements of concessions, then the procedure to be applied for the contract award is the one stipulated by the Law on Public Procurement.

What is common to both of these procedures are general terms and conditions that apply to contract award procedure. That starts with a general requirement that the following principles should be applied to all public procurements: equal treatment, non-discrimination, transparency. These principles are followed by the requirement for public procurement of an appropriate type and value to be advertised openly in domestic and international arena. Eventually, fairness and openness of bidding criteria and criteria for selecting and awarding projects, as well as dispute resolution systems, are very important standards that are defined and have to be met in both procedures described in the Law on Public-Private Partnerships and Concessions and Law on Public Procurement. Both laws set the following procedures for contract award:

- Open procedure
- Restricted procedure
- Qualification procedure
- Negotiated procedure with public announcement for submission of proposals
- Negotiated procedure without public announcement for submission of proposals
- Competitive dialogue
- Concourse for design
- Procedure for public procurement of small value.

It is important to mention that these laws introduced new technique in the field of public procurement in the Republic of Serbia - Competitive Dialogue procedure. In other words, the Republic of Serbia introduced the CD procedure through enacting the Law on Public-Private Partnership and Concessions (Official Gazette of Republic of Serbia, No. 88/2011) and elaborated in the Law on Public Procurement (Official Gazette of Republic of Serbia, No. 124/12).

2. Competitive Dialogue as an Instrument of Implementation of Public-Private Partnership (PPP)

3. About Competitive Dialogue (CD)

There were many findings that the “old” Directives, Directives 92/50/EEC, 93/36/EEC and 93/37/EEC, *“do not offer sufficient flexibility with certain particularly complex projects due to the fact that the use of negotiated procedures with publication of a contract note is limited solely on the cases exhaustively listed in those Directives”* (Explanatory Note – Competitive Dialogue – Classic Directive, EC Directorate General Internal Market and Services, p.1). In March 2004, the European Commission published Directive 2004/18/EC on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts (Public Service Directive, hereinafter also: “Classic Directive”). The term “Classic Directive” is used extensively in order to differentiate Public Service Directive from the

Directive 2004/17/EC of the European Parliament and of the Council of 31 March 2004 coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors ("Special Directive"). Special Directive applies to public procurement contracts concluded by a contracting authority in the sectors in question for supplies, services, works, which are not exceptionally excluded by this Directive. However, in contrast to the Classic Directive, this Directive does not apply to works concessions.

Classic Directive beside other issues, introduced the new procurement procedure – Competitive Dialogue procedure. In that time, it was foreseen that it would largely replace the negotiated procedure except for *"the most exceptional projects"* (OGC/HMT Guidance on Competitive Dialogue, 2008, pp. 3). The main goal of competitive dialogue procedure (hereinafter: CD procedure) is to provide the procurement procedure suitable for the complex project for which established and common modalities of procurement are not eligible. The target of CD procedure is, among others, the realization of projects involving public authorities and private partner in the framework of public private partnership concept.

Therefore, CD procedure is used for major computer networks, integrated transport systems, complex framework agreements, Private Finance Initiative and other forms of Public Private Partnerships. The legislation *"…has therefore set itself the objective of providing for a flexible procedure which provides not only competition between economic operators but also the need for the contracting authorities to discuss all aspects of the contract with each candidate"(*Classic Directive, 2004, Recital 31).

Since the introduction through Classic Directive, CD process acquired the legitimacy in the discourse of PPP procurement. For example, in France at the moment 88 projects are in the phase of CD procedure. In the Netherlands during the period from 2006 to 2012, the competitive dialogue was applied 27 times, while CD procedure was applied for the "*procurement of most Danish PPP projects to date*" (PPP in Transport, 2013, p. 47). Competitive Dialogue is also elaborated as the tool for procurement of PPP project on the universal level, not only in the EU.

According to the study on the procurement procedures used in PPP procurement across Europe with a particular focus on CD conducted by the European PPP Expertise Centre, 24 EPEC members in Europe were asked to fill in the questionnaire on PPP procurement practices in their jurisdictions. The outcome of the questionnaire is: 17 responses were received as answer to Part I of the questionnaire (General Procurement issues) and 12 responses to Part II (Competitive Dialogue). The outcome received includes "*most of the countries in Europe that have significant experience in the use of CD*" (A review of the public sector's practices across the EU, 2010, pp.4).

Table 1 How Frequently CD Appear to be in Use to Procure PPPs in EU Countries?

Level of frequency (measured by number of deals)	Respondents (percentage)
1. Frequently	60% of the respondents report using CD frequently
2. At least occasionally	12%
3. Never use CD	28%

Source: EPEC/European Investment Bank

As the results of the study show, all of the procurement procedures provided for in the Procurement Directive appear to be in use to procure PPPs. Most frequently used procedure is the CD procedure, as presented in the Table 1.

3.1. Terms and Conditions to Use CD

In order to benefit from potentials of the use of the CD procedure in PPP implementation, the projects have to meet certain "preconditions", otherwise, the use of the CD will not be appropriate and the added cost of the CD procedure (compared to other procedures) will not be justified by the potential outcome improvements. Regarding the circumstances under which the CD can be used, commonly present are the following:

- When open or restricted procedure do not allow award of the contract, due to the extraordinary complexity of the project.
- Technical complexity of the project. CD is particularly useful for complex facilities or buildings where functional design or technology is critical to the success of a project but where many means to realize the goals are available, e.g. prisons, hospitals.
- Financial and legal complexity
- Additional requirements. In Serbian legislation, consent of the Public Procurement State Office is necessary.

The purpose of introducing the Competitive Dialogue is based on Classic Directive recitals and stems from the need the flexible procedure to be provided suitable to secure the competition between private economic actors, on the one side, and enabling at the same time the contracting authority to discuss the all relevant aspects of the project with every bidder.

The CD procedure applies by particularly complex contracts, as defined in the Classic Directive, Art. 29 § 1. Although the CD procedure is by the European Commission seen as the ideal method for the procurement of PPP project and therefore enjoys impetus of political nature, the Classic Directive provides only the general direction for the national legislators.

The first direction is contained in Art. 1 § 11, Point c) of the Classic Directive prescribing that a public contract is considered to be ‘particularly complex’ where the contracting authorities: are not objectively able to define the technical means or capable of satisfying their needs or objectives, and/or are not objectively able to specify the legal and/or financial make-up of a project.

In order to define if contracting authority is lacking the capacity to realize the PPP project without participation of private parties, it is crucial to know what level of knowledge would be necessary for the third party in the similar situation. The incapacity is objective if, for example, PPP for which procurement the CD procedure is initiated is (alternatively): the first of the kind; causing unreasonable costs for the contracting authority; depending on the specific knowledge which could not be acquired by contracting authority without time and cost beyond reasonable considerations.

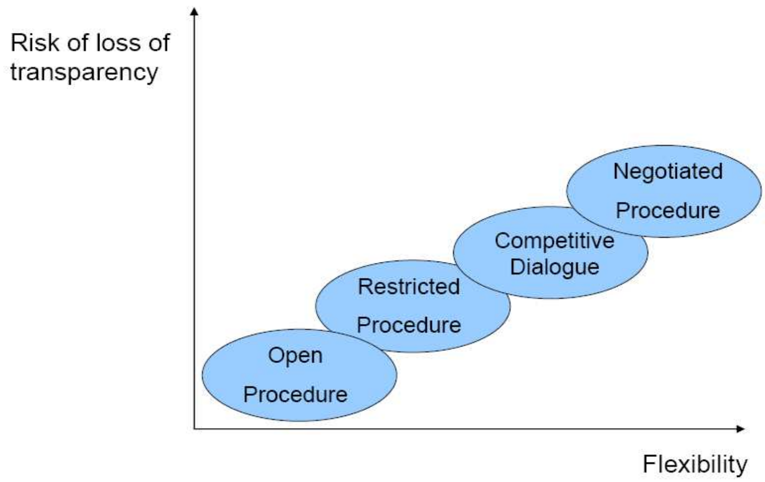
The contracting authority is not obliged to obtain countless expert opinion on whether the PPP objectives can be described sufficiently clearly from a technical perspective. The discretion on the side of contracting authority is borderless: contracting authority should take all necessary steps (judged in accordance with “best effort” criteria), to obtain the necessary knowledge before the start of procurement, not only during the tender procedure.

Second direction is contained in recital 31 of the Classical Directive Preamble. It is prescribed that "particularly complex contract" exists when it comes to important integrated transport infrastructure projects, large computer networks or projects involving complex and structured financing. For those three types of projects there is rebuttable presumption that those projects are “particularly complex” in the sense of par. 2. Art. 29. of Classical Directive. Consequentially, the PPP projects intended to build schools, sport venues or similar objects are not presumably “particularly complex contracts” in the sense in which the projects which object is listed in the recital 31of the Classic Directive Preamble are. Therefore, for the PPP projects placed outside definition of the abovementioned recital to be procured using the CD procedure, it is necessary to prove the “complexity” feature (on the basis of the circumstances of the concrete case at stake and comparison with the similar projects).

3.2. Relationship with Other Types of Procurement Procedure

EU legislation provides for four procurement procedures: open, restricted, negotiated and competitive dialogue. It should be noted that these procedures are not defined particularly for PPP: they apply to all goods, works or services contracts. Various factors lead contracting authority in the decision making process of the preferred procurement procedure. The open and restricted procedures are used for simple projects; for the more complex projects - the more flexible competitive dialogue or negotiated procedure will be used. The presumably applicable procurement modalities are in the Classic Directive the open and restricted procedure, while negotiated procedure and the CD procedure are conducted under defined conditions. This range of choices is related also to the issue of the so-called „trade-off" between the risk of transparency loss and flexibility, as shown below in Illustration 1:

Illustration 1 "Trade-off" between the Risk of Transparency Loss and Flexibility in Procurement Procedures



Source: EPEC/European Investment Bank

Beside the issue of trade-off between the risk of transparency loss and flexibility in general, particularly meaningful is the relationship between the CD and other procedures. Namely, in terms of PPP implementation the important issue is to find the hierarchy of implementation between the CD procedure and negotiated procedure. Both created to be the tool for procurement of complex, time-consuming, financially demanding projects with significant engagement of public interest, the abovementioned procedure differs in their course. Namely, the negotiated procedure allocates the responsibilities for and cost of determination of essential elements of PPP project proposal (elements relevant for the considerations and judging the quality and suitability of the proposal) on the contracting authority. By competitive dialogue, however, the costs and responsibilities are allocated on private actors participating at the procedure.

The Classic Directive gives the hierarchical advantage to the competitive dialogue in relation to the negotiated procedure. However, in the implementation procedure there are the examples (Germany) that national authorities did not accepted the supremacy of competitive dialogue over negotiated procedure. The justification for the departure of the solution as defined in Classic directive is found in the wording of art. 29 of the Directive: " *In the case of particularly complex contracts, Member States may provide that where contracting authorities consider that the use of the open or restricted procedure will not allow the award of the contract, the latter may make use of the competitive dialogue in accordance with this Article"*. There is no breach of the Classic Directive since the Article 29 introduces Competitive Dialogue with the words "may provide". Hence the introduction of CD is not obligatory, but facultative. To secure and preserve *effet utile* of the Classic Directive, it is enough to provide the possibility of competitive dialogue, not to insist on its priority in application over the negotiated procedure.

So, the hierarchy between competitive dialogue and negotiated procedure is not the part of the requirement. In particular circumstances the CD procedure may have not been the part of the national legal instruments if the state finds negotiated procedure efficient and purposeful for the complex, long term and financially demanding projects such PPP.

4. The Analysis of the Course of the CD Procedure

According to the Classic Directive, the competitive dialogue begins with the publication of a notice in the EU Official Journal. Notice is the form for definition of ideas and requirements of contracting authority regarding the project which is the object of the procurement. In case that more elaborated data about project are available, it is possible for contracting authority to attach additional description of the projects features. The recommendation is to be cautious regarding the requirements directed toward potential bidders: namely, changing of once given procurement criteria is inadmissible. Consequently, it is also important to stress, the public body as a contracting authority is to the end bound to the (robust) award criteria set at the beginning of CD in the notice, in terms of content and ponderation. But, at that point (zero point in terms of knowledge) contracting authority is not objectively in the position to know which technical, legal or financial solution for its PPP could be suitable.

Just like in the negotiation process, there is also a pre-qualification phase of the competitive dialogue, during which contracting authority selects first favorite among the unlimited number of applicants. At this phase, also has the function of aptitude/eligibility test. The particular significance of the competitive dialogue, in contrast to the negotiation process, however, is that the goal of the dialogue is not only to identify those companies that promise a flawless performance, but also the bidders able to present the contract content and technological variations already in the preliminary stages of dialogue. The filter is based on the criteria set out in the notice, criteria that have to be meticulously demonstrated by all applicants. The contracting authority is free to structure the dialogue. He can provide, for example, that the dialogue is conducted and completed in successive stages in order to successively reduce the number of solutions to be discussed during the dialogue stage.

A dialogue leads further in order to help the contracting authority and dialogue participants to negotiate about content and conditions for task realization until is clear: how to achieve the wished performance; on what terms the dialogue partners should provide the mutual actions; allocation of duties and responsibilities. The dialogue is a dynamic process in which the contracting authority has to ensure the disclosure of project-specific information, but at the same time the information lie behind the particular approaches of the dialogue partners must be treated confidentially. Dialogue phase ends with one or more solutions eligible to achieve the object of PPP. The dialogue phase can also end with the finding that no suitable solution was identified.

The companies that have completed successfully the dialogue phase are invited to make the offer. The approaches and solutions reached during the dialogue are the basis for the bid. The offer shall contain all the details necessary for implementation of the project. The contracting authority may require clarifications and additional information to be include in the bid. The risk of incompleteness is burden by the bidder. The know-how already rudimentary disclosed during the dialogue phase must be fully disclosed in the bid, insofar the content of the task this requires.

Contracting authority has to assess the bids within a reasonable time. The bid(s) should be made in writing and in accordance with the provisions laid down in the contract notice. The “preferred-bidder” is in position that even after it is characterized as the “chosen one” to explain certain details of the offer or to confirm the taken commitments. The award made to accept an *aliud* or “something-else-solution” which is not based on the results of the dialogue phase is excluded. The bid phase of the competitive dialogue ends with the decision of the contracting authority to determine the suitable offer. Before a contract is concluded the 14-day waiting (standstill, “Alcatel clause”) period must be complied with, in order competitors to be informed shortly before the end of the tender which company is awarded the contract and what is the justification of such award.

5. Legal and Economic Aspects of Strengths and Challenges of the Competitive Dialogue

From a public body (contracting authority) perspective, a number of positive aspects of CD are the motivation to launch it. According to the results of the study conducted by the EPEC/EIB, the following positive aspects of the competitive dialogue procedure are reported by the countries that use it relatively frequently compared to alternative procurement procedures (European PPP Expertise Center, p. 5):

- Improved communication between the contracting authority and the bidders. This leads to result in final solutions that better fit the needs of the contracting authority.
- Enhanced competitive tension
- Better priced discipline
- Fostering and bringing innovations
- CD implementation in general does not expose the contracting authority to greater risk of legal challenges than alternative procurement procedure.

In comparison with other available procurement procedure, the CD procedure offers to the contracting authority the highest level of flexibility in finding the best solution for the proposed PPP. The contracting authority is in the course of the competitive dialogue completely free to make the allocation duties using the criteria of the particular knowledge of private bidders (actors). The need for coordination (including the development of extensive contract structures), which by other procurement methods (types) lays by the contracting authority: the coordination has to be provided in advance and in the preliminary phases of the procurement. The need for coordination (as well the cost of its conducting) is reduced significantly in the CD procedure since it is also partially handled by the private bidder. Thus, the competitive dialogue allows the government to behave in PPP almost like a private person, who wants to meet a specific need using the market and inquiring by various providers for potential solutions.

However, the procedure provided in this dialogue phase leads to a tension between the public interest emanated in the demand the best possible solution (from the public point of view) to be achieved, on the one side, and the interest of the CD participant to secure confidential treatment of their technological and managerial know-how on the other side. Of course, the contracting authority is obliged to confidentiality when it comes to conceptual, technical and pricing solution proposals by individual dialogue partners. Therefore, the contracting authority has to be careful not to interfere with the crypto-competition among bidders providing them with the information about the solution proposed by other competitors.

The knowledge of contracting authority during the competitive dialogue is much lower than in the negotiation process. In this premise lies the importance of CD procedure: it enables contracting authority to continuously improve its knowledge of a possible solution by exchanging the consideration with several partners in dialogue about the legal, technical and financial structure of PPP.

The contracting authority uses the knowledge gained from a dialogue in the ensuing dialogue, thus gaining the necessary detailed knowledge about the object of procurement. In this procedure a know-how transfer takes place, inevitably taking into consideration the structure and conditions on the application of competitive dialogue. Namely, by the CD procedure it is impossible for the contracting authority at the beginning of the procurement to determine sufficiently specific the content of PPP-performance. Therefore, contracting authority rather must rely on the knowledge of the bidder to determine sufficiently and concretely the content of PPP-performance.

The abovementioned conditions for the use of CD causes the following: the preparation of offer and the whole procedure is much more expensive for the bidder than in the negotiated procedure. Namely, the contracting authority is not (and should not be) able to create a full and exhaustive data sheet about the project performance and features. Rather it is the bidder the one who must conceptualize all particularities necessary for the implementation of the project in the competitive bid. What is by the other procurement result of external consultant’s involvement or the task for the mobilized in-house professionals, in CD option is on the burden of private actor. Therefore, its cost rises. This may imply that SMEs are often not in the position to participate in a PPP tender. The reversal of cost characteristics for the CD procedure toward the private party (in comparison with the other types of procedure) increase and emphasize the tendency of restricted circle of companies eligible to be part of PPP - the large ones.

To conclude with, the Competitive Dialogue raises the question of how different offer content should be properly assessed, for example, if A and B are equally acceptable solution for the realization of the same PPP. The variety of offers makes their evaluation even more difficult and increases the risk of legal challenges in the competitive dialogue. No other procurement procedure is therefore more predestined to incline toward judicial and administrative review proceedings. The taxes and attorney's fees for such a verification procedure that must be carried by either the public or the private side, increase the risks and transaction costs of the PPP.

6. Main Considerations – Potentials for CD Implementation in the Republic of Serbia

All procurement procedures provided for in the legislation should be used to procure PPP projects in Serbia, as it is the practice in other countries. Which procedure will be used, depends mostly on the complexity of the project and other factors.

From a bidder perspective, the motivation to participate in a PPP project is usually defined by his/her expectations regarding the experience and the extent of preparedness of the public body as a contracting authority, the perceived project certainty and bid cost estimates rather than by the procurement procedure chosen. But, from a public body (contracting authority) perspective, a number of positive aspects of CD are the motivation to launch this procedure and not alternative ones. CD allows:

- Improved communication between the contracting authority and the bidders.
- Final solutions that better fit the needs of the contracting authority
- Enhanced competitive tension
- Better priced discipline
- Fostering and bringing innovations
- CD implementation in general does not expose the contracting authority to greater risk of legal challenges than alternative procurement procedure.

However, CD should not be taken as a "one fits all" option for PPP implementation. Furthermore, there are some concerns regarding the use of CD and the main are: a) CD is perceived as a complex procedure, with a negative impact on procurement cost and time, and b) CD is perceived as lacking flexibility and/or clarity and having insufficient capacity to adjust to changed circumstances.

For these reasons, the public sector in the Republic of Serbia should be encouraged to take a case by case approach on whether CD is likely to deliver the best results and to be objective in decision-making process. Although the PPP implementation through the CD procedure has various challenges, it is crucial to keep strengthening the public sector awareness and knowledge of the CD procedure and its potential and advantages. In addition, it is very important to support capacity and ability of the public sector, particularly at the level of the local self-governments to deal with CD as a novelty in terms of qualifications, training and staff resources.

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KONKURENTSKI DIJALOG KAO INSTRUMENT PRIMENE JAVNO-PRIVATNOG PARTNERSTVA U REPUBLICI SRBIJI

Apstrakt: *Konkurentski dijalog (competitive dialogue - "CD") kao način nabavke u javno-privatnom partnerstvu (public-private partnership - "PPP") je značajan metod za izbor privatnog partnera u slučajevima kada javni sektor zna ciljeve koje želi da postigne projektom, ali ne raspolaže znanjima o načinima i metodima koji se moraju primeniti za dostizanje istih. I PPP i CD kao jedan od načina za njihovo sprovođenje predstavljaju novitete u Republici Srbiji. Zato, ovaj rad analizira zakonski i institucionalni okvir za PPPs, kao i procedure za njihovo sprovođenje, posebno naglašavajući proceduru CD. Cilj istraživanja je da pruži doprinos javnom sektoru i da ga ohrabri da primenjuje CD kao kompleksan ali vrlo koristan koncept, naročito u zemljama u tranziciji, analizirajući važne pravne i ekonomske aspekte kao glavne pokretače i prednosti CD.*

Ključne reči: *Javno-privatno partnerstvo, konkurentski dijalog, javni sektor.*

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AN ANALYSIS OF NATIONAL COMPETITIVENESS THROUGH THE PRISM OF FOREIGN DIRECT INVESTMENT

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Abstract: The importance of foreign direct investment in the process of economic development of the host country does not end with the transfer of capital as a necessary component for the growth, but also in the transfer of intangible resources of development. Transfer of capital through foreign direct investment has a direct impact on increasing national competitiveness, since its engagement in fixed investment raises the level of employment, increasing production, exports, but the transfer of intangible resources package achieves an indirect impact on improving the competitive performances. The link between foreign direct investment and national competitiveness is causal: foreign direct investment in the host country may potentially contribute to increasing national competitiveness, and vice versa, higher rankings of national competitiveness can be stimulating effect in attracting greater foreign direct investment flows. This paper will explain the relationship between these two variables, with special attention to their cause-and-effect relationship in the Republic of Serbia.

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1. Introduction

Problems in the field of economic development and finding the ways to solve them have been a constant preoccupation of economic policy makers of

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each country. This issue has been further complicated by the fact that there are many factors that act on this phenomenon with different intensity and, therefore, there is possibility to its observation from different angles.

In contemporary global environment, for many countries where the shortage of capital acts as a significant development barrier, foreign direct investment occurs very often as the only possible saving solution. It is well proven in practice that foreign direct investment is the dominant mode of movement of international private capital flows, which offers multiple opportunities to accelerate the pace of economic growth and raising the level of development of the host country.

However, regarding the effects of foreign direct investment on the host country economy, it is noticeable that the attitudes of researchers on this issue vary greatly. Analysis of the literature also demonstrates that just the biggest controversy in discussions about the activities of multinational corporations, as the institutional drivers of foreign direct investment, relates to the determination of the effects of their cross-border investment activities in the host country. The opinions of the researchers can range from very positive, those who treat foreign direct investment as a determinant of economic growth and development, to extremely negative, those who expose the suspicion and mistrust of the positive effects of cross-border investment activities of multinational corporations in the host country. On the other hand, the fact that foreign direct investment accompanied by both positive and negative effects on the economy of the host country indicates that these effects occur in reality at the same time, not isolated and independent of each other, makes it necessary to find a way to maximize effectuate positive and minimize the negative effects.

It is general known that for the developing countries and countries in transition foreign direct investment is not a panacea for all development problems, but only a necessary evil, necessary step in the development path and catch up with the developed countries. The ratio of developing countries and countries in transition to the role of foreign direct investment in the process of economic development has changed over time, especially after the eighties of the 20th century. Among the key factors that have caused a change in their behaviour are:

- An increase in the quantum of private capital in the last decade of the 20th century. Foreign private capital during the nineties of the 20th century became the dominant source of capital for many developing countries. Private capital flows during the eighties of the 20th century accounted for only one-third of the total capital flows to developing countries. According to the World Bank, they now make up over 80% of the total capital that is being directed to developing countries. Motivated by the capabilities to create high profit, private capital flows will continue their further expansion, owing to the continuous process of the globalization of production, trade liberalization and financial integration (Jovanović, Radukić, Petrović-Ranđelobvić 2011, 102).

- In the last decade of the 20th century particular attention is attracted towards the expansion of multinational corporations in terms of number, size, as well as in terms of their impact on the global economy.
- Emphasized development character of foreign direct investments in the condition of declining of public international capital flows or foreign aid.

Foreign direct investment in developing countries and countries in transition are considered as the most effective tool for increasing productivity, employment and international competitiveness and a mechanism for raising the standard of living and reaching a dynamic economic growth. However, as stated above, foreign direct investment does not represent a "panacea" for all developmental problems nor large quantum of foreign direct investment in itself means a greater contribution to the achievement of positive developmental high score.

It is believed that foreign direct investment is one of the key development factors, since the benefits that host country achieves does not approves automatically. It can contribute to achieving long-term sustainable growth and development of the host country only under the condition of existence of right policy framework and investment climate that contributes to the achievement of the profit interests of foreign investors and is in the interest of development of the host country. The contribution of foreign direct investments to the realization of the objectives of economic growth and development, therefore, depends on their effective use, which are not only reflected in maximizing the benefits, yet in minimizing the costs which it generate in the host country.

According to the established goal the paper is structured as follows. After introduction the attention will be routed towards the explanation of the balance of payments effects of foreign direct investment. Further, the paper examines the problems that arised from the repatriations of profits will be discussed. In the third part, the paper establishes the relationship between foreign direct investment and national competitiveness. Special attention will be paid to the direct and indirect effects of FDI that affect the efficiency of markets, exports, GDP, and therefore the level of national competitiveness of the Republic of Serbia. In the conclusion brief review of the main remarks will be given.

2. The Balance of Payments Effects of Foreign Direct Investment

As an integral element of international private capital flows, foreign direct investment leaves certain consequences that are carried through the balance of payments of the host country. Since almost all the characteristics of a country reflect through the balance of payments in order to more clearly understand the impact of foreign direct investment on national competitiveness it is imposed as needs an assessment of the relationship between foreign direct investment and the balance of payments of the host country.

The basic premise of international finance is that capital flows move from developed countries, that are abound in capital, to developing countries, that lack in capital. In principle, the flow of capital from rich to poor countries is in the interest of the investor country and the host country of foreign direct investment. Benefits for the host country are reflected in the increase of capital accumulation as a source of funding for investment in physical and social infrastructure, thus creating conditions for increasing their productivity in the future. Benefits for the investor reflected in achieving higher returns on equity, given that the rate of return on invested capital is relatively higher in countries lacking capital.

The inflow of foreign capital in developing countries and countries in transition is a supplement to domestic savings, which increases the possibility to finance investments in the national economy. In other words, the inflow of foreign capital creates the conditions that the country consumes more than it produces and invests more of their own accumulation.

Based on the current account balance, as constitutional part of the balance of payments of a country, it can be estimated that the country spends more than it earns. So, by the deficit in foreign trade, a national economy is increasing its development potential and beyond accumulation stemming from the social product and national income. If the deficit in foreign trade exclusively treated as a supplement to domestic accumulation, then we can say that it happens only in order to support and accelerate economic growth and development.

The deficit can be financed by direct investment in specific investment projects, by foreign aid and borrowing of funds through the global capital market or from international financial institutions. Deficit financing by using foreign capital has profound economic sense if the foreign economic resources use effectively. In fact, they need to accelerate economic growth and to encourage structural transformation of the economy. For these reasons, it is considered that any involvement of foreign savings is economically justified only if the using of foreign funds gives rise to economic growth, apropos increase national income, in aggregate and per capita terms, and thus the accumulation of their own income make the singular reliance of development. "In this context, it should not conclude that a satisfactory rate of economic growth achievement simultaneously means hiring and termination of all forms of foreign savings. On the contrary, high rates of economic growth imply a high level of transfer of foreign capital, and vice versa expressed the dynamics of flow of domestic savings to foreign" (Cvetanović 200, 140).

On the other hand, encouraging the structural transformations by using foreign accumulation represents imperative to the efficient integration of an economy (an economy that is in the process of development) in the contemporary world economy. If the deficit in foreign trade is financed through foreign loans, it is of essential importance to in a such manner obtained additional accumulation from abroad strengthen export performance of the country, whereas the export can provide foreign currency for the regular servicing of foreign debt.

If we are guided by the premise that in the contemporary conditions foreign direct investment is main lever for accelerating economic development of developing countries and countries in transition, it is of great importance to understand the role of foreign direct investment in solving the balance of payments problems of these economies.

Transfer of capital in tangible and intangible forms through foreign direct investment achieved great development effects on the host country. Direct investment in the establishment of an affiliate wholly or majorly owned by multinational corporations through foreign direct investment creates the conditions for an increase in the employment rate in the host country, through the creation of new businesses and new jobs. In addition, if foreign direct investment is accompanied by technology transfer, there is an increase in productivity in the host country and increase in competitiveness, which directly affects the increase in the rate of economic growth in the host country. The growth rate of gross national product *per capita* means simultaneously and increasing possibility of saving (accumulation), and consequently, increasing investment opportunities in the host country and further increase the rate of economic growth. This sequence of events might affect that after a period of time an economy from a state of high debt and capital import, move to a country with great potential for the export of capital.

“Charles Kindleberger argues that the evolutionary path of economic development is characterized by four phases. In the first, the young debtor phase, country borrows abroad in order to start the investment cycle. In the phase of the mature debtor, used debts must be returned, so the country with the increase in the national product crosses to exporters of capital (young creditor). Finally, in the collection of loans, economy becomes mature creditor, thus completing the movement sinusoidally cycle with the national product at a much higher level” (Todorović 1998, 32).

Each stage of the development process is characterized by a certain change in the balance of payments situation. At the very beginning of the development process, in order to bridge the differences that exist between the investment opportunities and the size of their own accumulation, country that borrows has a deficit in the current account, and surplus in the capital part of balance of payments. In the mature stage of the debtor, when creating income and accumulating excess demand for investment, the country returns debt and the situation in the balance of payments deficit is characterized by surplus in current account and deficit of the capital part of balance of payments. At the stage of a young creditor, when a country exports capital, key characteristic of the balance of payments is surplus in the current account and deficit of the capital part of balance of payments, and vice versa in the mature stage of the creditor.

Therefore, it could be concluded that the inflow of foreign capital in the form of direct investment can contribute to solving the balance of payments disturbances in the short term. However, a big problem arises when performing the repatriation of profits from foreign affiliates to the home country, whereas repatriation conduces to the outflow of domestic capital accumulation that is part of the national income, with all of its negative repercussions for the host country.

3. Repatriation of Profit as the Ultimate Goal of Direct Investment Abroad - Issues and Problems

FDI possesses huge potential impact on growth performance and can make a major contribution to the improvement of the balance of payments situation and improvement of the competitiveness of the host country. However, the fact is that for multinational corporations, as carriers of foreign direct investment, repatriation of profit is the ultimate goal of taking direct investments abroad. The degree to which repatriation of profits is performed determines the size of the output of financial flows from the host country. This problem particularly came to the expression in the early seventies of the 20th century, when most of the developing countries adhered to a solid exchange control measures.

In the development interest of the host country of foreign direct investment is to retain foreign capital as long as possible in the country, and that the profits that affiliates of multinational corporations achieve reinvested in the host country. It is not rarely, as practice confirms, that with the measures of direct state regulation or law prescribing of various restrictions or even a ban on repatriation of profits and imposing obligations reinvesting profits in the host country generate counter-developmental effects on the host country.

In order to keep foreign capital as much longer and reinvestment of profits realized by affiliates of multinational corporations, the underdeveloped countries should consciously act to create more favourable conditions for attracting foreign direct investment (primarily the creation of a stable macroeconomic environment and minimize political risk) in order to create conditions for achieving primary motive investment (higher profits) and stimulate the process of reinvesting profits. This moment points to a strong positive correlation between the first two pillars of competitiveness (institutions and macroeconomic environment) and foreign direct investment. In fact, institutional development and macroeconomic stability are the basic prerequisites for larger inflows of quality foreign direct investment flows in the potential host country. “Globally, we can say that the history of international finance is mainly the result of reinvestment. There is a relatively small portion of fresh capital, which is included in the international financial flows” (Todorović 1998, 65).

From a time perspective, the balance of payments usually registers transactions at the time of transfer of ownership of the goods or financial claims between residents of a country and permanent residents of other countries. However, according to the fifth edition of the Balance of Payments Manual (IMF, 1993), there are cases where there is no change of ownership, or an exchange of currency between residents of a country and permanent residents of other countries. However, transactions are recognized and recorded in the balance of payments. Reinvested profits of affiliates in foreign ownership represent a typical example of the registration of transactions in the balance of payments. The returns on investment, whether distributed as dividends paid to the parent company or reinvested in the foreign affiliate into the host country, are included in the balance of payments as a deficit item of the current account. “It might seem paradoxical, but the countries that receive more foreign direct investment inflows, that reject the profits reinvested in the local economy, will be faced with a large deficit in the current account, and besides through the reinvestment of profits are hiring local inputs such as land, infrastructure without additional funding to foreign capital” (Brada, Tomšik 2003, 3).

Among the key factors that determine the degree of influence of the reinvested profits on the size of foreign trade deficits of the host country include the following:

(1) The factors which are quantitative in their nature. The higher inflows of foreign direct investment relative to the size of the national economy and the greater profitability of foreign companies, the larger the volume of financial assets can be reinvested in the affiliate in the host country.

(2) The factors related to, rightly we can say, the institutional characteristics of the investment country and the host country that determine the allocation of the total profits of affiliation into the dividends that are transferred to the parent company, and to assets dedicated for reinvestment in local affiliation. The following factors have an impact on making a decisions on the allocation of profit: the expected level of risk in the host country, the tax treatment of dividends in the home country of investors and in the host country, possibility of withdrawing the investor funds from affiliates through transfer pricing, as well as the attractiveness of alternative ways of financing investment needs of affiliations.

(3) The groups of factors associated with the financial life cycle of foreign direct investment in the host country, which determines the size of profit, as well as its distribution on dividends and reinvested profits.

“At the outset, the MNC makes an investment in the foreign country to found an affiliate. At first, the affiliate will operate at a loss. In the case of an acquisition, this period may be short if the acquired firm is, or can be easily reorganized to become, profitable. In the case of a greenfield investment, during the time taken to acquire a site, build and equip a production facility, train workers and begin production, the interest on the capital invested may result in sizable and longer lasting start-up losses. Thus, in the first stage, the affiliate operates at a loss and pays no dividends” (Brada, Tomšik 2003, 5).

In the second stage, the foreign affiliate started to achieve the profits, due to the impelling the production or enhancing the competitive performances by reason of making some internal organizational restructuring or using the competitive advantages of the parent firm. “However, as the affiliate becomes more successful on the market, it is likely to have significant needs for additional investment, both for working capital as well for increased plant and equipment. Thus, at first, all profits may be reinvested to meet these needs. As time passes and profits continue to grow, the parent firm may begin to require that the affiliate remits some of the profits in the form of dividends, although the monetary value of reinvested profits may continue to increase. The length of the second stage will in part depend on the size of the domestic market, which will determine for how long the affiliate can continue to expand its capacity, on the availability of export markets to the affiliate and on the attractiveness of alternative ways of financing the affiliate's expansion. In third stage, the affiliate has reached a “mature” stage where its market share and profit margins in the host country have stabilized. At this point, the parent firm will choose to repatriate a larger share of the profits in the form of dividends so that these funds can be used to finance investment opportunities that offer more dynamic prospects elsewhere, and reinvested earnings will decline both as a share of profits and absolutely” (Brada, Tomšik 2003, 5).

It is noteworthy that reinvestment of profits in developed and underdeveloped countries and countries in transition follows the time path similar to that described in advance, although the length of time which it takes to accomplish the transition from one to another stage of the financial cycle, or the tendency to reinvestment of profits in each session varies from country to country.

Foreign direct investment as a complex investment package has a number of advantages in relation to other forms of international movement of private capital that directly justifies the efforts of developing countries and countries in transition for the prolonged retention of foreign direct investment into the framework of their economic systems. One of the potential benefits of foreign direct investment relates on the providing the opportunities for the host country to engage in a global network of production and sales as well as facilitating access to foreign markets. Moreover, the development of cooperation between local companies and foreign affiliations, either in the form of vertical relations forward or backward, can contribute to increase the exports, improve the competitiveness and consequently, to improve the situation in the trade part of the balance of payments. Besides, the potential positive effects of the balance of payments may occur due to import substitution (hiring of foreign capital in fixed investment) and subsequent export expansion of part of the production from start-ups.

However, if the profits are reinvested there will not occur the positive balance of payments effects. Having in mind that the interests of foreign investors do not coincide with the interests of the host country, repatriation of profits, which occurs later, after the inflow of foreign direct investments, may contribute to the outflow of the part of the created accumulation, thus reducing the accumulative capacity of the host country and the ability to finance new investments, creating new jobs, increasing employment and productivity, and improve the competitiveness of the national economy. This directly indicates that measures of state regulation in the host country should act towards creating a persuasive investment environment in order to reinvest the realized profits, and host country enjoyed the full benefit from the presence of foreign investors.

4. Establish the Relationship between Foreign Direct Investment and National Competitiveness

From the point of view of GCI, establishing links between foreign direct investment and national competitiveness is not an easy task. The complexity of this problem is caused by the character of this index: it is a comprehensive index that takes into account the microeconomic and macroeconomic aspects of national competitiveness.

By subtle analysis, we may find that foreign direct investments interact with all 12 pillars of competitiveness, both in terms of the ability to attract these investments, and in terms of the effects that these investments generate. In fact, technological equipment, openness and market size occur as direct beneficiaries of the benefits from the presence of foreign direct investment, infrastructure, higher education and training, market efficiency, labour market efficiency goods and services generate indirect benefits, whereas they are a precondition for the inflow of foreign direct investment, while institutions and macroeconomic stability are a *conditio sine qua non* for attracting foreign direct investment. It is not a rare cae that the concepts of export performance and competitiveness are identified and treated synonymously.

“In one of his fundamental works, Porter (1998) argues that the level of national competitiveness is measured by two sets of indicators: (1) the presence of substantial and sustained exports to a range of countries as diverse and (2) significant presence of FDI outflows based on skills and assets created in the motherland. Certainly the simultaneous presence of these indicators is feasible only in developed economies, which already can afford to engage themselves in FDI. For developing countries, the share of exports is higher compared to that of FDI outflows in the general level of competitiveness” (Clipa 2013, 3).

The high degree of dependence between exports and competitiveness, according to the World Economic Forum, can be seen in the second phase, which includes economy based on efficiency (Serbia ranks among the efficiency driven economy). It is notable that 10 pillar of competitiveness, openness and market size, establishes a direct link between exports and national competitiveness.

Table 1 Foreign Trade in mil. EUR, 2001-2012.

	2001	*2002*	*2003*	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*	*2010*	*2011*	*2012*
Exports of goods	1.922,2	2.201,7	2.441,3	2.831,6	3.608,3	5.102,5	6.432,2	7.428,8	5.961,3	7.393,4	8.441,4	8.836,8
Exports of goods in%		14,5	10,9	16,0	27,4	41,4	26,1	15,5	-19,8	24,0	14,2	4,7
Exports of goods in EU	892,4	960,7	1.202,3	1.456,5	2.117,6	2.942,9	3.602,7	4.028,5	3.195,5	4.235,2	4.868,5	5.132,3
imports of goods	4.759,2	5.956,8	6.585,5	8.623,3	8.439,2	10.462,6	13.506,8	16.478,1	11.504,7	12.622,0	14.250,0	14.782,3
imports of goods in **%**		25,2	10,6	30,9	-2,1	24,0	29,1	22,0	-30,2	9,7	12,9	3,7
Imports of capital goods	-	-	-	2.495,3	1.971,6	2.429,8	3.495,9	2.965,1	2.038,6	2.335,9	2.807,2	2.922,4
Imports of intermediate goods	-	-	-	2.830,6	3.027,6	3.781,4	4.892,1	4.631,5	3.410,5	4.389,6	5.037,3	5.078,5
Trade deficit	-2.837,0	-3.755,1	-4.144,3	-5.791,7	-4.830,9	-5.360,1	-7.074,6	-9.049,3	-5.543,4	-5.228,6	-5.808,6	-5.945,6
The deficit of current trans. (Excluding grants)	282,4	-671,8	-1.345,4	-2.620,4	-1.778,6	-2.355,4	-5.052,5	-7.055,1	-1.910,1	-1.887,2	-2.870,0	-3.155,1
The deficit of current trans. (Excluding grants) as % of GDP	2,2	-4,2	-7,8	-13,8	-8,8	-10,1	-17,7	-21,6	-6,6	-6,7	-9,1	-10,5
Balance of payments, total	561,9	995,7	826,7	342,6	1.647,3	4.268,9	742,1	-1.686,6	2.363,5	-928,7	1.801,5	-1.137,2

Source: Ministry of Finance of the Republic of Serbia, 2013.

Based on the fact that the size of the country is one of those crucial factors that determine the amount of resources available for development and the degree of dependence of an economy from the outside world, it could be concluded that for the Serbia, as a relatively small country with limited resources, effective integration into the global economy is necessary to accelerate growth and development. This immediately suggests that increase in exports is an imperative to improve the economic performance of Serbian economy in the future and a key determinant to improve its competitiveness.

Analyzing the presented data it can be seen that despite the fact that the Serbian economy in the period before the global financial and economic crisis was characterized by relatively satisfactory macroeconomic performance, however looking at its external position it could be its continued deterioration scan be seen. Namely, percentage share of the current account deficit to GDP increased from -2.9% in 2001, to -22.1% in the 2008, mainly due to a deficit in foreign trade.

After 2008 with the negative spillover effects of the crisis on the Serbian economy, the value of key macroeconomic indicators deteriorated. It is notable that the contraction of foreign trade because of the crisis led to a reduction in the external current account deficit in 2009 by 70% compared to 2008. After 2009 due to the implementation of measures to mitigate the effects of the global financial and economic crisis in 2010, there is a recovery of economic dynamic. Positive movement in the field of foreign exchange confirmed by the fact that exports in 2010 was increased by 24% and imports decreased by 9.7% in regard to the previous year, which along with a high level of coverage of imports by exports (58.6%) resulted in the reduction of the deficit in trade balance of 5.228 million and the deficit of current account of 1.0% compared to 2009. During the 2011 and 2012 positive trends in the movement of the key macroeconomic indicators were recorded, while in the area of foreign trade is a visible growth trend of trade balance deficit.

An analysis of past experience proves unequivocally that as the key issues in the field of foreign trade can be identified: (1) a higher rate of import growth than export growth rate, which initiated the dynamic growth of the trade deficit, indicators of low competitiveness of the Serbian economy, (2) the high import dependence on exports, since export growth entails the growth of imports, (3) a constant trade deficit, which crucially affects the movement of the external current account deficit, and (4) the unfavourable structure of foreign trade, given that the export structure is dominated by labor- and resource-intensive products, whose leading position for a long period of time has been showing a slow and limited change in the structure of exports by factor intensity. In addition, insufficient quantum of inflows and unfavourable sectoral orientation of foreign direct investment, mainly to the service sector slow further complicate the issue and change the export structure towards increasing the share of products that would be competitive in the global market.

In the recent period of intense implementation of reforms, foreign direct investment served as a driver of growth and development of the Serbian economy and a key mechanism for resolving balance of payments difficulties, apropos the source off finance the current account deficits. However, the unsustainability of foreign direct investment, in terms of their sectoral orientation, indicate necessarily the importance of applying the economic policy measures aimed at encouraging the inflow of the kind of foreign direct investment that are geared towards the production and export of higher quality processed products. It also represents a requirement for dynamic growth of the Serbian economy, improvement of the balance of payments and improve its competitive performances.

5. FDI as a Factor of Improving of the Serbian Economy Competitiveness

Export performance and competitiveness are often regarded as synonymous. Just as a firm competitiveness can be measured by its sales or increasing market, competitiveness of a nation is identified by its export performance.

Indirect effects of FDI on exports of an economy can be found mainly in increasing the capacity of local firms to export, to meet international competition. Overall competitiveness is much improved by the exposure of a competitive environment in which MNCs have certain specific benefits related to export activity. If direct effect is easier to quantify, percentage calculations, indirect effects are generally resumed, in particular the determination and quantification is much more difficult, requiring in-depth analysis based on complex regression models. But it is important to note that the indirect mode of influence in time can gain the sense of macroeconomic dimensions of competitiveness, engaging demonstration effects through much of the economy sectors.

An interesting parallel is to track the evolution of FDI inflows and the Global Competitiveness Index, their relationship is already established. The following table shows evolution of indicators on FDI, national competitiveness and market size in the case of Serbia for the period of 2009-2013.

Table 2 Evolution of Indicators on FDI, National Competitiveness and Market Size in the Case of Serbia

	2009	**2010**	**2011**	**2012**	**2013**
FDI (mil. EUR)	1.372,5	860,1	1.826,9	231,9	278,6*
GCI	93	96	95	95	101
Market size	67	72	70	67	69

* Data for the period January-June 2013

Source: Author's review on the basis of WEF Reports and data of Ministry of Finance of the Republic of Serbia.

Before going further with this analysis,it is interesting to note that from the perspective of the 10th pillar of competitiveness, namely market size, in the last five years Serbia ranks from 72nd to 67th, which is very low in the hierarchy of competitiveness global (the middle of the list). Indicator of market size includes the level of exports, entitling us once again to support the link between FDI inflows and the level of competitiveness as it is calculated in the World Economic Forum.

Based on data for Serbia, we can say that during the global economic crisis, there has been a decline in FDI, which are now at a very low level. The decline in investment activity, in addition to maintaining stable the index of market size, is accompanied by a fall in the competitive position of the country.

Competitive advantages of Serbia are the following: infrastructure of primary health care (1st – 40th places), as well as the communication infrastructure, according to fixed telephone lines (37th place), mobile broadband subscriptions (41st place) and Internet bandwidth (29th place). In these segments, Serbia had previously recorded competitive advantages, but it is noticeable reduction in rank compared to the previous period. In addition, according to the tertiary education enrollment, Serbia is on a solid 50th position. Also, in area of goods market efficiency, Serbia has competitive advantages by number of procedures to start a business (47th), and imports as a percentage of GDP (42nd). In the labor market, there are a competitive advantage which applies only to the redundancy costs (23rd place) and the flexibility of wage determination (35th place), "because of that the whole of this segment of the market makes it uncompetitive, as evidenced by high unemployment and social tensions" (Petrović-Randjelović, Radukić, 2012, 42). Competitive advantage in financial market is realized only in the legal rights index where Serbia takes 42nd place.

However, the competitive disadvantages in all the components are very severe and are the main weaknesses of the competitiveness of Serbia. The main disadvantages are: the "brain drain" or the country capacity to retain and attract talent (146th and 147th place), administrative infrastructure and legal state (from 66th to 144th place), logistic infrastructure (from 95th to 139th place) and capital market (from 99th to 136th place). Within the administrative infrastructure, the most favorable position is realized in the field of business costs of terrorism (66th), but the least favorable position is recorded in the field of protection of minority shareholders' interests (144th) and the efficacy of corporate boards (138th).

In a sample of 148 countries, according to the level of competitiveness, Serbia has a very low rank. According to the degree of market orientation of the economy, in addition to a small number of competitive advantages Serbian economy (legal rights index, imports as a percentage of GDP and the number of procedures to start a business), there are a number of competitive disadvantages expressed primarily in the market for goods and services.

It should be noted that within this pillar of competitiveness (efficiency of the goods market - pillar 6th) there are indices that are related to foreign direct investments. According to the business impact of rules on FDI, Serbia is placed on 129th position, and to the prevalence of foreign ownership on 118th position. Thus, it can be concluded, among other things, that there are not enough foreign direct investments and the environment because their attraction is not attractive enough. This conclusion is confirmed by the value of the sub-indices of 10th pillar - market size. As mentioned previously, FDI contributes to GDP growth and increasing exports. According to the volume of GDP, Serbia is ranked 73rd, and to the volume of exports as a percentage of GDP ranks 71st, therefore, we are somewhere in the middle of the list. The main recommendation is that in future pay more attention to these economic policy measures that encourage FDI just because of their multiple direct and indirect effects.

Conclusion

The fact is that foreign direct investment is accompanied by both positive and negative effects that propagate simultaneously or out of phase in the host country economy. Based on this belief, the problem turns into a manipulation of these effects, so that the positive parts to be operated with maximum efficiency.

Linking Foreign Direct Investment inflows and competitiveness of a nation is not a very easy approach from the perspective of the Global Competitiveness Index. This is a fairly complex indicator, established following the analysis of twelve pillars. The World Economic Forum, assigning different weights, determines the following pillars: 1) institutions, 2) infrastructure, 3) macroeconomic environment, 4) health and primary education, 5) higher education and training, 6) goods market efficiency, 7) labor market efficiency, 8) financial market development, 9) technological readiness, 10) market size, 11) business sophistication, 12) innovation.

Going on the principle that the whole is more valuable than the parts separately, we can say that the interaction of these components is very important and they cannot operate effectively in isolation. Thus, the positive effects of FDI on a pile will spreads to others and create a spiral, which enhances the positive impact of investment.

This paper considers the relationship between foreign direct investment and national competitiveness in the case of Serbia and determines the proportional relationship between the two variables. In the period from 2009 to 2013 slight increase in foreign direct investment has been evident. Increase in the inflow in 2011 was the result of the application of anti-crisis measures of the Government of the Republic of Serbia and the first half of 2013 has seen a slight increase in the inflow, announcing gradual coming out of the recession. Along with this, the level of national competitiveness was at a constant level, while in the last year it decreased. Given the fact that Serbia is lagging behind other countries in the region in terms of foreign direct investment, as well as in terms of the level of competitiveness, Serbia should in the future pay more attention to economic policy measures aimed at achieving the best possible results in these fields.

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ANALIZA NACIONALNE KONKURENTNOSTI KROZ PRIZMU STRANIH DIREKTNIH INVESTICIJA

***Rezime**: Značaj stranih direktnih investicija u procesu privrednog razvoja zemlje domaćina ne iscrpljuje se samo u transferu kapitala, kao neophodne komponente za pokretanje razvoja, već i u transferu nematerijalnih resursa razvoja. Transfer kapitala preko stranih direktnih investicija direktno utiče na podizanje nacionalne konkurentnosti, budući da se njegovim angažovanjem u fiksne investicije podiže nivo zaposlenosti, pokreće proizvodnja, raste izvoz, dok se transferom paketa nematerijalnih resursa ostvaruje indirektni uticaj na poboljšanje konkurentskih performansi. Veza između stranih direktnih investicija i nacionalne konkurentnosti je uzročno-posledična: priliv stranih direktnih investicija u privredu zemlje domaćina može potencijalno doprineti podizanju nacionalne konkurentnosti, i obratno, viši rang nacionalne konkurentnosti stimulativno deluje na privlačenje većih tokova stranih direktnih investicija. U ovom radu biće objašnjenja veza između ove dve varijable, sa posebnim osvrtom na njihov uzročno-posledični odnos u Republici Srbiji.*

***Ključne reči:** nacionalna konkurentnost, strane direktne investicije, izvoz, efikasnost tržišta, Republika Srbija.*

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WHY HAS SERBIA REGULATED FACTORING TRANSACTION?

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Abstract: After numerous drafts and attempts Serbia has finally enacted the Law on Factoring on 16th of July 2013 becoming with this fact one of rare countries in Europe which has a lex specialis in factoring transactions. The factoring market in Serbia is seven years old, with 15 banks and factoring companies providing this type of short-fall financing service. Because of the non proprietary nature of the receivables in the civil law legal tradition factoring as the legal transplant in civil law countries has been adapted to the different legal environment by means of contractual legal techniques. First of the legal technique was the fiduciary transfer by assignment and other way was a security instrument which role is to overcome the lack of the proprietary effects of the assignments of the receivable. Those obstacles create a legal problems and uncertainties for implementation of the factoring agreements in all civil law countries as well as in Serbian legal environment. The solutions of new Serbian legislative in factoring intending to solve difficulties and legal obstacles in factoring practice in Serbia are analyzed in the paper.

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Introduction

Factoring started its history in the US as the commercial service where factors were commercial agents who would traditionally sell products and collect receivables for their principals. Financially, factoring acquired a special meaning by inclusion of financial aspect as a funding tool which developed as

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guarantee in respect of receivables. The core transaction of factoring services was the assignment of receivables which nature was twofold. From the legal standpoint, some of those transactions were outright sales of receivables or on the other side they were the security assignments of receivables. In the first case, loan given from the factor to the client was an advance prepayment for the receivable purchased by the factor, but in the second case loan given to the client was secured with the receivable assigned to the factor.

In European countries in the legal environment of civil law factoring agreement is a legal transplant that due to its advantages and despite its complex legal nature and business conclusion technique, expanded from its country of origin, the USA to civil law countries after the seventies of the century behind us. It came into being in the common law legal system as a business of buying out the rights to receivables with a discounted price, or by virtue of the technique of taking over the receivables as the form of providing the advanced payment. In the USA, factoring, on the basis of a specific real-legal treatment of receivables (receivables *in rem*), evolved as a business in which the entire risk was assumed by the factor, without the right to recourse in relation to the client.

Nevertheless, the duality of legal-contractual and real-legal structure of the factoring business, as the most complex legal issue of this unnamed agreement of the new *lex mercatoria*, posed numerous complex legal and practical questions in European countries. The most difficult of all was the one of how to enable providing effective legal protection and priority in factoring payment due to the inability of the effective agreement on selling receivables (since there is no modus that would be adequate for receivables as a non-material matter). The agreement on assigning receivables (cession) is, in most European countries, with all its limitations, most commonly used as *iustus titulus* of the factoring business. However, *modus acquirendi* was still missing for the effective transfer of the receivables to the new receiver in the form of factor. Receivables are an obligatory right and their assignment cannot create real legal effects per se. For this reason, business practice differently treated this issue in different national legislations taking into account the needs caused by differences. The cession of receivables as the legal basis of factoring was always supplemented with some other element that was always an instrument of the real-legal capacities of which would enable the priority of payment and the protection of the factor as the new creditor. These problems lead to the development of factoring with the right to recourse (recour factoring) where the responsibility for the payment was taken by the assignor of the receivables – the client.

In Serbia, factoring has been developing since 2007. Today, there are more than 15 banks and factoring houses that operate very successfully, using primarily bill of exchange and its real-legal capacities of effective collection and creditor protection.

The importance of the factoring market in Serbia was also recognized by the international factoring association International Factoring Group (IFG) that held the First Factoring Conference for South-East Europe in Belgrade on the 10th of April of this year where a considerable part was dedicated to the need of regulating this complex business in Serbia as well as in other Civil Law countries. In July of this year, Serbia got *lex specialis* – the Law on Factoring.

This work starts from the position that the duality of the legal nature of factoring is its obligatory character. Yet, the necessity to provide security by an instrument of real PROPERTY law creates a need to regulate this business by special legal regime in Civil Law legislations.

1. The Origins and Duality of the Legal Nature of the Factoring Business

Factoring represents a particular financial technique of discount character which is based on the obligation agreement between **the assignor** (creditor, exporter and client) and **the factor** (the bank or any other specialized institution – factoring house) and the essence of this business is the assignment of receivables and of the risk for collection from the client to the factor. Factoring is the product of the Anglo-American trade practice that evolved from the commission *del credere* business. The rise of modern factoring is associated with the development of the textile industry at the end of the 19th century in the USA and it was initiated by the introduction of customs restrictions for the former massive import of textile goods from England (Γαλάνης, B. (1994)). Having lost the opportunity to earn from the import of goods, trade agents started financing and crediting domestic American textile manufacturers in order to enable the activity of selling textile, which they were well acquainted with. For their own security, the manufacturers demanded from the trade agents collection guarantee by means of advanced payments. In time, the agents gradually moved from mediating selling to financing the production; thus, the so called factors, instead of giving advanced payment, started buying out their client's receivables (current and future ones) at a lower price. In that way out of commission agreement that was most commonly present in the form of *del credere* commission and by introducing credit elements, the new factoring agreement was created that in time, besides collecting payments and securing receivables, started having a service function as well. (Salinger, F.R. (1984) p. 27, Milenkovic-Kerkovic, T. (2008), p. 23)

This technique of collecting payments, crediting and securing payment very soon spread to other *common law* legal systems (Great Britain, the USA, Canada, Australia and so on) as well as to both the countries with the legal systems founded on the civil law (*ius civile*) like France, Germany, Italy and other European countries and the countries out of European continent the legal system of which is based on the postulates of the European civil law system, like Japan, Turkey and others.

The legal business of factoring represents a contractual relationship the matter of which is specific short-term financing or taking over the right to collect receivables due in the future with the maximum maturity deadline of 180 days. Moreover, this financial instrument also has an important crediting function as it represents an important technique of financing economic subjects so it emerges as an alternative to credit operations (Γεωργιάδης Σ, (2000), p.18). The client- assignor from the basic business gives the factor the right to collect receivables that they have toward the third parties and thus, renounces the rights in relation to their debtors, keeping the obligation to guarantee the existence (verity) of the receivables. (Dalhuisen, J. (2004), pp. 885-906, Salinger, F.R. (1999), p. 15, Goode, R. (1982) p. 338, Spirovic-Jovanovic, L. Milenkovic-Kerkovic T. (2009), pp. 278-291)

A stereotype perception of factoring as a method of collecting receivables is made far more complexly by its numerous functions. Apart from having the character of credit operation, factoring comprises four essential functions: **financing the client, book-keeping** (service "*outsourcing*" function of factoring), **securing collection** (which is *del credere* function of factoring as the risk of collecting is taken by the factor) and the very **collection of receivables**. The most significant international law source that regulates this business – the UNIDROIT Convention on International Factoring (Ottawa, 28th of May, 1988) defining factoring contract indicates that this is a transfer of receivables from the basic contract of sale concluded between the client and their debtor, where the factor performs at least two of the following functions: 1. Financing the client by crediting or advanced payment of the transferred receivables, 2. Book-keeping of the receivables, 3. Collecting receivables, securing the client from the risk of not being paid the receivables. Business practice, particularly abroad, indicates that factors perform other services for their clients, related to the transferred receivables such as analysis, examination of the debtor's creditworthiness, tax calculation, statistic records and the like. (Denčić-Mihajlov Ksenija, Milenković-Kerković Tamara (2011)p.420). However, other services can be included in the contract, only indirectly connected with factoring; for example, market research, advisory services and the others. (Houtte, H. (2005) p. 285) These additional services, performed by the factor, enable the client to dedicate themselves to their legal business, selling the products and performing services on the market. Factoring is most frequently used for short-term receivables (30 days to three months) while the factor's commission ranges depending on the solvency of the receivables and the kind of factoring agreement and amounts from 2,5 % to 5,5% for advanced financing. However, there are agreements in the business practice where the factoring fee is expressed in percentage, for example, 0,30 % of the nominal amount of the accepted invoice and its VAT. In addition, considering the fact that paying the VAT for the amount of factoring fee is still an open question in practice, it is common to include in the agreement that paying tax is the obligation of the client, i.e. assignor.

2. The Varieties and the Legal Techniques of the Factoring Agreement

Depending on the structure of contractual obligations in the factoring business, there are two possible ways of financing – by means of the so-called advanced financing, where the amount of receivables is paid to the client in advance and by means of discount financing. In case of **the advanced financing**, the factor keeps between 5 % and 30 % of the receivables on a separate account as the cover for possible complaints of the debtor on the basis of the quality of delivered goods or services and that retained amount of the security is paid back to the assignor either after the maturity of the invoice or after the payment, depending on the modality of factoring service. In case of **discount financing**, the factor pays the entire amount deduced for the fees (interests, payment risks, management of the receivables…). The amount of the fee usually ranges between 4, 5 % and 5,5 %. What is specific for Serbian factoring business practice is that the most frequent form of this kind of financing is the discount bill of exchange.

The trend of increasing use of factoring at the international level is very evident, so according to the data of IFC (Factors Chain International) that brings together 257 factoring houses from 68 countries, factoring turnover on the global level from 557 billion euros in 1999 till today has grown to nearly 1500 billion euros, where the factoring experienced the highest growth in Great Britain (the turnover of 240 billion euros), and the highest turnover was reached in Europe as compared to other continents with 806,9 billion euros in 2006 and nearly 1000 billion euros in 2010. Having reached an extremely high growth rate of 10 to 15 % annually in the period prior to 2008, factoring records a fall of 3 % in 2010 while Turkey indicates these new trends of growing with the growth rate of 140 % or 50 billion dollars. IFC data indicate that the total turnover that factoring achieved in Serbia amounts to 470 million euros in 2009, 90 % of which was realized in domestic factoring. The latest available data show a turnover of 680 million euros in 2010 with a high growth rate during 2011. It is estimated that despite the continuing growth of factoring in Serbia, the participation of this business in the gross domestic domestic product (GDP) amounts to only 1,5 % while the potential market would be 5 % of the GDP, which is about 1,5 billion euros.

These data indicate that the concept of factoring industry is becoming rather significant in domestic legal and economic literature as well as in the business practice. This work aims to indicate to the needs, ranges and modes of regulating factoring agreement in the Republic of Serbia *de lege ferenda* from the standpoint of business practice.

3. The State of Factoring Market in Serbia

Factoring agreement was a legal void of Serbian legislation, thus, this situation created a number of issues starting with the ones if it would be useful for international factoring operations to ratify the UNIDROIT Convention on International Factoring and thereby incorporate its solutions in the internal law, whether a specific factoring legislative is necessary and if so what would be the solutions of the specific factoring legislative, if it is necessary to predict the obligation of registering concluded factoring agreements or only to register the ceded receivables and others. Until legislation has been created, business practice, along with the existing legal framework, will be of utmost importance for the development of this instrument of financing economy. Therefore, this work will, after stating the current condition of factoring in Serbia, deal with the techniques and major characteristics of this obligation-legal instrument – factoring agreement.

The legal aspects of factoring are, at the national as well as at the international level, of immense importance for the implementation and presence of these transactions, primarily because of the difference between conceptual standpoints of the legal systems of the *common law* countries where factoring was created and those of the countries with the Roman legal tradition that had to coordinate the specific nature of factoring with the postulates and provisions of their law. The greatest problems of the *civil law* countries is the impossibility of ceding the future and overall receivables (*bulk assignment*), the so-called global cession, as well as the problem of the ban of the assignment of receivables (*pactum de non cedendo*). For this reason, in most *civil law* countries, before the specific legislative was adopted, extensive business practice had been created. Comparative legal regulations indicate that legislatives that regulated factoring did that after a long application of this institute in economy and adequate jurisprudence (the USA, France, Italy, Russian Federation, Moldova) (Milenkovic-Kerkovic, T. (2006) pp.458-472), Spasic, I. (2010) pp. 355-370).

As the economy in the Republic of Serbia is characterized by constant problems with both liquidity and solvency and a large percentage of outstanding claims, which leads many companies into the proceedings of enforced collection and frozen accounts, factoring (Dobric, N. Mihajlovic, M. (2009) pp. 143-159) together with discounted bills is becoming a more and more important financial product. Factoring market in Serbia generated the turnover of 658 million euros in 2010, which is a rise of 60 % compared to 2009. The general upward trend in factoring in Serbia is evident, not only because of the increase of number of factoring companies, ten of which are currently present, but also because of a greater number of banks engaged in factoring. These developments justify the term “Serbian factoring industry”. The year of 2012 was very successful in this financial sector and according to the data from Factoring Section Questionnaire within the framework of the Association of Financial Organizations PKS the total turnover of factoring was over 950 million EUR where the domestic factoring was represented by 93 %.

Nonetheless, the public debt of Serbia that is already near 20 billion EUR, along with vast insolvency of the private sector, indicates that the perspectives of factoring are far greater, primarily as a supplementary or alternative source of financing export; yet, the perspective of domestic factoring is, most of all, solving the problem of insufficient working capital in Serbian companies, primarily in MSP whose business represents the most significant market for factoring. As for the prospects of domestic factoring and its projected growth to 5 % of GDP, it is important to mention a very low purchasing power of the population that imposes an obligation on producers, distributors and retailers, if they want the market, to grant the possibility of deferred payment of consumer goods, which raises the possibility for factoring to become an alternative source of financing these transactions. In addition, factoring should offer the solution for very low solvency of Serbian companies as well as for the improvement of production cycle, primarily by favoring export-orientation of MSP. All of these facts indicate good prospects of this business, both export and domestic factoring, in the Republic of Serbia.

4. Necessities for Factoring Legislation in Serbia

In the EU only 6 countries has the specific factoring legislation in the form of lex specialis or factoring is covered by the laws which regulate banking system. Those countries are Austria, France, Greece, Italy, Portugal and Spain and it is difficult to say if legislation of factoring has influenced the volume of factoring activities in observed country.

In many civil law countries, such in Germany, legal problems derived from the factoring acitivities which by origin is the legal instrument of common law, create gaps which are not covered by the provisions of civil code , and jurisdiction is trying to fill it gaps by appliying general principles of law. (Bazinas,2002,pp. 2)[2] Legal uncertainity is the typical for the contracts such as

[2] For example in France there is no regulation for the situation in which could find several factors who obtained the same receivables from the same supplier (assignor). In this situation which

factoring which has been developing for the last decades and derives from the other family of law, in the legal fammily of common law which business practice has created factoring as the complex legal instrument which has the features of several commercial contracts such as credit contracts, bill of exchange escont contracts, and other banking law legal instruments.

The civil law countries traditionally have not looked very optimistically on the factoring agreement which consideration is assignment of specific type of intangibles such as receivables. Factoring as the creation of business practices of the common law countries is not predominantly legislated in the countries with the Roman law tradition (civil law countries). In those countries which do not have specific factoring legislation for those type of transactions factors use the traditional obligation law instrument where the subject in the transaction has been changed, type of the assignment of receivables such as cession (cessio), personal subrogation or endorsement of invoices (Milenkovic-Kerkovic, T.(2013) p.12). But there are many obstacles in using the traditional legal instrument for the realization of such a specific arrangement such as factoring. There are also a lot of restrictions which have been settled in order to prevent different varieties of assignment agreement such as future assignment, some national legislations ask notification of the assignment as the condition for the legal enforcement of the assignment. Thus, in a number of civil law countries legal environment creates a variety of obstacles to the practices of the factoring agreement such as:

- Prohibition of the transfer **of *the future* and *the bulk receivables*** which in different legislations could not be an object of transfer. UNIDROIT Factoring Convention deals with this obstacle giving the affirmative approach (UNIDROIT Factoring Convention, 1989, art.5) and enable those transfer [3] ;
- Impose the concept of ***the obligatory notification*** of the assignment in form of *cessio* which is condition for the legality of the assignment contract. In some of the countries (for example in the French Code d Commerce, art.1690) the *consent of the debtor* is the condition for legality of the assignment agreement which prevents factoring contract in the form of cession in France legal context. This obstacle is overcame in international

could be treated as the legal gap, courts have created the praxis by applying the general principle of law "*Nemo dat quod non habet*" (he who had not, cannot give) which principle recognize only right of the first in time factor.

[3] (a) a provision in the factoring contract for the assignment of existing or future receivables shall not be rendered invalid by the fact that the contract does not specify them individually, if at the time of conclusion of the contract or when they come into existence they can be identified to the contract;

(b) a provision in the factoring contract by which future receivables are assigned operates to transfer the receivables to the factor when they come into existence without the need for any new act of transfer.

factoring by the UNIDROIT Factoring Convention prescribing that the debtor is under duty to pay the factor if the notice in writing of the assignment is given to the debtor (by the supplier or by the factor with the supplier authority), if notice in writing reasonably identifies the receivables and the factor to whom or for whose account is to be paid, and if notice given to the debtor relates to receivables which arise under sale of goods contract which is made at or before the time the notice is given (UNIDROIT Factoring Convention, 1988, Art. 8)

- Impose ***the concept on the specification*** of the assigned receivables which prevents transfer of the unspecified or future receivables which was the case in Italian legal environment. Those obstacles were overcome by the Italian lex specialis for factoring 1991 (*La Lege 21 febbraio 1991).* UNIDROIT Convention prevented this threat to international factoring by prescribing possibility for transferring existing or future receivables (UNIDROIT Factoring Convention, 1988, art.5) as well as with solution which create possibility of subsequent assignment of the receivable or by the subsequent assignee (UNIDROIT Factoring Convention, 1988, Chapter III, art 11). Liberal approach of the Convention deviated only by the prohibition of the subsequent assignment which are prohibited by the terms of factoring contract (UNIDROIT Factoring Convention, 1988, Chapter III, art 12)
- Enacting the rule on ***anti-asignement clause – pactum de non cedendo*** which prohibited future contract between creditor (supplier) and the new creditor in any form of transfer of receivables. This is more serious threat for the factoring to became a competitive tool in the finance sector with the possibility given to the debtor to prohibit the supplier from assigning his/her right to payment under the factoring contract. This possibility exists in the most of legislation, as well as in the Serbian Law of Obligation (Law of Obligation, art. 436)[4]. In the following Section effects of this possibility given to the debtor will be analyzed from the prospective of competitiveness of the Serbian economy and possible threat of this provision for the development of factoring sector in Serbia. At the other side, big success of the UNIDROIT Factoring Convention lays in the fact that Convention make the anti assignment clause derived from the original contract between supplier and debtor to became practical invalid by the Art. 6 of the Convention ((UNIDROIT Factoring Convention, 1988, Art. 6)[5]

[4] The *Serbian Law* on *Obligations* (*Official Gazette* of SFRY, No. 29/78, 39/85, 45/89, 57/89 and *Official Gazette* of FRY, No. 31/93, 22/99, 23/99, 35/99, 44/99)

[5] 1. - The assignment of a receivable by the supplier to the factor shall be effective notwithstanding any agreement between the supplier and the debtor prohibiting such assignment.

2. - However, such assignment shall not be effective against the debtor when, at the time of conclusion of the contract of sale of goods, it has its place of business in a Contracting State which has made a declaration under Article 18 of this Convention.

This solution given by the creator of the Convention enables the factoring business at the international level to be competitive tool in the financial markets without the possibility to be prevented by the acts of debtor.

All those prohibited practices create restrictions which limit the financing possibilities available to many companies. Those restrictions create many additional costs, realizing in loss of time and money and administrative costs, which has impact on the cost on credit, such as costs of describing every receivable, costs of notifying the debtor and minimize positive effects of factoring contracts as the tool of the improvement of the competiveness of the firms.

On the other side, common law countries adopt a property rights approach to receivables or approach *in rem*, where the creditor has a property rights on receivables but not only in its original collateral then also in the interests (proceeds) which obligation could have in its life cycle (Torselo, 2000, p. 45). For example, if some equipment was the object of security interest, the sale of this equipment without the consent of the secured creditor, the rights of the secured creditor would not only continue on the equipment itself, but according to *in rem* approach, security interest will automatically extend to the compensation or sales price which seller will received, independent if those payment instrument is check, letter of credit or cash. Because of the proprietary legal approach to the receivables common law country imposed registration system, where security may be given over existing debts, future debts or both, and independent of the type of receivables, if it is embodied as pure intangible or it is embodied in negotiable instrument such as bill of exchange (Goode, 1982, pp.80-87) .

5. Resolutions of the Obstacles in New Serbian Law on Factoring

The Serbian factoring *lex specialis* enacted on 16th of July 2013 (Official Gazette No. 62/2013) defines the concept of factoring as well as it deals with the subjects and types of factoring, conditions and manner of providing factoring services. Beside, it regulates factoring contracts, rights and obligations of its parts, and especially governs reverse factoring as a variety of those transactions. The oversight of factoring is performed by Ministry or by another authorised body for the factoring company and oversight of banks that provide factoring services will be performmed by National Bank of Serbia, according by legislation concerning the operations of the banks.

3. - Nothing in Paragraph 1 shall affect any obligation of good faith owed by the supplier to the debtor or any liability of the supplier to the debtor in respect of an assignment made in breach of the terms of the contract of sale of goods.

Definition of factoring business is important part of the legal solutions because it frames the scope of those transactions in Serbia, especially from the perspective of type of the factoring services as well as in defining the type of receivables which could be transferred according the factoring agreements.The factoring is defined as the financial service of selling and purchasing existing non-matured or future short-term recivables, which arise from the agreement on the sale of goods or provision of the services, either nationally or abroad (*Law on Factoring*, Art. 2 (1) 1)).

The effects of the definition of factoring transactions are numerous. First, their importance affects the contractual side of the factoring transaction deffining them as a sale-purchase agreement where object of the sale is recivables.This solution minimizes the necessity of using the assignment of receivables (cession) as an legal instrument for effective transfer of receivables in factoring transactions. By defining factoring as a sale-purchase transaction the legislator enable direct legal effects to the factoring contract in the manner that factoring agreement *per se* creates a legal effects of transfer of property on the receivables from the assignor to the factor without any further legal acts. This solution is important not only because of its pragmatic aspects but it is important from the theoretical reasons also. It creates factoring contract as an agreement capable to transfer ownership to the receivable without any further legal act such it was assignement of receivables. In order to be a subject of the factoring agreement the future receivables should obtain only condition of identifiabilty. Future receivables should be subject to the factoring only if their characteristics are such that they may be defined and if the factoring agreement stipulates the debtor (Law on Factoring art. 3.). In which moment the future receivable should be identified? This solution is also very flexible settled says that any provision od an agreement assigning future receivables shall have legal effect as of the time such receivables arise. In this manner the law connects the legal destiny and legal effects of the factoring contract with the existance of the receivables which is subject of the previous. Second, definition of factoring defines it transaction as a financial sevice, which solution will have important fiscal and accountant consequences, as well as it make it clear that factoring is not an exclusivelly banking transaction such as credit transactions. Third, the defintion of factoring embraces the object of factoring as a exisitng or future non-matured short-term receivables. It is worthy to mention that Serbian Law of Obligations was not reluctant to recognize global assignments or assignments of future receivables or receivables which derive from the future contracts, as some European legislations, for example those in France and in Italy. But definition in the Serbian Law on Factoring now in very explicit manner sets out possibility of purchasing from the factor any existing or future receivables, either in whole or in part. But, from the other side the Law forbids the purchase of mature receivables in factoring contracts which was the practice of numbers

Serbian factoring companies, in the so-called mature factoring, where the so-called bad debts were taken from the assignor and then collect from the factors. With this solutions those factoring of mature receivables are dealt as the trasnaction which stays out from the factoring business. It does not mean that collection of the mature receivables is forbiden by the law, than this transaction are now outside the scope of factoring. Beside, law regulates the manner in which receivables will be treated as short-term receivables. According the Art. 2 (1)4) the short –term receivables are receivables maturing up to one zear from the date of sale of goods or provision of services under the pertinent agreement of sale of goods or provision of services. Defining maturity of receivables the new Serbian Law on Factoring frames the scope of factoring transaction. All other transactions can be put in the scope of forfaiting or collection transactions which are outside the scope of the solutions in the Serbian Factoring Law.

Simmilar to other jurisdictions, as in the international legislations (UNIDROIT Convention of International Factoring) as well as the Serbian Law of Obligations there are recivables which could not be transferred and collected in factoring business, and those are receivables which are personal, or which are established for familly or houshold needs. As the Law regards the subject of factoring transactions as only legal entities and entepreneurs as subject of the company law it is clear that consumer contracts and receivables derive from those contracts outside of the regulation of Serbian Factoring Law.

Another important solution is that receivables (as described existing, future, non-mature and short-therm) arising from any agreement on the sale of goods or provision of services entered into beneficiaries of funding provided by the budget of the Republic of Serbia, a sub-national unit, or local authority, or beneficiaries of funding provided by mandatory or social security organizations may also be a subject of factoring. It is also very important solution in Serbian law providing that State and budget institutions shall be debtor in factoring agreement, that state debts could be factorized which leads to the higher level of financial discipline, in the circumstances where the State is the biggest debtor.

By defining the types of factoring as domestic and international (Art. 11-Art. 14 of the Factoring Law), the Law provides that domestic factoring is always the case when the subjects are domestic entities independently on the place where receivable is created. The Law accepts the subjective criteria in deffining the domestic factoring activities. International factoring is defined as factoring the object of which is the sale of receivables arising from foreign trade in goods and services, within the meaning of the legislation governing foreign trade Law on Foreign Transactions. In international factoring the Law provides it may entails as one-factor system and as a two-factors system where interfactor agreement should be concluded between factor domiciled in Serbia and another factor domiciled abroad using the internationally recognized legal and technical framework by international associations (*International Factors*

Group and *Factors Chain International*). The Factoring especially regulates recours and non-recours factoring and recognizes factoring with recours as a credit risk transaction, icluding the risk of the debtor insolvency. (art.15. Law on Factoring). Recognizing insolvency of the debtor as a credit risk of the non recours factoring the Law very clearly assumes that factors in insolvency procedure against the debtor has not a priority rights and could not be treated as a privilegded creditor. The Law defines the factoring with recourse as a factoring which entails the assignor being liable to the factor for the collectability of the receivables on their due date.

Among other important solutions the Law on Factoring governs and the main obstacle which as regards the factoring business existed in Serbian law in the manner of *pactum de non cedendo* stipulate in original contract of sale or providing the services that prohibits transfer of receivables from the creditor to another person. In Art. 30, the Law regulates that where the sale of receivables is prohibited under an agreement between the assignor and the debtor or the general operating conditions of the debtor, such prohibition shall not have legal effect on the sale of receivables to a factor subject to a factoring agreement and in compliance with this Law, except where otherwise provided for under an international treaty. This solution is orchestrated with solution in UNIDROIT Convention on International Factoring which states out that the prohibition of assignment is without legal effects in factoring contracts.

It is expected that explained types of provisions of the Serbian Law on Factoring will facilitate factoring business in Serbia as well as they will reduce variety of uncertainties existing in the Serbian legal environment in order to promote domestic and international trade and development of financial market in Serbia.

Conclusion

Factoring has many advantages in relation to other financial forms. As a means of financing, assignment, collection and security of debt collection it is characteristic and different from other, similar instruments, and its benefits may be briefly expressed as the following:

- Efficient debt collection,
- Faster financing of the working capital,
- Improvement of the liquidity and solvency of the company,
- Risk protection,
- The possibility of getting the necessary means regardless of the credit potential and the level of indebtedness,
- Saving money and time,
- Financial reports and taking care of the receivables,

- Improvement of financial reports (balances) of the company
- More competitive conditions for the sale of goods or offering services in the market through deferred payment.

Numerous varieties in which factoring appears in the business practice and reflects its presence on the market of goods and services, domestic and foreign, characterize it as a contemporary financial service which is a significant alternative and even substitute for banking arrangements, price-competitive, flexible in performing services and available for a wide range of users that appear in the role of the assignor of receivables or the debtor.

Adoption of the Law on Factoring in the Republic of Serbia will provide conditions for state authorities that have only sporadically taken part in factoring operations, to be the users of the services of this contemporary financial instrument and to get rid of stereotypical perceptions of the factor as a coercive collection method.

Other than normative, the Adoption of the Law on Factoring in Serbia has a strong marketing function as well. Its role in international trade and as incentive to exporters who are provided with collection abroad, financing and export insurance, as well as the possibility of more flexible import financing by means of deferred payment, is an extremely important microeconomic component that can be reflected even as mitigation of the imbalance of domestic economy.

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ZAŠTO JE SRBIJA REGULISALA FAKTORING UGOVOR?

Rezime*: Nakon brojnih pokušaja srpske legislative da posao faktoringa reguliše posebnim zakonom i time stvori podoban pravni ambijent za ove transakcije, 16. jula 2013.godine, usvojen je Zakon o faktoringu čime je Srbija postala jedna od retkih evropskih zemalja koja je faktoring ugovor regulisala putem lex specialis-a. Faktoring je na srpskom tržištu prisutan gotovo sedam godina i danas postoji 15 banaka i faktoring kuća koje pružaju ovaj vid usluge kratkoročnog finansiranja. Nastao u poslovnoj praksi američkog common law pravnog okruženja, u kome je prenos potraživanja podvrgnut stvarno-pravnom sistemu registracije (in rem pristup) faktoring je u svim evropskim zemljama utemeljenim na civil law sistemu prava. To mu je dalo sudbinu pravnog transplanta, pa je specifičnim pravnim tehnikama morao da se prilagodjava koncepcijski drugačijem pravnom okruženju. Najraširenija ugovorna tehnika u realizaciji faktoringa u Evropi bila je cesija potraživanja (fiducijarna cesija) koja uprkos svojoj apstraktnosti i fleksibilnosti sadrži brojna ograničenja i uslove, koji su bili smetnja razvoju faktoring posla. Duh i smisao srpskog Zakon o faktoringu jeste prevazilaženje tih ograničenja, stoga je analiza tih rešenja u fokusu ovog rada.*

Ključne reči: *ugovor o faktoringu, Srbija, Zakon o faktoringu, cesija potraživanja*

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CREATING CONDITIONS FOR THE INNOVATION ACTIVITY OF SMALL AND MEDIUM-SIZED ENTERPRISES IN SLOVENIA

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Abstract: The global economic crisis has exposed the structural weaknesses of the Slovenian economy, which are reflected in the relatively low complexity and added value of products and services. The article stresses that an increase in added value can be achieved by strengthening the factors of innovation ability and human capital and by creating a stimulating environment for the operation of enterprises. An enterprise never innovates in isolation and hence one of the principal elements of the concept of innovation systems is the interconnection of the elements of an innovation system. It is not enough to merely analyze the elements of an innovation system; one must also explain their interconnections (networks), which in fact present a precondition for the transfer of knowledge among them. In light of the sufficient investments in research and development and in innovation and education, focus must be placed on increasing their effectiveness. Increasing innovation investments does not (necessarily) lead to increased innovation effectiveness. The article presents the conditions for successful implementation of the innovation activity of enterprises and explores how they are manifested in reality from the perspective of small and medium-sized enterprises in Slovenia.

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Keywords: innovation activity, innovation system, knowledge, supportive environment, interconnections.

1. Introduction

The global economic crisis has become part of our everyday life. Its consequences are clear. Consumers are increasingly rational in their behaviour and the process of purchase decision-making and, at the same time, they are more and more complex. On the other hand, providers are increasingly forced to ensure a comprehensive value and quality in a different manner from their competitors. This means that the necessity of constant changes is becoming an ever more important guideline in the operations of a company. If you have just developed a good product, your next thought should be how to improve that product. This kind of thinking means two things: you should strive to be competitive and actually beat the competition and, at the same time, compete with yourself and do new, better things every day - this forces us to make constant progress. And this is the essence of innovation activity. OECD (Oslo Manual, 2005, 47) defines innovation activity as all the scientific, technological, organisational, financial and commercial steps that (will) lead to the implementation of innovations.

Innovation activity starts as a complex thinking process which presents the development of an idea, and is constantly present in an individual. If these individuals are included in groups, there is mutual cooperation/action in the development of new ideas. Due to continuity and the number of participants, there are a lot of thinking processes, which is important for innovations. The creation of an idea presents the beginning of the process of innovation, whereas the innovation itself presents a successful launch of the idea on the market. On the one hand, the benefits of this idea are very clear and, on the other hand, there are only few introduced and implemented ideas (Drucker, 1992, 40). The main characteristic of innovation is that a society or system in which innovation exists does things in a different way rather than in the way that already exists.

Since innovation means a new feature with application value that can be measured, it is generally associated with the company as a market entity. This is understandable, because the criterion of application and abilities of commercialisation are the most important for market entities, which connects the company with its existence. Of course, other conditions have to be met as well, which will be dealt with in this article.

The article presents results of the study conducted among Slovene small and medium-sized enterprises (SME) regarding conditions for a successful implementation of innovation activity. Firstly, let us explain in short the theoretical bases from which we derive: the national innovation system and the national innovation capacity, the Chesbrough concept of open innovation and networking in the field of innovation activity. This is followed by an analysis of the state in Slovenia and conclusions.

2. Theoretical Starting Points National Innovation System (NIS)

The industry could not develop and use new technology anywhere, if institution did not ensure support services and qualified people. The same applies when technology is imported. This finding was transformed by the OECD into the definition of the National Innovation System (NIS), which was adopted in the 1990s. It is defined as "the system of institutions which together and separately contribute to the development of new technologies, and in the scope of which governments influence the innovation process by formulating and introducing policies".

The NIS includes five groups of organisations as follows: companies, universities, research institutions, organisations which promote scientific-technological progress and the state. If innovation is every useful thing, the aforementioned elements should be complemented by invention-innovation processes that are not part of R&D, the structure of economic and non-economic activities besides industry, including innovation in the scope of the government, the prevailing culture / ethics / values rather than just knowledge (education and training) (Mulej, Žeko, 2004). The success of the NIS depends on the operation of individual institutions and especially on the development of relationships and connections or a network of connections within the whole innovation system. Its development and an effective and successful operation of the NIS depend on the fluidity of knowledge flows. Therefore, we will analyse the context of cooperation between SMEs and other players of the NIS in Slovenia from the viewpoint of SMEs.

We will try to analyse if companies have the ability to learn (measured by investments in R&D), functional abilities (the implementation of the invention-innovation process) and strategic abilities – as well as the ability to understand the market and market demand. The limitation of the NIS approach is that it relatively neglects the question of the implementation of inventions (process), where an invention is confirmed in the market and becomes an innovation. For this critical factor, which is important for the decision of a company, to even enter the invention-innovation process, the (economic) motive for cooperation between SMEs and other players is the most important. Of course, we cannot disregard the support services within and outside a company.

National Innovative Capacity

In addition to certain characteristics of companies and the focus on innovations, the approach of national innovative capacity emphasises the importance of perception of potential partners for cooperation. National innovative capacity depends on three building blocks (Furman, Porter, Stern 2002, 905-907):

- *Common innovative infrastructure* (technological complexity and human and financial resources available for R&D): This involves the development of new technologies and public policy measures and related resources, such as investments in education and training, copyright protection, the tax measures associated with R&D and an openness to international trade.
- *Innovative environments of an individual country in clusters* (the environment in which concrete companies develop and commercialise their innovations): This involves conditions for demand, related and support industries, contextual conditions and levels of competition on the market or a company strategy.
- *The quality of connections between the aforementioned building blocks*: These connections can be provided by various institutions (e.g. universities, student clubs or commercial associations of a particular cluster). If there are not enough connections, it involves a risk that the benefits of scientific and technological discoveries will be reaped in other countries rather than being exploiting by the national economy.

The quality of connections is measured in the share of the whole expenditure of companies for R&D which is conducted by universities and the power of the venture capital market (Furman, Porter, Stern 2002, 909), or through the general quality of scientific-research institutions and the availability of venture capital for innovative, but risky projects (Porter, Stern, 2002, 7).

Our research primarily deals with realised cooperation, which is why this theoretical starting point has a limited benefit for us. Since we believe that the perception of the quality of a research organisation – as seen by SMEs – is definitely an important factor, we will check if SMEs find a research organisation an important source of information for innovation activity.

Open Innovation

Today, applicable knowledge is widely spread and companies cannot just effectively innovate, irrespective of their abilities or size. Chesbrough (2011) defines open innovation as the use of purpose-specific inflows and outflows of knowledge to accelerate internal innovations and expand the market for external use of innovations. His definition includes the external aspect of open innovation that refers to the introduction of ideas and technologies in a company and the internal aspect where the company's ideas and technologies that are not used or are used insufficiently are implemented in innovation processes outside the company. Open innovation is a more lucrative way of innovation for companies because it reduces their costs of development, increases the speed of entering the market, increases differentiation on the market and creates new sources of revenues.

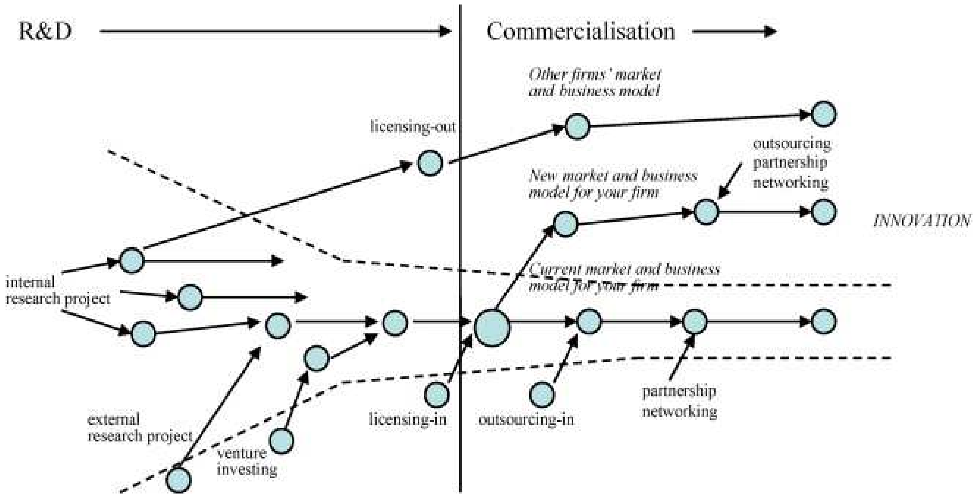
Table 1 Differences among the Principles of Closed and Open Innovation

Closed Innovation Principles	**Open Innovation Principles**
The smart people in the field work for us.	If we create the most and the best ideas in the industry, we will win.
To profit from R&D, we must discover it, develop it, and ship it ourselves.	External R&D can create significant value: internal R&D is needed to claim some portion of that value.
If we discover it ourselves, we will get it to the market first.	We don't have to originate the research to profit from it.
The company that gets an innovation to the market first will win.	Building a better business model is better than getting to the market first.
If we create the most and the best ideas in the industry, we will win.	If we make the best use of internal and external ideas, we will win.

Source: http://www.openinnovation.eu/open-innovation/

According to Lee et al. (2010, 292), SMEs primarily use external sources as the way to access marketing and sales channels. The concept of open innovation is important for them because they have the necessary flexibility and specific knowledge, but they lack adequate capacities to manage innovation resources. The more complex the technology, the less company's management can ensure the technology because the necessary knowledge is also outside the company. The figure below shows the concept of open innovation in SMEs, as defined by Lee et al. (2010).

Figure 1 The Concept of Open Innovation



Source: Lee et al., 2010, 292

SMEs use the concept of open innovation when they establish a partnership with another organisation that is actively involved in cooperation and significantly contributes to the innovation process, for example, by analysing the market, consumers and similar. Since SMEs face a lack of resources and capacities in open innovation, it is an important motive to cooperate with other organisations. At the same time, this is a limiting factor in seeking suitable partners to cooperate with. As an appropriate way of solving the problem of limitations, Lee et al. (2010, 293) propose an active role of an intermediary.

A company can and should implement external ideas in the same way as internal ones because the central idea in the background of the open innovation concept is that companies cannot rely on their own research in the world where knowledge is so widely spread. Quite the contrary, companies should buy and licence processes and inventions, such as patents of other companies (Chesbrough, 2011).

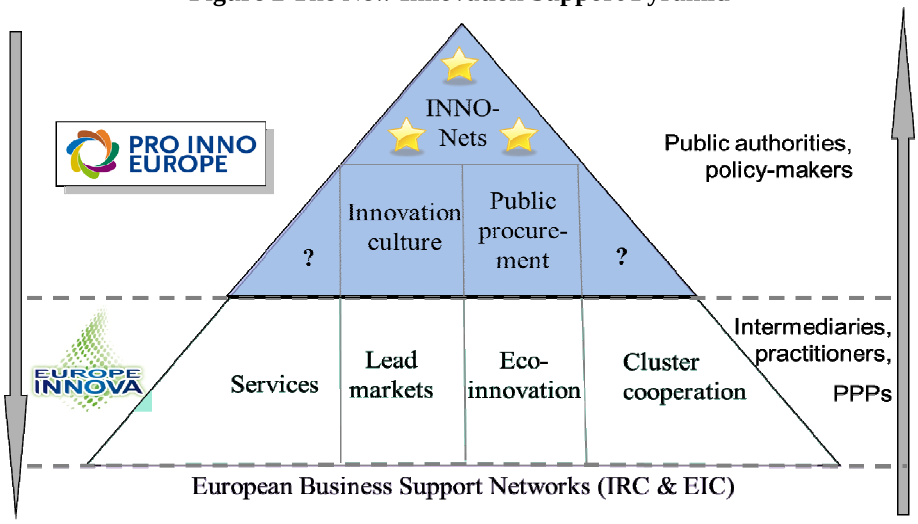
In our opinion, the Chesbrough concept of open innovation shows that the understanding of the importance of knowledge outside a company is changing. If a company begins to act in accordance with the changed concept of knowledge, it facilitates more frequent cooperation with other organisations. Therefore, SMEs can solve the problem of limited resources if they know appropriate sources of knowledge. In the research, we explore if we can speak of open innovation in SMEs in Slovenia. In our opinion, greater staff mobility, the availability of venture capital and the technological progress contribute to increased co-creation and transfer of knowledge among social subsystems, which actually means open innovation.

Networking (Mutual Cooperation) in the Field of the Innovation Activity of SMEs

When studying the network of connections on the inter-organisational market, attention should be paid to social capital. Lengnick-Hall (2003, 53) defines it as a network of relationships among employees and groups (within and outside companies) which provides information, helps solve problems, increases the base of buyers and other, meaning that it adds value and improves the strategic capabilities of a company. Bourdieu and co-authors (in McFadyen, Canella, 2004, 735) speak of social capital as mutual connections among people, and of resources embodied in these mutual relationships. Social capital is the key factor in understanding the process of creating knowledge. It directly influences the process of exchange and ensures a relatively easy access to the desired resources in the network.

With the aim of linking various players in an innovative environment and thus improving the competitiveness of the economy, Slovenia has established clusters, technological networks, technological platforms and excellence centres that are mostly artificially created institutional organisations. A detailed analysis of the operation of these organisations in Slovenia was made in 2004 (Jaklič et al., 2004). With regard to the conclusions and proposals of the European Commission (2012), these organisations should be a lever to achieve the goal of the Europe 2020 strategy, i.e. the Innovation Union with innovative companies which create new high-value added jobs and innovative products that meet social needs and expectations.

Figure 2 The New Innovation Support Pyramid



Source: Schierenbeck, 2007, 21

The horizontal connections in the form of clusters, excellence centres, technological networks, etc. are a particularly interesting approach for SMEs. SMEs can effectively replace their small size with greater flexibility and connections with others. In these forms of connections, it is important that a company is aware of its key competences and appropriately protects them. Mutual connections among companies can be manifested in numerous ways (Zajc, 2012, 42). Let us point out some of these connections: contracts on the implementation of R&D activity; the purchase of technology/prototypes developed at a university; informal networking – conferences, paper presentations and other similar events with the participation of representatives of the economy and the research sphere; joint companies or investments; various forms of temporary staff mobility in a public research organisation, such as staff substitution, sabbatical years and secondments; joint research studies and joint research programmes; the use of research premises and equipment at a university by companies, etc. *Why are SMEs interested in this kind of cooperation?* The table below lists the motives that lead representatives of both subsystems to cooperation.

Table 2 Groups of Reasons for Cooperation with a Public Research Organisation (PRO) by Companies and Concrete Motives

REASON	**CONCRETE MOTIVE OF A COMPANY**
Necessity	Answer to government initiatives and policies
	Strategic institutional policy
Asymmetry	Supervision of proprietary technology
Reciprocity	Hiring students or providing practical training
	Hiring researchers from PRO
Effectiveness	Commercialisation of technologies developed at a university
	Financial benefits from unpredictable research results
	Cost efficiency
	National incentives for cooperation
	Promotion of technological abilities and economic competitiveness of companies
	Shorter life cycle of products
	Development of human capital
Stability	Shift to the knowledge economy
	Company growth
	Access to new knowledge, the latest technology, research equipment, etc.
	Multidisciplinary character of the latest technology¤
	Access to research networks and other forms of cooperation
	Solution of specific problems
	R&D procurement from PRO due to lack of own capacities
	Reducing or dividing risks
Legitimacy	Improving the company's reputation

Source: Ankrah et al., 2007, p. 11, in: Zajc, 2012, 44

Numerous authors dealt with analyses of the *obstacles for innovations in SMEs* (e.g. Lee et al., 2010, Trotter, Vaughan, 2012, Xie et al., 2010). The emphasised obstacles in the aforementioned studies are: the costs of innovation activity, a lack of appropriate financial and human resources, an estimated high level of risk and a lack of marketing and technological information. We believe that the innovation activity of SMEs in Slovenia is hindered by other factors. They include the specific characteristics of the support environment and related culture, a lack of adequate knowledge (especially in terms of management and marketing), reduced demand and pessimism on sales markets as a consequence of the economic crisis as well as institutional and systemic obstacles (e.g. high burden on labour costs, particularly for experts).

We wish to research with whom SMEs cooperate and what the main obstacles for mutual cooperation are. This will serve as the basis for the analysis of networking by SMEs in Slovenia.

3. Methodology

3.1 The Purpose and Goals of the Research

In the analysis of conditions for the innovation activity of SMEs in Slovenia, we are primarily interested in how managers understand the importance of constant changes in a company, how they assess the support environment, the practice of open innovation and their mutual connections (networking), and what presents obstacles and problems for innovation. The goals of the research are: to determine the most common obstacles of innovation activity, to analyse the role and success of the support environment and to analyse networking in the field of the innovation activity of SMEs in Slovenia. The focus on SMEs distinguishes our work from similar analyses that deal with a wider scope of innovation as the centre of their research (e.g. Bartlett, Čučković, 2006, Rašič, Markič, 2008, Rebernik et al., 2008), focus on other aspects and motives (e.g. Cigler et al., 2008, Zajc, 2012), or examine the views of companies (all sizes) as part of the analysis (e.g. Jaklič et al., 2008, Likar, 2003).

3.2 Research Method

We used a descriptive, non-experimental method of empirical research.

3.3 Sample

The basic population that was examined is represented by small and medium-sized enterprises in Slovenia. The research included 309 companies (10.7% of 2,897 companies participating in the research), of which 91 properly filled in the questionnaire. With regard to the Companies Act (ZGD, OGRS, No. 65/09), we divided companies on the basis of the fulfilment of three criteria: the average number of employees in the business year, their net sales revenues and the value of assets. Given the primary activity, and according to the Standard Classification of Activities, 26% of the surveyed companies were from the manufacturing sector, 10% from the retail, maintenance, the repair of motor vehicles and information and communication activities, 8% from professional, scientific and technical activities and various other commercial activities. There were 3% of companies from catering, transport and warehousing, education and financial and insurance activities. We should also mention that this is not a representative sample, which is why the results cannot be generalised per population.

3.4 The Process of Collecting Data

Data was collected in the last week of August and in the first week of September 2013 via an anonymous questionnaire prepared for directors, managers and heads or other employees in 2,897 companies. The companies' addresses were found in public databases (AJPES, IBON, IPIS, BIZI) or on their websites.

3.5 The Description of Measurement Instruments

Based on the survey questionnaire, we gathered the following data: the general information about companies, information about the importance of innovation and the reasons for innovation, information about the percentage of revenue for R&D per year, views on the importance of sources of information for innovation activity and views on whether a particular factor influenced the implementation of the companies' innovation activity in the 2010-2012 period as an obstacle or incentive.

Questions were formulated according to the scale model of the Likert type views. The scale levels for two questions were from 1 to 5, in a logical continuum from the minimum to the maximum acceptance of views. In the case of two questions, the scale was divided into two opposite statement, where the positive answer was ranked from 1 to 5.

4. Results and Interpretation

4.1 The NIS and National Innovation Activity from the Viewpoint of SMEs

In the first set of questions, we examined the role played by the NIS in the operation of respondents. We asked them how much they invested in research and development, with which players of the NIS they cooperated and how they understood the market and its demand.

We found that almost half of the companies allocate 1-5% of their annual revenues for R&D, just over tenth allocate 10-25% and a quarter allocate less than 1%, which is shown in Graph 1. R&D expenditure shows companies' moderate ability to learn, since they earmark a small percentage of funds for R&D. This is also partly confirmed by the replies of respondents with regard to the use and importance of sources of information for innovation activity. As we were interested in which sources of information companies use and how they assess the importance of these sources, we used a scale with 18 statements (a five-point Likert scale): 0 – unimportant, 5 – very important). Table 3 shows results for four most important and four unimportant sources of information for SMEs.

Graph 1 Investments in Research and Development per Year (in % of the total revenues) (n = 61)

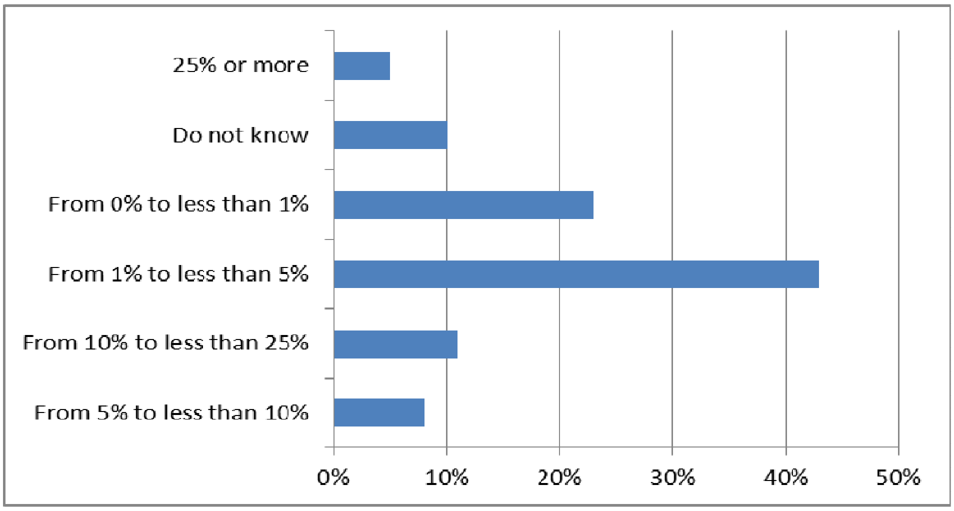


Table 3 The Importance of Sources of Information for Innovation Activity (n = 53)

	unimportant-not a source of information	somewhat important	neutral	important	very important	$\bar{x}$	SD
Customers or buyers	4%	6%	9%	40%	42%	4.1	1.04
Learning from failure	6%	2%	25%	35%	33%	3.9	1.09
Learning from findings in testing and/or production	6%	2%	23%	38%	31%	3.9	1.07
Learning from research and development within your company or group companies	6%	4%	23%	38%	29%	3.8	1.09
Government and business delegations and other contacts at the international level	40%	25%	26%	6%	4%	2.1	1.11
Databases with patent applications	32%	30%	26%	11%	0%	2.1	1.01
Government or public research institutions, research partners	30%	26%	34%	9%	0%	2.2	0.99
Universities and other higher education institutions	29%	13%	37%	17%	4%	2.5	1.20

Companies mostly get information from customers or buyers (42%), through learning from failure (33%), learning from findings in testing and/or production (31%) and learning from research and development within the company or group companies (29%). Contrary to expectations, the companies attributed extremely low importance to universities, faculties, research institutes and professional and industry associations. As unimportant sources of information, the companies state the following: government and business delegations and other contacts at the international level (40%), databases with patent applications (32%), government or public research institutions, research partners (30%), universities and other higher education institutions (29%) and advisers, commercial laboratories, providers of marketing studies or other private institutions for research and development (25%).

From the aforementioned, we can conclude that despite numerous support institutions that Slovenia has introduced in the last two decades, one of the most important issues of the innovation policy is the promotion of cooperation of companies with other players of the innovation system.

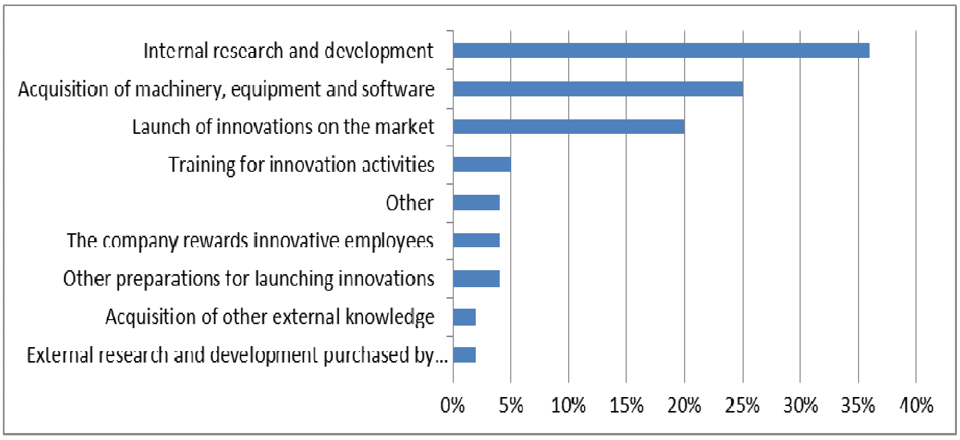
In the survey, we also checked the ability to understand the market and market demand, which was operationalised in the share of a company which knows well its customers, examines changes in the market, examines the problems of buyers with the aim of offering a new or better solution, and the share of the company which develops new products, services and processes based on its innovation activity in order to satisfy the unexpressed needs of customers. On average, 79.5% of the companies agreed or certainly agreed with all the four given statements, which leads to a conclusion that the majority of SMEs are market oriented and aware of the importance of knowing their market.

4.3 Open Innovation and Networking

Open innovation involves a combination of internal and external ideas as well as the internal and external marketing ways to contribute to the improvement of the development of new technologies and, consequently, to a rise in added value. We assumed that the concept of open innovation is important for SMEs because they have the necessary flexibility and specific knowledge, but they lack adequate capacities to manage innovation resources. We were interested in what innovation activities mostly influence the growth in added value per employee in their company and with which partners/associates they cooperate in innovation activities.

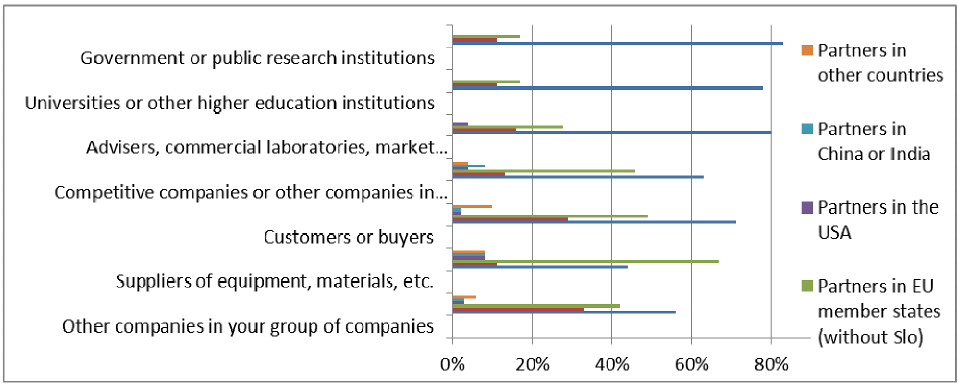
Since an individual innovation activity differently affects the growth in added value per employee, we asked participants in our survey which innovation activity was the most influential for their company. We found (Graph 2) that the majority of respondents chose internal research and development (36%), followed by machinery, equipment and software (25%) and the introduction of innovations on the market (20%). Only one respondent pointed out external research and development bought by the company as the most influential factor, and only one respondent pointed out gaining knowledge from an external source. Equal to the previous section of questions, the results in this section of questions indicate poor mutual cooperation among players of the innovation system.

Graph 2 Innovation Activities that Mostly Influence the Growth in Added Value per Employee in SMEs (n = 56)



The partners with whom SMEs cooperate in their innovation activities are shown in Graph 3. As expected, most companies cooperate with Slovene partners. The key factors for performing innovation activity are customers or buyers.

Graph 3 Partners in the Innovation Activity of SMEs



Among 23 offered statements, the surveyed companies answered the question whether the aforementioned factor influenced the implementation of the company’s innovation activity in the 2010-2012 period as an obstacle or incentive as follows:

- as an important incentive: the actual support of the management (via funds and activities) (55%), an independent innovation strategy of the company (28%), internal activities and financing of R&D (26%), strategic orientation and a written strategy of the company;
- as an important obstacle: the effectiveness of the labour market (flexibility, legislation, regulations) (30%), access to appropriate sources of financing (also maturity) (30%), programmes/tenders/projects that promote mutual cooperation among companies (24%), private and state support institutions (21%).

5. Conclusion

The innovation activity of a country/region/company depends on investments in research and development, human capital, the educational system and the whole social infrastructure (social capital), since there is no direct link between scientific achievements and competitiveness. Modern theories of the economic development emphasise the importance of the basic infrastructure (e.g. research institutes, universities, organisations that promote scientific-technological progress) as well as the importance of mutual cooperation among all the relevant economic agents (better knowledge, diffusion of knowledge). The basis for innovation activity is an individual's and group's creativity in a company that plays the role of the leader of progress in today's society. In addition, we should consider the forms of values that have been set in the process of evolution in our narrower and wider environment.

The characteristic of the surveyed Slovene SMEs is that they are quite introverted – their innovation activity is primarily focused on internal research and development – and, on the other hand, they are focused on the innovation of new products and gradual improvement of the existing products, taking into account the needs, wishes and requirements of buyers. Based on the data of the survey, we can conclude that Slovene SMEs do not fully exploit open innovation, but there is a good basis for networking (mutual cooperation). Therefore, stimulating companies to cooperate with other players of the innovation system is one of the most important questions of the innovation policy.

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STVARANJE USLOVA ZA INOVACIONU AKTIVNOST MALIH I SREDNJIH PREDUZEĆA U SLOVENIJI

***Rezime**: Globalna ekonomska kriza pokazala je strukturne slabosti Slovenačke privrede, koje se ogledaju u relativno niskoj složenosti i dodatoj vrednosti proizvoda i usluga. U radu se naglašava da se povećanje dodate vrednosti može postići jačanjem faktora inovacione spposobnosti i ljudskog kapitala, i kreiranjem stimulativnog okruženja za poslovanje preduzeća. Preduzeće nikad ne inovira samostalno, i samim tim jedan od glavnih elemenata koncepta inovacionih sistema je povezanost elemenata inovacionih sistema. Nije dovoljno samo analizirati elemente inovacionih sistema, mora se objasniti i njihova međupovezanost (mreža), što je uslov za transfer znanja među njima. U svetlu dovoljnih ulaganja u istraživanje i razvoj i u inovacije i obrazovanje, fokus mora biti na povećanje njihove efikasnosti. Povećanje investicija u inovacije ne znači (nužno) povećanje efikasnosti inovacija. Rad razmatra uslove za uspešnu realizaciju inovacione aktivnosti preduzeća i istražuje kako se ona u realnosti manifestuje iz perspektive malih i srednjih preduzeća u Sloveniji.*

***Ključne reči:** inovaciona aktivnost, inovacioni sistem, znanje, podsticajno okruženje, interkonekcije.*

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GLOBAL TALENT MANAGEMENT AS A FACTOR OF MULTINATIONAL COMPANIES' COMPETITIVENESS

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Abstract: The involvement of the organizations at the international business scene opens up many opportunities, but also many challenges. They are mainly related to the fact that at the global business scene the growing number of companies participates and as a condition for their survival and development arises the need to be better and more effective than competitors. One way to achieve this aim is to effectively manage global talents, especially because of the fact that quality human resources are the only true source of organizations` sustainable competitive advantage. This requirement places in front of the function of human resources in multinational companies (MNCs) new and very strict requirements in terms of attracting and retaining global talents. Given the above, the aim of this paper is to highlight the importance and need for effective global management in MNCs in order to be competitive, to present its specific content, and to point out the implications for competitiveness of Serbia which arise from the fact that many talents in previous period left this country.

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Keywords: talents, global talent management, competitiveness, multinational companies, international human resource management.

1. Introduction

In the modern business environment achieving, maintaining and increasing competitiveness, in which base is the attempt to achieve better results than the competitors, become an imperative for all companies since it is a sure path for ensuring their survival and development. While competitiveness as an economic category can be monitored and measured at four levels (product, organization, industry, country) in practice it often divides and looks across the three segments: business performances, the potential of the activity or business and quality of management and processes (Buckley et al., 1988). Therefore, when it comes to the competitiveness of the organizations, it is usually monitored and measured by following parameters: production costs, productivity, quality of products and services, quality of technology, but also by the creativity, adaptability, innovativeness, competency of management, etc. (Niță, Dura 2011).

In the previous period, the competitiveness of organizations, especially at the international business scene, was based on low production costs which were generated by cheap work force and cheap raw materials. However, in contemporary conditions, these sources of competitiveness are not often sufficient to achieve sustainable, long-term competitiveness. In addition, other potential source of the competitiveness, such as financial, technological, commercial or organizational competitiveness (Vasile, 1997) today cannot provide competitiveness in the long run because the solutions in these areas can be relatively easy copied by competitors. It turned out that in today's business environment for achieving sustainable competitiveness rapid response and adaptation to the requirements of customers, as well as to the actions of competitors, is extremely important. In order to succeed, organizations today need skilled and capable employees whose knowledge, skills, abilities and creativity can provide that organizations recognize and meet the subtle demands of the market better than the competition. This fact was recognized by many companies and consequently they started to heavily rely on human capital in generating their competitiveness (Agunis, Gottredson, Joo 2012).

Within the category human capital, according to its significance for generating competitiveness, however, earmarked specific category of the employees. It is about *talents* who possess specific forms of competences that can generate superior business results. This is confirmed by numerous practical examples where individuals in different fields, such as telecommunications, finance, media, etc., achieved outstanding results and make their companies very successful. That is the reason why in the labor market “fight” for these individuals is strengthening - simply they have become the cornerstone of the company's success (Collings, McDonnell, Scullion 2009; Guthridge, Komm 2008). Also, it is important to note that the battle for talents is not only motivated by the efforts of the companies to improve their performance, but also it became a carefully designed strategy to prevent other companies to come up to talents (Gardner, 2005) and their superior results.

Thanks to the globalization and the MNCs’ need to become competitive in the global business scene, fighting for talented individuals moved from national frameworks to the global business scene and became one of the key strategic activities of these companies. The reason why this question comes into the focus of MNCs is the fact that many MNCs have recognized that human resources with exceptional competencies are critical for their competitiveness and that for such resource they should look for at the whole global labor market (Bryan, Joyce Weiss 2006). Therefore, an increasing number of MNCs is making significant efforts in the field of attraction, development and retention of the talented individuals (Boudreau, Ramstad 2005; Lewis, Heckman 2006). Those MNCs which are more successful in these activities have the precondition to be more competitive, and consequently, more successful than the competitive MNCs.

In order that these attempts in achieving competitive advantage through talents could give results it is not, however, sufficient enough that these talents are only identified. Availability of talents has little strategic value if they are not motivated and effectively utilized (Mellahi, Collings 2010). This is the reason why the specific relation toward them, starting with the attraction, recruitment, development and rewarding, can be considered as a factor of companies' competitiveness, too. These activities taken together create the new concept that emerged in the field of human resource management - *talent management*, which in the field of global business became the concept of *global talent management*.

Given the importance of talents for companies' competitiveness, and in terms of globalization to the competitiveness of MNCs, the aims of this paper first is to point out that talents, thanks to their specific competences, give proportionally greater contribution to the organizational performances, and that thanks to that fact they can become source of competitiveness of the organization, then to point out the importance of global talent management in MNCs, as well as to present the specific content of this activity.

The basic assumptions from which this paper starts are following: (a) talented individuals are rare resource that provide superior performance and contribute to the competitiveness of the companies (b) effective management of global talents in MNCs is a factor of their competitiveness at the global business scene. The paper is mostly of theoretical nature. It is structured in the way that in the first part it gives the short overview of the referent literature and attitudes about talents and talent management concept (which is current but insufficiently explored concept and therefore attracted the attention of the authors), the second part will highlight the importance of global talent management for competitiveness of MNCs, and in the attempt that this paper has practical implications, the third section will analyze the impact of knowledge globalization on going talents from Serbia and the implications that arises for the competitiveness for its economy.

2. Summary Review on the Concept of Talents and their Contribution to the Performance and Competitiveness of the Companies

Although the talented people are given the increasing importance in the literature there still exist dilemmas what exactly a talent means. Thus, some authors believe that talent is a special ability to perform a certain activity that leads to the achievement of better results than the others (Bersin, 2006). On the other hand, some authors do not describe the talent as a feature, but as an individual who possesses certain characteristics (Morgan, Jardin 2010). However, all dilemmas about who can be considered as talent, though, can be summarized into two opposite views. One advocates the researchers from the consulting firm *McKinsey* and the other represent the views of *Dave Ulrich* and the authors who support his attitudes. However, there is a third solution, which is a sort of compromise, which offered consulting firm *Towers Perrin*, now *Towers Watson Company*.

The standpoint about talents which advocates the researchers from the consulting firm *McKinsey* is that the talents are those individuals who possess specific skills, knowledge, attitudes, innate gifts and have a strong capacity for learning and development (Chambers et al., 1998). In a word, they are "the best and the brightest". In the literature for these employees could be found some other terms, too, such as "A players", "superstars", etc. The participation of such employees in the total number of employees in companies is usually between 10% and 20%, although there are some opinions that their share could be much smaller, from 1% to 5% (O'Boyle, Aguinis 2012). This view of the talents has its foundation in the resource-based theory of the firm by which, in order that companies achieve sustainable competitive advantage, it is necessary to possess or engage valuable and unique resources that meet the following criteria: (a) strategic value, (b) rareness, (c) inability to imitate and (b) inability to replace (Barney, 1986; Peteraf, 1993).

If these determinants are considered in the context of talents, in order that they can be qualified as superior resources, and thus a potential source of competitive advantage, they must also meet the above criteria. In other word, it is necessary that they have strategic value which is reflected in the fact that their contribution in their area of expertise is significantly higher than of the other employees, then, they have to possess rare skills and knowledge which is difficult to imitate, and that there are difficulties in their replacement.

Contrary to the above, standpoint about talents by *Dave Ulrich* and his followers is that almost any employee in the organization can be considered as a talent (Ulrich, 2006). These authors believe that talent is essentially a function of competencies, commitment and contributions of the employees, so that can be formulated following relation:

Talent: competence x commitment x contribution (1)

Competence in this relation means that individuals (talents) have knowledge, skills and values that company needs. *Commitment* means that employees are willing to work hard and commit their time and efforts to what is required from them, but also to do what is not explicitly required from them (in the literature this kind of behavior is known as *organizational citizenship behavior*). *Contribution* means that employees (talents) provide a real contribution to the company finding in that the meaning and purpose of their own work, too (Ulrich, 2006). According to these determinants, it can be concluded that talent can be almost every employee in the organization whose competencies matches the requirements of jobs, who provides performances that are required of he/she, and that he/she is ready to engage in those activities which are not always explicitly required and rewarded. Finally, their work should really contribute to the achievement of company's goals.

The third viewpoint in terms of talents is the view promoted by the researchers of the consulting firm *Towers Perrin* who believe that every company needs to define by itself what talents are, i.e. which employees are valuable resource for it.

When it comes about the impact of talents on performances, and thus on the organizations' competitiveness, many authors suggest that talents have a significant contribution. For example, by studying the programs which the companies implemented to develop talents and build profiles of successful employees (especially managers) *Consentino, Erkert* and *Tefft* found that 60-70% of the companies has the continuous improvement of business results, such as financial performance, productivity, quality of products and services, increased customer satisfaction and the like (Consentino, Erker, Tefft 2011).

Also, the research conducted by consulting firm *Towers Perrin* confirmed the positive impact of talents on the companies' performances. First of all, their research has shown that different categories of the employees have different contributions to the costs reduction, increasing quality of products and improving customer relationships (Towers Perrin, 2005). Although in their study the term talent was not explicitly used, but the term "highly engaged", indirectly can be concluded that when it comes to highly engaged that it is actually about talents since one of the dimensions of their talents is their readiness for extra-role behavior (Collings, Mellahi 2009). The research of the mentioned consulting firm has showed that talented individuals (highly involved) contributed to the increased quality of products and services at 84%, while the impact of the average employees (moderate engagement) was 62% and below-average employees (disengaged) 31%. The same is the case when we speak of their impact on cost reduction. Talents' contribution to the cost reduction was 68%, while the contribution of the average was 42%, and a below-average 19%. The differences are even more evident when we speak about the impact of certain groups of employees on improving relationships with customers. Talents' contribution in improving relations with customers was 72%, while the contribution of the other groups of employees was less, 27% average and below-average 19%.

In support of the fact that talents have superior influence on business performances are also results from recently published study that was conducted by *O'Boyle* and *Aguinis.* Their comprehensive study shows that the greatest performances in companies were achieved by a small group of “elite”, i.e. talented individuals. In different samples of the companies that were surveyed, the share of these employees was from 1% to 5%. The same study found that the share of talents in the overall productivity was from 10% to 26%, while, on the other hand, 65.8% and 83.3% of the employees exercised performances that were below average (O'Boyle, Aguinis 2012).

Bearing in mind the results of these studies which indicate the positive influence of the talents on the performances, and thus on the companies` competitiveness, it is clear why the “war for talents” is of great importance, both for those companies that operate in the national framework, and for those operating in the global business scene.

3. The Concept of Talent Management: Different Perspectives

Because talents are, in essence, a rare and specific resource, it is necessary that toward them should be established a specific relationship. Therefore, relying solely on traditional activities in the field of human resource management is not enough to attract and retain them (Kim, McLean 2012). That is the reason why in theoretical area and business functions of human resource management a specific concept, *talent management,* has been developed.

Talent Management (MT) covers almost all activities that traditionally cover human resource management, such as recruitment, selection, hiring, developing, rewarding, etc., but the content of these activities has certain specificities. Since the question of talents in literature is still open, the questions which are related to the concept of TM are also opened. Consequently, in theory exists different opinions of what should be the focus of TM and according to who these activities should be implemented.

In the attempt to summarize the different opinions about the essence of TM *Iles, Chuai* and *Preece* all perspectives classified into four groups: (a) the perspective of exclusive (extraordinary) people, (b) the perspective of exclusive position, (c) the perspective of inclusive people and (d) social capital perspective (Iles, Chuai, Preece 2010).

The perspective of exclusive (extraordinary) people has relatively narrow focus of talents according to which the talented people are those who have the ability to significantly impact the organizational performances. Therefore, only toward such segment of employees should be applied specific activities in the field of attraction, development and retention. The application of this approach in MT previously requires segmentation of employees into certain groups according to their quality and value that they can create for companies.

Justification of the opinion that in the area of TM is necessary to implement different approaches toward different groups of the employees can be found in the concept of human resource architecture developed by *Lepak* and *Snell*. Specifically, these authors found that employees could be divided into four groups according to their value and to the uniqueness and specificity of the skills they posses (Lepak, Snell, 1999). According to the model developed by this authors the most important human resources to the companies (either domestic or MNCs) are employees who have a specific (unique) skills and great strategic value. This opinion, we may say, completely corresponds to the perspective of exclusive people, i.e. the focus of TM should be only on the elite employees (Collings, McDonnell, Scullion 2010).

The perspective of exclusive positions in TM also has a relatively narrow approach but on a different base than is the case with the perspective of exclusive people. According to the perspective of the exclusive position, TM should be linked to key positions in the company, which are usually marked as "A" positions. According to this approach, only those individuals who are in these positions can be called talents and only this segment of the employees should be in the focus of TM. It is considered that it would be ideal if there is a match between "A position" and "A players" because only then we can expect "A performances" (Iles et al. 2010).

The perspective of inclusive people is in a direct contradiction to the first perspective since it assumes that all employees in the company have potential to be talents, and consequently, they should be managed in a manner to achieve high performances. This perspective in its essence is in a line with *Dave Ulrich's* attitudes about talents. The authors that support this view believe that it is crucial to give the opportunity to everyone to realize its potential, because "talent requires an opportunity to be displayed" (Walker, 2002). However, the practice shows the opposite evidence: there are rare examples of the companies in which all employees are talents (Microsoft, Google, etc.). Consequently, this approach in TM can not be supported and massively applied.

The authors representing the social capital perspective in TM consider that the previous perspectives are too individualized since the talent is seen only as a form of human capital, regardless of the context in which it arises and develops. They believe that talent is developed through the development of social and organizational capital, and that the focus in TM should be encouraging teamwork, building a proper culture, developing the leadership, creating social networks, etc., which all will provide the preconditions for building talents (Iles, Chuai, Preece 2010).

According to the predominant interpretation by which the talents are rare and specific resource that generate superior results, the dominant attitude in the literature is that a narrow segment of employees should be in the focus of TM. Consequently, the perspective of exclusive people in TM comes into the first place and has the largest practical implications. At the same time, the practical evidences confirm that TM as a specific activity in companies generates a number of positive effects, both in terms of financial performance, and in terms of non-financial (Bethke-Langenegger et al., 2010), which indicates the validity of a specific relation toward employees with the exceptional competences.

4. Global Talent Management (MGT) in Multinational Companies

4.1. The Importance of Global Talent Management

The issue of competitiveness, though it is important for companies that operate at the national level, is extremely important, and perhaps more, for companies that operate in the international business scene. This is because that in the international business scene the competition is more intensive and the imperative to “be better than the others” is more difficult to achieve.

Generally, the competitiveness of MNCs can be viewed from static and dynamic perspective (www.unctad.org). In the focus of the static perspective is the price competitiveness generated by low labor costs and cheap natural resources. On the other hand, the dynamic perspective in its focus has not only costs and prices, but also the company's ability to learn, to adapt to new business conditions and to innovate. In other words, the competitiveness of MNCs is based on how successful they adapt to the demands of the local environment comparing to the other MNCs.

Since the above mentioned determinants of MNCs competitiveness according to the dynamic perspective are primarily related to competent and qualified human resources (who have the talent to recognize what market requires), it is natural that the MNCs in them recognized source of its competitiveness. Therefore, today on the global business scene, despite the recession, the “war for talents” becomes more intensive. In this regard, the case of *Motorola*, which is known as one of the first MNCs that implemented TM programs, is an illustrative example. In this company, besides the fact that it tries to recruit the best experts, this company invests heavily in their further development. The aim of the development programs that are organized in all subsidiaries of this company is to provide opportunity to talented employees for continuous learning and developing of which will benefit the company itself. For example, this company in 2012 invested millions of dollars in various training and development programs for employees in its subsidiaries all over the world (www.motorola.com). Aside from the fact that this company invests heavily in the further development of talents, this company is trying to keep them by the appropriate policy of rewarding, too. In this company it is usual to reward superior performance at the individual level, at the level of business units and at the level of the entire company, but also to provide long-term incentives for achieving those goals that are important to the company.

Intensifying the fight for talents on a global business scene by the opinion of many authors, except for the fact that they can generate superior results, contribute another factor - their deficit (Collings, McDonnell Sullicon 2009). According to some researches, despite the expectation that working population in some parts of the world such as Africa, the Middle East and Asia in the future will significantly increase, it is estimated that over the next 20 years in most developed countries this growth will slow down. It is estimated that the working population in Europe will decrease by 50 million (Hayutin, 2010). Although the birth rates in less developed countries are high, it is assumed that this will not solve the problem of talent deficit because these countries tend to have inadequate educational programs which cannot produce quality professionals.

The importance of the effective TM for MNCs arises from the fact that on the global business scene appears a growing number of companies and a growing number of countries that have opened their borders to global business. In such conditions, it is very difficult to keep managers who possess talent needed by MNCs (McDonnell et al. 2010). In addition, the importance of talents for MNCs arises from the costs, too. The costs of their failure in international business are potentially much higher than when it comes to business at the national level. According to some authors, the costs of losing talents are from 1.5 to 2.5 times higher than their annual salary (Solomon, 1998). These costs are primarily caused by their replacement (the cost of recruiting, interviewing, training, etc.). In addition to these costs, there are also costs of lost effectiveness and efficiency (Himller, Himller, Roberts 2004). Therefore, some authors believe that the costs of losing talents, in fact, are non-recoverable (Aguinis, Gottredson, Joo 2012).

When it comes to the conceptualization of MGT, under this concept it is usually assumed the activities of MNCs in attracting, developing and retaining talents in line with the global strategy, taking into account the specificities of the global business scene and cultural differences between countries (Tarique, Schuler 2010). To understand the essence of the concept of GTM it is important to note that there are differences comparing the concept of international human resource management (IHRM). In this regard, *Tarique* and *Schuler* suggest that the area of IHRM is broader and cover a range of stakeholders (customers, suppliers, the community, employees and the organization itself), while GTM is primarily related to two stakeholders: employees and the company itself. Also, it may be thought that the successful GTM will have a positive impact on the entire MNCs and thus all stakeholders; GTM is a narrower concept because it is related to two mentioned stakeholders only. Finally, the difference lies in the fact that IHRM covers a much wider set of policies and practices than does the GTM and the theorists and professionals in the field of human resources have numerous choices, when it comes to human resource management practice (Tarique, Schuler 2010).

Having in mind the dominant interpretation of talents in the literature, as a rare and specific resource that is linked to exceptional quality, it can be said that GTM is focused on attracting, recruiting and retention of a narrow segment of high quality human resources derived from the global labor market. It is important to note that such human resources, due to the specific characteristics of international business, besides superior knowledge in a particular field, should also possess certain specific global competencies which commonly include: cultural self-awareness, global perspective, language skills, risk tolerance and diversity, cultural flexibility and highly developed communication skills. These global competencies could be summarized as follows, i.e. they have to posses *cognitive capital* (ownership of mental models of how knowledge should be spread within a globalized organization), *social capital* (refers to the necessary contacts which for activities of the organization to be effectively realized), *political capital* (ownership of legitimacy, justification for one to be recognized as a talent, and *human capital* (competencies necessary to work in a cross-cultural context) (Farndale, Scullion, Sparrow 2010).

The complexity of the competencies that global talents should posses make activities on their identification, development and retention very complex and a very expensive investment from which companies expect a significant income.

4.2. Specifics of Global Talent Management

Talent management in MNCs is generally much more complex than talent management in national companies, since it is necessary to coordinate activities in a much wider geographical scope which, in addition, significantly differs in cultural, economic and social terms.

The fact that the GTM covers wider geographic area with significant cultural and other differences creates for HRM function challenges in terms of providing high-quality human resources. This function is expected to design specific methods, processes and techniques that will attract and retain them. In other words, it is often necessary to implement different recruitment strategies, different approaches for development, different rewarding systems, career development paths comparing the practices in national organizations. All this often require a specific knowledge and competencies of HR professionals, too (Marquardt, Berger, Loan 2004).

When it comes to the *planning* of human resources in MNCs the key role of HRM function is to scan the environment to identify opportunities and threats, as well as to scan existing human resources. Without this internal review strategic plans of MNCs would be threatened if for their realization there would be no adequate human resources. Therefore, the HRM function, from information that are collected in the process of human resource planning, may in advance signalizes a need for necessary experts, regardless of the fact where they are located in the world. Because the traditional methods of planning in the dynamic and unpredictable conditions in the global business arena have limited value, it is considered that the method of scenarios for MNCs is much more convenient since it may provide proactive human resources planning in these companies (Paik, Vance 2006). This is also a precondition for the effective management of global talent, too.

When it comes to talent *recruiting* in MNCs in front of them, as well as in front of national enterprises, the same dilemma emerges: whether to develop internal base of potential candidates (talents) for key positions, or opt for the external labor market. Both options have advantages and disadvantages that are related to the time required for building talents, investment that is needed and the like. If the orientation of MNCs is to search for talents at the external labor market, it is clear that a wider geographic focus requires more complex activities in the recruiting, then when it comes to the development of internal pool of talents. And as the focus at the external labor market expands, the activities of HRM function become increasingly complex. Widest focus in attracting talents is associated with geocentric strategy of MNCs because in this case potential candidates may be located all over the world. If the MNCs opted for regiocentric approach, the geographical area in which they search for experts becomes slightly narrower, and if MNCs opted for ethnocentric approach, then looking for talents is realizing within the state. On the other hand, in order that MNCs become attractive to talents in the recruitment process, it is important that they offer to talents what is important to them, but also what MNCs can really provide.

When it comes to *training and development* practice confirms that these activities are becoming of a more priority in MNCs. It turned out that the training and development of global talent is mainly focused on the development of general international competences, such as the ability to adapt the work in a foreign environment, language skills, knowledge of the local law, development of managerial and leadership skills, etc. (Vance and Paik, 2006). However, when it comes to talent development programs in MNCs it is specific that it is recommended an exclusively individualistic approach (Aguinis, Gottfredson, Joo 2012). It is believed that only this approach is effective to retain talents since the individualized plans directly touch the expectations of talents themselves (learning new skills, individualized attention, etc.), and because such plans provide a structural basis for their involvement in mentoring and other development programs. In addition, if individualized talent development programs over time become closely associated with the specific objectives of a particular company, than the competition can have difficulties to imitate them, which also reduces the possibility that talents may go over to them. Practically, by individualized development programs MNCs create specific human capital that may not be interesting for competitors.

Rewarding system in the GTM takes also a special place because of its importance for retaining talent in MNCs. The compensation system for all employees (including talents) usually involves two sets of rewards: financial and non-financial. *Vance* and *Paik* believe that both sets of rewards must be perceived as valuable in order to have an impact on employees` behavior (Vance, Paik, 2006). Conversely, if employees believe that the reward is not proper and fair in exchange for their work, it will affect their decision whether to continue with the same level of effort, or perhaps even to leave the company.

When it comes to the material (financial) rewards, which include basic salary and other forms of payment, there are almost no doubt that their size and structure is important for talents retention. Talents typically are aware of how much their contribution to the organizational performances is. Therefore, if these employees are unsatisfied with their financial reward, it can result in reducing their efforts or in decision to leave the organization. It is important to note that high quality staff usually prefers rewarding system that gives a chance for increasing the reward itself. Since the talents are more productive than the average employees, their compensation should reflect that fact, not only that it should be significantly higher, but to have the potential for increasing as they improve their performances (Aguinis, Gottfredson, Joo 2012). In the company *Novartis,* for example, compensation is an important part of their GTM and is structured in a way where payment is based on the performances. In addition, the performances are measured at the individual level, but also at the level of organizational units. Since the company searches for talented individuals all around the world, the compensation system that it designed reflects the global environment, and many employees have higher wages than they would have in their own countries (Schuler, Jackson, Tarique 2011).

In general, in order to keep talents, it is necessary to design such rewarding system which will be hard to imitate by the competition. At the same time, relying on only one aspect of rewards, such as a wage as a way to retain talents, is not enough, because then the other aspects of the rewarding would be neglected, which will then give the competition a chance to better design it and to attract talents more successfully. Therefore, it is important to establish a balance between the financial and non-financial rewards and to find such a combination that will be hard to imitate by the competitors, on the one side, and on the other, to provide talents to be satisfied.

4.3. The Impact of Knowledge Market Globalization on Talents Going from Serbia

Globalization of business causing the globalization of the knowledge market consequently has led to migration of talented individuals between countries.

The most attractive country in attracting talents is the USA which indicates the value of the Index of Global Talent (IGT) (Table 1). It is believed that the United States take such a prominent place primarily due to the quality education provided by its universities (one third of universities that make the top 500 in the world are from the U.S.) and supportive work environment that is not constrained by restrictive regulations related to employees (The Global Talent Index Report: The Outlook to 2015). The Nordic region (Denmark, Finland and Norway) is also very attractive and highly ranked in terms of attractiveness for talents, as can be seen in Table 1, too.

Table 1: Ranking of Countries According to the Value of the Index of Global Talent in 2011

Rank 2011	Country	Score 100
1	Unated States	74, 2
2	Denmark	64,7
3	Finland	63,2
4	Norway	61,9
5	Singapure	60,2
6	Australia	60,1
7	Sweden	59,5
8	Hong Kong	58,1
9	Switzerland	58,5
10	Israel	58,3
10	Netherlands	58,3

Source: The Global Talent Index Report: The Outlook to 2015, http://www.managementthinking.eiu.com/sites/default/files/downloads/GTI%20FINAL %20REPORT%205.4.11.pdf (20.05.2013.)

When it comes to the value of IGT for some neighboring countries data show that Hungary is the highest ranked (30th place), then Romania (36th place) and Bulgaria (49th place). Serbia, among the 60 countries which are ranked, is not ranked at all (The Global Talent Index Report, 2013).

Globalization of knowledge significantly influences the migration from Serbia. Although migration from Serbia has a tradition of more than 150 years (Avramovic, 2012), a particular problem in recent years is the exodus of young talented people. It is estimated that since the 90s 40,000 young university graduates left Serbia (Grečić, 2010). At the same time, most of the scientific emigrants are in the United States. Their number in 1999 was 4100, and in 2009 was 6000, of which 2000 had PhD degree (Grečić, 2010).

Although the mobility of scientific and technical personnel generally is seen as something positive, it can be said that in Serbia it has almost exclusively had negative connotation. The reason for that is when professionals leave the country it remains deprived of their knowledge. Also, it means the loss of funds invested in their education. Some estimates suggest that young people leaving Serbia caused the loss of 12 billion dollars (Avramović, 2012). However, the consequences are not just direct financial losses. The consequences are indirect, too, where they can be divided into short-terms and long-terms. Short-term consequences are reflected in the fact that the country loses step for social and economical development, while in the long term, this situation creates a base for society to become technological colony of the developed countries (Avramović, 2012).

How the problem of "brain drain" from Serbia is serious is documented by the latest data by the World Economic Forum. The data show that according to "brain drain" Serbia takes 141st place among of 144 countries. According to this indicator, Serbia is behind Montenegro (60), Slovenia (83), Albania (96) Croatia (126), Bulgaria (128), Hungary (129) and Bosnia and Herzegovina (140) (The Global Competitiveness Report 2012-2013). This trend of experts' migration certainly has a serious impact on the overall competitiveness of Serbia, which, according to the latest data of The World Economic Forum, is currently at the 95th place of 144 countries (The Global Competitiveness Report 2012-2013).

The question that logically arises here is why high educated and talented individuals leave Serbia. In response to this question it should be pointed out that the decision to leave the country generally affects two groups of factors: *push* and *pull* factors. *Pull* factors are those that attract individuals to immigrate to other countries. Usually, it involves higher wages, better working conditions, more opportunities for advancement in the profession and the like. *Push* factors are those that encourage people to leave particular country. These are usually hopelessness, the lack of opportunities for advancement, low wages etc. (Group 484, 2010).

In Serbia's case studies show that the decision to leave the country primarily affects *push* factors. Research conducted in 2011 showed that as the main reasons why the respondents wanted to leave the country were the standard of living and a sense of lack of perspective. Compared to the research that was conducted on this topic in 2003 (Table 2), it can be concluded that there has been a significant increase in those whose low life standard, lack of perspective and unemployment are seen as the main reasons for leaving the country. These results are interpreted by the researchers as the consequences of the economic and social crisis that has engulfed the society of Serbia (Jaric, Živadinović 2012). Other possible reasons for leaving the country are also shown in Table 2.

Table 2 The Most Important Reasons for the Going out of the Country (research in 2003 and 2011)

Reasons for leaving the country	2003 (%)	2011 (%)
Further education	5,4	5,6
Low standard	18,9	24,6
Political reasons	0,5	0,6
Unemployment	3,1	8,6
Lack of perspective	14, 4	15,2
Safer life abroad	10,2	9,6
I do not want to leave Serbia	46,4	35,8

Source: Jarić, I., Živadinović, I. (2012) Otići ili ostati: identiteti mladih i orijentacija ka iseljenju, u zborniku radova *Mladi – naša sadašnjost - Istraživanje socijalnih biografija mladih u Srbiji,* Beograd, Čigoja štampa, p. 218.

There is a view that poor economic conditions are not always sufficient reason for highly educated and skilled people to leave particular country. It is considered that the reason for that decision could be the combination of poor economic conditions and poor government administration. “Where the criterion for promotion is obedience, not competence, emigration of the potential critics for political oligarchy is actually desirable” (Group 484, 2010). Then the reason for leaving the country from economic develops into ethical one (Group 484, 2010).

When it comes to measures which the Republic of Serbia can implement in order to reduce the number of young people who plan to leave the country, or to reduce the harmful effects because many of them have already left, two strategies emerge as key. These are: (a) improving the physical and economic conditions in the society, and (b) creating the condition for returning or inclusion of diaspora (Avramović, 2012). In the first case, improving economic conditions would improve employment opportunities which consequently could positively affect the decision of highly educated professionals to stay in the country. On the other hand, improving the business environment could stimulate those who have already left to return or engage "at a distance" by their investments or by connecting with local business entities. Consequently, it can be expected that this could increase economic activity and, therefore, provide retention of highly educated individuals.

Among the concrete measures that the Government of the Republic of Serbia is implementing the adoption of the Strategy of Scientific and Technological Development can be mentioned. It was formulated with the aim of stopping the exodus of young and talented people from Serbia. Also, the Ministry of Diaspora has launched some projects with similar goals. One of them is a free education for 100 students from abroad at the undergraduate, master's and doctoral studies level in Serbia, which was supported by around 20 faculties from Belgrade, Nis, Novi Sad, Kragujevac, Kraljevo, Krusevac, etc. In addition, the Ministry of Diaspora is implementing *The Brain Gain* project that allows graduate students to do summer internship in foreign companies operating in Serbia (for example, *British American Tobacco*, *Gorenje*, etc.) (Group 484, 2010). The assumption is that many of those who did the internship can later find employment in these companies. Thus, the presence of foreign MNCs in Serbia could be used to stop the exodus of highly educated professionals, among which certainly are many talented individuals.

Conclusion

The paper points out that talent due to their exceptional competences can generate superior results, and that on that base can be the drivers of companies` competitiveness. This is supported by the results of different studies that have been presented in the paper. Studies also confirmed the dominant attitude in the literature that talents are rare and specific resource with exceptional abilities. Due to these facts in the labor market continues to strengthen the struggle for talented, elite individuals.

This struggle is particularly strong in international business because on international business scene competition is more intensive. Thus, the issue of talents is of particular importance for MNCs that have recognized that superior quality of human resources (primarily managers and experts in different areas) can make the difference between successful and less successful companies. Therefore, many global companies has already established practices of finding, developing and motivating progressive individuals, since it is confirmed the exceptional talents add value and have become brand themselves. In accordance with this practice, the theoretical concepts that have been developed by some authors enriched the literature in the field of human resources: they created the concept of talent management, and in particular, in line with the trend of globalization, global talent management.

Since the management of global talent in MNCs covers a much wider geographical area than is the case with national companies, the activities of identifying, attracting, developing and retention talent in MNCs require a different approach than when it comes to talent management in national companies. In this regard, this paper points out some specifies in the field of GTM which, consequently, put in front of HR function new challenges.

Finally, the paper points out the problem of going talents from Serbia. Especially, it emphasizes the fact that their leaving cause loosing their knowledge and expertise which in the long term can cause even greater Serbia's lagging behind the developed market economies. Also, their leaving from the country means enormous loss of funds invested in their education, while countries in which they have gone almost immediately are able to realize benefits from their expertise without previous investments. In this regard, the paper points out that, in order to stop the exodus of talent from the country and to encourage the return of those who left, it is necessary to improve economic opportunities and to create stimulating economic environment in which talent will have the opportunity to express itself and generate deserved income.

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MENADŽMENT GLOBALNIH TALENATA KAO FAKTOR KONKURENTNOSTI MULTINACIONALIH KOMPANIJA

Rezime: *Uključenost organizacija na međunarodnu poslovnu scenu otvara brojne mogućnosti, ali donosi i mnoge izazove. Oni su uglavnom povezani sa činjenicom što na globalnoj poslovnoj sceni participra sve veći broj kompanija i što se kao uslov njihovog opstanka i razvoja javlja potreba da budu bolje i efektivnije od konkurencije. Jedan od načina da se taj cilj ostvari jeste efektivno upravljanje globalnim talentima, posebno zbog toga što su kvalitetni ljudski resursi jedini pravi izvor održive konkurentske prednosti. Ovaj zahtev stavlja pred funkciju upravljanja ljudskim resursima u multinacionalnim kompanijama (MNK) nove i veoma rigorozne zahteve u pogledu privlačenja i zadržavanja globalnih talenata. Imajući to u vidu cilj ovog rada je da ukaže na značaj i potrebu za efektivnim menadžmentom globalnih talenata u MNK kako bi bile konkurentne, da predstavi menke njegove specifičnosti, kao i da ukaže na implikacije u pogledu konkurentnosti Srbije koje proističu iz činjenice što je mnogo talentovanih ljudi u prethodnom periodu napustilo ovu zemlju.*

Ključne reči: *talenti, menadžment globalnih talenata, konkurentnost, multinacionalne kompanije, internacionalni menadžment ljudskih resursa.*

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EQUAL OPPORTUNITIES OF WOMEN: PROCESSES OF EMPLOYMENT AND PROMOTION ON HIGHER POSITIONS

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Abstract: The employment and promotion of women on higher positions is regular topic of research among social sciences and organizational studies. The equal opportunity aspects have been issues that are important within organizations because men and women are different and do things differently. New researches showed that being women can be advantage in the process of working, cooperation, communication and performance within organizations. But there are issues in this battle between men and women. The main argument in this paper is that women are underrepresented in senior management positions than men because of the lack of equal opportunities during the processes of employment and promotion. Among the many factors that might influence the position of women vis-à-vis men on higher positions this paper will try to include two additional variables, namely, the impact of family and domestic tasks that might influence the women career and the trust in women as managers.

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Keywords: women managers, equal opportunity, promotion, employment, career development

1. Introduction

Even though the women made carrier advancement in the last 3-4 decades, they are not yet equally represented on higher managerial positions worldwide. Raising the awareness of low women representation on higher positions maybe emphasizes the need for restructuring of organizations and having bigger participation of woman. Because women are rarely awarded with higher positions, there is little evidence of the influence they can have. This is common conclusion even though there are data how different men and women can be as managers. This is important for both public organizations (government and state sector) and private companies. The research has shown that men and women managers communicate and manage in different ways. Men dedicate more time to the results and the women are more concerned with the process itself. The previous results proved that women interactive style lead towards consensual and collaborative process. (Rosener, 2011: 36) Some presumed that this is because of their natural concern for personal human relations. It is presumed that if more women are promoted on higher positions and acquire bigger power that will positively influence company's human relations and communication and overall results.

The research on presence of women on managerial positions in organizations is an open window. All aspects can be studied: whether or not higher positions are easy to reach by women, in what sectors women are more prone to get higher than men, is there relation between absence on women in higher positions and women less pay, is meritocracy respected on entrance to higher positions in general, what are the differences between problems in state and private sectors, are women dominating only in the less paid sectors, are women feeling as outsiders while applying for the job, are there legal protective mechanisms on discriminations on women, how the women are surviving the rapid and big changes in organizations, whether women from minorities have less chances for getting to higher positions, are women less successful because they start on much lower positions than men, finally, do women generally have equal chances for employment on higher positions than men. So there are plenty of opportunities for investigations.

In the Republic of Macedonia the research on this topic is absent or rare. Still, taking the importance and the role that women have in the society and family this research will try to show the current state of affairs of the existent opportunities for higher positions of women in public and private sector in Macedonia. The research will explore the reasons why the women are absent from the higher positions in Macedonia particularly. The argument will be that the women are absent from this positions because of not having an equal chances during the first employment and have less chances on further carrier development. Additional factors will be subject of research like family obligations and trust in the women managers vis-à-vis men. The paper is based on original quantitative and qualitative research done by postgraduate students of Human Resource Management at the Institute for Sociological Political and Legal Research at the University of “Ss. Cyril and Methodius” Skopje[1].

2. Women Equality Vis-à-Vis Men

Women continue to be underrepresented in senior positions in many fields despite the fact that they make up nearly half of the workforce and more than half of new university graduates in the EU. Today, only one out of 10 board members of the largest companies listed on the national stock exchange of EU Member States is a woman and progress has been slow in recent years. The disparity is widest at the very top where only 3% of such companies have a woman directing the highest decision-making body. We have to deplore that women’s talents are not being tapped to their full potential.[2] These are the words of *Viviane Reding,* Vice-President of the European Commission, Justice, Fundamental Rights and Citizenship. Although more women are assuming leadership roles today than before, the notion of a woman as a leader is still foreign to many individuals, male and female alike. Changes in perception are difficult to achieve because the traditional norms of leadership are firmly entrenched. In our society, as in most others, leaders have customarily been males. (Moran, 1992)

True, managerial positions in most of the organizations, various structures and companies are usually dominated by men. Men have been managing for a long period of time to control the power and most of the resources. Managerial positions are territory of men and women's promotion to the top jobs is often blocked usually by men. But this situation slowly changes even though the women have a long way to go to ‘become’ equal as men or at least to be present together with men on each level of decision making. There is a little information on the impact that makes women in managerial positions in companies, too, because women rarely are given high positions. This also applies to positions in government structures, as well as entrepreneurs and executives of the large companies. The topic of women in higher positions is becoming more urgent. There is a belief that it takes three women in the meeting room and three women on the board of directors to make a significant impact. (Rosener, 2011: 36) There have been several attempts to measure impact through different categories but still no stable knowledge exists. It is

[1] The research is conducted by postgraduate students of Human Resource Management at the Institute for Sociological Political and Legal Research at the University of “Ss. Cyril and Methodius” Skopje (spring semester 2012), under the mentoring of professor Petar Atanasov and assistant Bojana Naumovska, PhD, during the Methodology of scientific research seminars. The authors express acknowledgement and gratitude to the students for their engagement and results.

[2] More women in senior positions: Key to economic stability and growth, European Commission, Directorate-General for Employment, Social Affairs and Equal Opportunities Unit G1, Manuscript completed in January 2010

assumed that if more women gain positions of power in the organization that will positively affect interpersonal relationships, communication and organizational learning. Men devote more attention to the results. Women however are more concerned about the process. (Rosener, 2011: 41) Some women assume that over time they will become as men and care more about results than process. Now we can conclude that men and women at the time being are not the same.

Maybe raising awareness of the underrepresentation of women is similar to actions to raise awareness of other cultural groups and communities or thinking about the need for reengineering of organizations towards greater involvement of women. But top executives need (would be good for them) to understand why change is needed. If you do not understand the ideas, projects and efforts to change the working environment will fail. It is also good to see the position of women before employment, during labor and after losing engagement (or dismissal) of the work. For example in the U.S. it is easier to hire a woman than to keep on working. Once hired, there are strong pressures on firms to ensure that men and women are treated equally. (Dencker, 2008: 473) Women often voluntarily leave employment probably because of the environment that does not behave friendly with specificities that woman possesses. You can do different things, to organize various training sessions, but it is difficult to prove a direct causal link between numbers and efforts to change because there are always a lot of other factors acting simultaneously. The assumption is that by creating a more inclusive work environment for women, the organization gets more. While this is hardly measurable, the assumption is that women have a competitive business advantage. (Rosenor, 2011b)

Many researchers believe that gender inequalities at work result in part from the practices of managers – often assuming that these practices are associated with managers' gender. Namely, if more women in positions of power make crucial decisions about salaries, promotions, hiring, and firing, gender differences in earnings should decline. (Cohen and Huffman, 2007) It is often found that although men and women may have similar work in practice, their job titles and salaries vary. Women have lower wages (for example, private companies in Sweden) especially in organizations where there is none or there are few women in managerial or supervisory positions. This means that the structure of remuneration of workers in companies partially reflects the relative power of men and women in the workplace. Limited access of women to managerial and supervisory positions in the workplace is part of the explanation for unequal incomes. Establishment of gender differences in income is greater than the presence of men among organizational managers and supervisors. Assumptions for impact: principles and policies adopted at higher levels, but also daily decisions and daily interaction between bosses and employees. Data according to the theory of structural discrimination and access to social networking benefits, to explain why the gender composition affects the pay gap:

1. Organizational decision makers show power over general policies and also have the option to either initiate or maintain or weaken institutionalized gender bias in the reward. Male decision-makers are more willing to keep these prejudices.
2. The impact of daily decisions on wages. Subordinate women have greater opportunities if the organization has more women on decision making positions. Studies have shown that wages in "blue"workers depend directly from supervisors. That means the daily interactions and decisions at a lower level. (Hultin, Szulkin, 2003: 156)

There are a high percentage of women in positions in the public sector. There is increase on women's access to positions of power. (Mano-Negrin, 2004) But there is evidence of national differences in employment between public and private sectors. The U.S. women in the private sector earn 21.4% less than men, and 19.8% in the public sector for the same job in the same position. Often in public sector positions are systematically related to female employment and low incomes on women positions. Women suffered from prejudice and less employment in firms in the late 60s and early 70s in the U.S. despite existing anti-discrimination legislation. With increased pressure women entered in the management of companies (Dencker, 2008). Companies are trying to redo the missed. To understand gender inequality in organizations there is a need to understand and organizational change and the notion of gender inequality. There are interracial and gender disparities in the workplace in the United States. There are obstacles to fulfillment of true meritocratic system. Relative inequalities between white men and other groups remain. All groups experience disparities in wages compared to white men (except maybe a black men).

Even though in line with women political career, these remarks are valid for any women career. Recruiting early and recruiting often are vital ingredients for closing the gender gap in political ambition. In fact, recruitment might be the only quick fix for party leaders, elected officials, and political activists to pursue. Also, family atmosphere always matters. The gendered division of labour we uncovered demonstrates that women and men who are similarly situated professionally are not similarly situated at home. Any move toward a more family-friendly work environment and campaign arena would likely confer disproportional benefits to women. Organizations and individuals dedicated to closing the gender gap in political ambition, therefore, must be cognizant of the persistence of traditional family dynamics. (Lawless and Fox, 2012)

Although women made progress in the past decades, there are still less represented in leadership positions in big companies. Large corporate restructuring can themselves play a major role in generating the inequalities between men and women. An attempt is made for contrast analysis on the effects of corporate restructuring on gender differences in managerial promotion. There are two forms of restructuring: reduction of labor and reorganization of the HR systems and its effects on gender differences in managerial promotion. The first type of restructuring shows that there are inequalities and prejudices about women's participation in organizations. The second type provides safeguards aimed at reducing discrimination. Usually, fewer women advance to higher positions in companies during the reorganization because:

1. Reducing employees slows down the rate of promotion of all managers
2. Women start at lower positions than men and are less paid according
3. The promotions of the women had a shorter life. (Dencker, 2008)

When women are in a position of power, they look on the way how things are done. Their interactive style leads to a preference for consensus and collaborative process. This is the view of many experts. For some this is due to women's personal concern for interpersonal relationships. But when trying to imitate male behavior, they suppress their true self.

An experiment was made with solving problems with no specific response. They formed two groups - men and women. In male groups immediately arose leader whose process of solving problems is a top-down and is competitive. (Rosenor, 2011: 41) The men quickly come to the right answer. The women's groups took longer to complete. If we observe it is difficult to identify the leader. Women process is participatory and resembles a chaotic external viewer. Women in this experiment produced 5 different answers compared to one response of men and all were in if/then form. The experiment provides evidence of differences in male-female processes. There is little evidence that either of these two processes is superior. However, there is no assurance that the collaborative process (cooperation) has benefits recognized by experts. Organizing processes take many forms, including recruitment and selection, training and promotion. Fearful and Kamenou (2006) argue that, in order to achieve in organizations, women need to fit in with white masculine practices. (Healy and all, 2011: 473)

Tests to measure the hypotheses of glass ceiling and glass escalator are common where phenomena first are identified. Both phenomena are present in the United States. These are the results of the struggle and competition for money and power benefits. There are two types of blocked opportunities for women and racial minorities. There is evidence that race, ethnicity and gender may intersect and support special advantages for the white men and weaknesses for women and minority men. In professions dominated by women they favored men in the process of receiving and are encouraged to get the best jobs. This happens in professions where women rule and for jobs offering higher pay and more power. There is a lot of evidence that speaks of invisible barrier above which the promotion of women is impossible and even for the minorities in senior positions in corporations. Women want to be fair and to behave impartially. So, often white men are at good positions with good pay. Men have two socially valued statuses: being white and male. It is a prestige to have white men in a position because your status (women, minority woman) increases (Smith, 2012).

The research questions may be explored why the companies discriminate, to understand how and where firms discriminate and when discrimination is most possible and greatest. For sure the main dependent variable should be the promotion of women. Independent variables may vary from gender, pay, reduction in staff performance management, trust in women, family and promotion of women mangers etc. Also, other variables should be engaged like times spend in firm, education, occupation, ethnicity and private or state sector. Our main interest in the paper is whether women are given the same opportunities as men in employment and promotion on higher positions. The general research issue is the following: Women are underrepresented in senior management positions than men because of the lack of equal opportunities for employment and advancement. This general research question is supported by four operationalized research issue: women are not given equal opportunity in employment, the women are not given equal opportunity for promotion, family and domestic tasks have negative impact on the career development of women managers, and trust in women managers is less than trust in men.

3. Research

In 2012, a research was conducted about women managers in Macedonia with the students from the MA studies in Management of Human Resources. The main hypothesis of this research was that “Women are less represented in the top management positions compared to men because of the lack of equal chance for employment and professional advancement.”

The specific hypothesis are referring to the equal chances for employment, equal chances for advancement, family and house obligation and confidence in women managers. For the purpose of the research questionnaire was conducted with 380 subjects (264 females and 116 males from the private and public sector) and 12 interviews were made with women working in managerial positions. Besides the gender and the sector they work in, the level of education, age and marital status were taken as independent variables. Most of the participants in this research are with higher education, aged between 26 and 35 years and are not married (table 1, 2 and 3).

In continuation the data from the research as well as the responses from the conducted interviews will be grouped and presented according to the hypotheses. The first specific hypothesis is “Women are not given the equal chance for employment”. From the conducted interviews, the conclusion is that women are not faced with discrimination during the employment, hence are in equal position with men. One part of the interviewed females stated that they got their job through open competition, while most of them got their management job through advancement within the same organization or other organization with which they were cooperating. From the previously stated it can be noted that this hypothesis was not confirmed.

Illustration 1 Level of Education

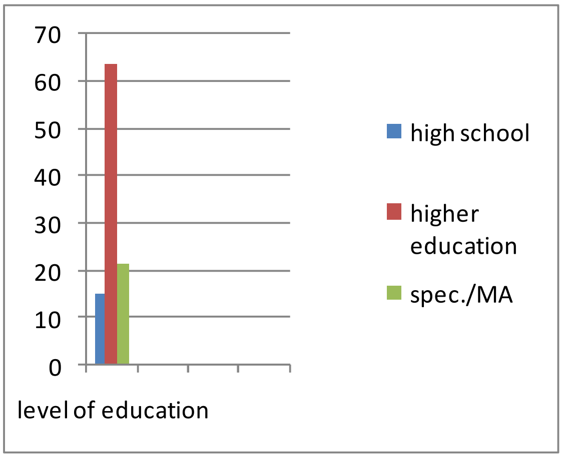


Illustration 2: Age

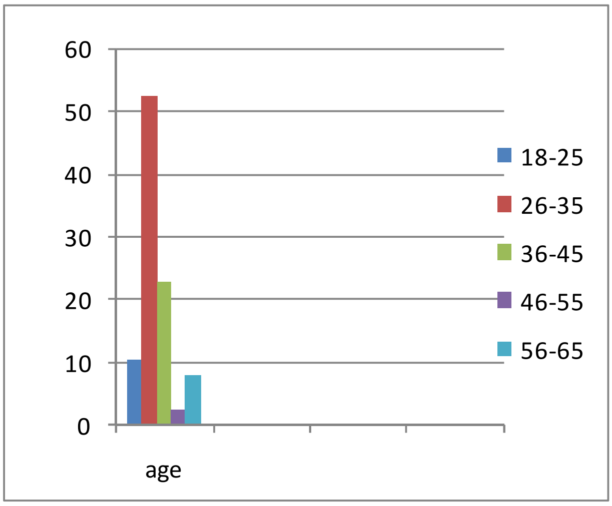
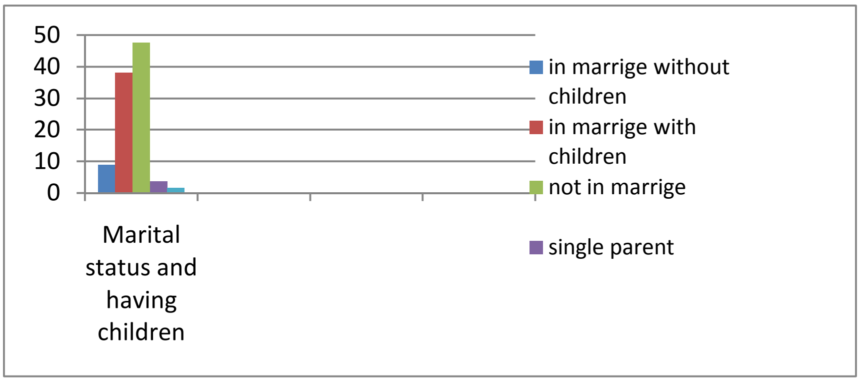
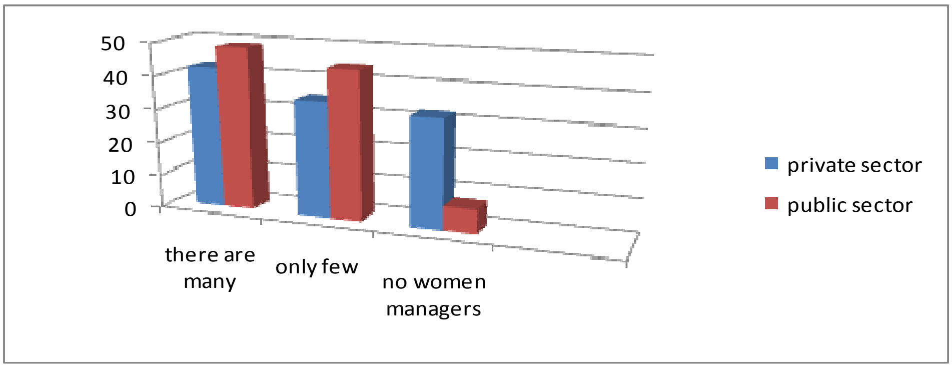


Illustration 3 Marital Status and Having Children



As for the second specific hypothesis for the equal possibilities for job advancement, "Women are not given the equal chance for job advancement". For analysis of this hypothesis two aspects are important: firstly, are there women managers in the organizations and secondly, are there possibilities for job advancement. When it comes to the first aspect, whether there are women managers, 15% of the participants in the research answered that in their organization there are no women managers, and 40% stated that there are but too few. However, when observed by sectors, the situation differs as it is illustrated in the table in continuation.

Illustration 4: Are There in Your Organization Female Managers (superiors)?



In addition, the answers to the question "Is your direct superior men or women?" are the following. Observed by sectors, women managers are around 3% more represented then men in the public sector, while in the private sector men managers are around 12% more represented then women.[3] When

[3] For better illustration of the data's, the percentages from the first and the third answers are shown cumulative, as well as the percentages for the second and fourth answers

analyzing the data with correlation with the independent variable "level of education", it can be noted that the participants in the research with high school education have for 36,8% more male managers (or they themselves are managers), subjects with higher education have for 7% more female managers (or they themselves are managers) and subjects with specialization (Spec./MA) have for 17% more male manager (or they themselves are managers).

Table 1: Who is Your Direct Superior?

Is your direct superior:		LEVEL OF EDUCATION		
		High school	Higher education	Spec./MA
	Women	29,8%	45,6%	36,6%
	Men	61,4%	41,1%	50,0%
	I am women superior	1,8%	7,9%	4,9%
	I am men superior	7,0%	5,4%	8,5%
In total		100,0%	100,0%	100,0%

Through analysis of these data it can be seen that men are more represented as managers in the sector which is more paid and women in the public sector which because it offers greater possibilities for balance between family and work (as it was stated in the theoretical part). In the same time it can be presumed that males are better represented on higher manager positions.

As for the second aspect "Are there possibilities in your organization for professional advancement?" different answers were given. From Table 6 below it can be seen that 12% more males consider that there are possibilities for all for advancement, and on the other side 16% more females have stated that there are no possibilities for advancement.

Table 2: Are There Possibilities in Your Organization for Professional Advancement?"

Are there possibilities in your organization for professional advancement?"		GENDER	
		Men	Women
	Yes, there are for all	62,1%	50,0%
	Yes, but only for men	2,6%	0,4%
	Yes, but only for women		1,5%
	Yes, but only for young people	12,9%	9,8%
	No, there are none	22,4%	38,3%
In total		100,0%	100,0%

In relation to this question, it can be noted that a lot of female consider that they do not have equal opportunity for professional advancement.

As conclusion from the conducted interviews, referring to this hypothesis, it can be noted that women got to their managers positions with lot of work, effort and dedication. As for the advancement, they consider that till some level women are equal with men, hence having same possibilities for professional advancement, however when it comes to higher manager positions the situation is different, or in other words there are far less females represented on those higher managerial level. As a potential reason for the low number of women in top management, the interviewees point out the fact that the selection for these higher positions is done by higher number of men. The mentality was pointed out as another obstacle for the advancement of women in Macedonia, because of the understanding that women should take care more around the house. At this point, it is important also to mention that part of the large companies have realized that the quality and characteristic of females are contributing for better functioning of the companies, and they have introduced quota of 30% for the highest managerial positions for females[4].

From the presented data for this second specific hypothesis, we can conclude that the hypothesis is confirmed, hence, that women are not given equal opportunities for advancement to higher managerial position.

The third specific hypothesis is out of exceptional importance for this research. According to it, the family and house obligations have influence over the career development of the women. The responsibilities and care for the home and the family on the one side can have influence on women to not apply for some position that demands extra engagement outside of the working hours, and on the other side it can additionally be a reason for discrimination in the advancement process to higher managerial level. According to the data from the research the subjects were divided about the question “Is the marital status influencing the advancement of women to managerial positions?” Around 37% stated that the marital status was influencing, where 42% stated that it did not have influence and almost 21% responded with “I don’t know”. It is also very interesting to mention that 46% of the subjects aged between 18 and 25 responded that the marital status is influencing the advancement of females, although around 80% of them were not in marriage. In the same time around 40% thought that females with family obligations apply less for managerial positions.

In relation to this research, the data from the research in 2010 in the Republic of Macedonia that included 120 managers (equal number of men and women from the public and private sector) should also be presented. According to the data from this research the percentage of female managers with family obligations was 20% lower than the percentage of male managers with family obligations (Topuzovska, 2008). In addition to these data, there are as well the responses from the interviewed women managers. They stated that the main limitation to be

[4] Data from the interviews

on high position in a big company is having family (kids) and family obligations, because these job positions are demanding longer work time than 8 hours as well as many work travels in foreign countries. From the interviewees, female managers from the public as well as from the private sector that are working on the lower management positions think that balance can be made between work and private life, but women on higher management positions in big companies still do not have family obligations.

From the presented data for the third hypothesis, it can be concluded that it is confirmed, hence, that the family and house obligations have influence over the career development of the women.

The fourth and last hypothesis is referring to the level of confidence towards women managers. It states that "the confidence towards women managers is lower than towards men". In order to come to the answer if this hypothesis will be confirmed or rejected, the subjects in the research were asked several questions. On the question "Who are more capable managers?" the answers were the following: that men are more capable as managers responded 19,8% from the male and 14,4% from the female participants in the research. The highest percentage answered that men and women are equal, for this response opted 57,8% from the male and 66,3% from the female. The highest rate of the opinion that men are more capable managers is noticed in the eldest group of research subjects (between 56 and 65 years) with 20,7% which is leading to the impression that there are still prejudice towards women on superior, manager positions. In continuation follows the answers of the question "What is the level of confidence in the women as managers?" As with the previous question when most often answer was that men and women are equal, in this question generally the subjects responded that they have confidence in everyone equally not mater the sex. As it can be seen by the table 7 below, the eldest group responded with over 20% that they don't have confidence in anyone, that they have trust only in men responded 6,9% and there is no answers that they have confidence only in women. With this data the previous conclusion can be reconfirmed that the prejudice towards the women as manager are most present at the eldest population.

As the last aspect in confirmation of this hypothesis is the question "In which women managers do you have more confidence?" The highest percentage of trust is in women managers with larger experience, however when analyzing the independent variables there is difference in the percentage depending from the level of education and age. According to Table 8 below, it can be noticed that the participants in the research with higher education have more confidence in women managers with more experience/competence, the biggest difference in the responses is noticeable between the subjects with high school and higher education.

Table 3: What is the Level of Confidence in Women as Managers?

What is the level of confidence in the women as managers?	AGE				
	18-25 years	26-35 years	36-45 years	46-55 years	56-65 years
I have confidence in everyone equally	79,5%	71,4%	76,7%	70,4%	65,5%
I have confidence only in men		4,5%	1,2%	3,7%	6,9%
I have confidence only in women	2,6%	1,5%	4,7%	3,7%	
I don't have confidence in anyone	17,9%	13,6%	9,3%	18,5%	20,7%
Other		9,0%	8,1%	3,7%	6,9%
In total	100,0%	100,0%	100,0%	100,0%	100,0%

It is also important to point out the difference in the answers based on the age of the participants in the research. Hence, the lowest percentage of trust in the women managers with more experience and competence had the eldest with 58,6%, and the highest percentage of 79,5% was noticed with the youngest. In the same time, the eldest participants in the research had most confidence in the younger women managers with 13,8%, and the youngest participants in the research aged between 26 and 35 had the lowest percentage of confidence in the young women managers with 2,5%.

Table 4: Who Are women managers that You Have More Confidence in?

In which women managers do you have more confidence?	Level of Education		
	High school	Higher Education	Spec./MA
In nobody	10,5%	6,2%	2,4%
In everyone	1,8%	6,2%	4,9%
In the older ones	7,0%	3,3%	6,1%
In the ones with greater experience/competence	64,9%	77,2%	78,0%
In the ones with higher education	5,3%	3,3%	6,1%
In the younger ones	10,5%	3,7%	2,4%
In total	100,0%	100,0%	100,0%

As for the responses from the conducted interviews with the women managers it can be concluded that in general the confidence in managers is built with time and it doesn't depended from the gender of the manager, the key factors are his/hers capabilities and qualities, their professionalism and their personality and not their gender. As main characteristics of women managers they pointed out the following: thorough, intuitive, analytic, capable of establishing harmony in the organization, innovative, constructive, tactical, responsible, appreciative towards the esthetic of the approach and the protocol, they are better planners and have better instinct to make an assessment.

As a conclusion for this last hypothesis, it can be noted that the confidence in women and man managers is equal, or in other words the confidence in the manager doesn't depend from the gender. It is also important to be noted that the confidence in man as more capable managers is significantly higher with the eldest participants of the research which can lead to the fact that there are still existing prejudice towards the women as a superior (manager).

From everything previously stated in relation to the research as a whole, it can be concluded that the women are less represented in the top managerial positions in comparison to the men because of the lack of equal opportunities for professional advancement. As the most significant factor for this situation is when family and house obligations occurs, because women need to make balance between work and private life, hence women with family obligations tend to apply less for higher managerial positions. From the same reason women are more represented in the public sector where the working day consists of 8 hours, they have stable medical insurance, the maternity leave is 9 months, the right for medical leave is respected and the annual holiday is between 20 and 26 day, which means that they can have more time for the family and house obligations. Furthermore, it can also be concluded that the confidence in their manager, the employees are building based on his/hers personality and professionalism and it is not based on the gender, although the older population tends to favor the men as managers.

4. Conclusion

The main research question was whether the women are less represented on higher managerial positions than men because of unequal chances during employment and promotion. First, **the research finds out that there are elements that can prove that women do not have equal chances during the time of employment.** Men managed to keep priority of hiring men on higher managerial positions is the main line of thinking. Second, that women do have equal chances for promotion is common attitude, especially in moments that depend on stated criteria and education. But there are differences in responses between women and men in 16% of the answers. Namely, more women think that there are no equal opportunities for promotion. Third, that family and domestic tasks have negative impact on women career getting to the higher ladder was the next question. Here, it was divided, but generally the interviewed thought that this did not influence the promotion of women. Maybe, having more domestic tasks influence on less applying on higher managerial position. Still, our sample was full of young people without marriage obligations. Fourth, the numbers on trust are equal, the competence of the manager respondents do not relate to the gender by respondents. The trust is equal. Respondents do not care for the gender of the managers, but the older respondents do care or think about. They have more trust in men. This is another finding that men do not easily surrender to women managers. They would like to stay in control. The world is rapidly changing but some things changes slower than the world. Even though the students that conducted the research stated that nowadays more women are present in middle managers positions in both public and private sectors. But still, the first positions are more often reserved for men. Comparing to 15 years ago there are slightly more women on top positions in both sectors which are at least encouraging news.

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JEDNAKE MOGUĆNOSTI ZA ŽENE: PROCESI ZAPOŠLJAVANJA I UNAPREĐENJA NA VIŠE POZICIJE

Rezime: *Zapošljavanje i unapređenje žena na više pozicije redovna je tema istraživanja u društvenim naukama i organizacionim studijama. Jednake mogućnosti su bitna stavka u organizacijama jer su muškarci i žene različiti i poslove obavljaju drugačije. Nova istraživanja su pokazala da biti žena može biti prednost u procesu rada, saradnje, komunikacije u organizacijama. Ali, postoje i problemi u ovoj bitci između muškaraca i žena. Glavni argument u ovom radu je da su žene nedovoljno zastupljene na višim rukovodećim pozicijama u odnosu na muškarce zbog nedostatka jednakih mogućnosti prilikom zapošljavanja i napredovanja. Među mnogim faktorima koji mogu uticati na položaj žena u odnosu na muškarce na višim pozicijama ovaj rad će pokušati da uključi dve dodatne promenljive, uticaj porodice i domaće zadatke koji mogu uticati na karijeru žena i poverenje u žene kao menadžere.*

Ključne reči*: žene menadžeri, jednake mogućnosti, promocija, zapošljavanje, razvoj karijere*

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THE RELATIONSHIP BETWEEN GENDER, AGE, LEVEL OF EDUCATION, TALL OF AN INDIVIDUAL'S AND EMPLOYEES ENGAGEMENT

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Abstract: This paper examines the relationship between the demographic characteristics and employee engagement to the occasional sample of 849 respondents who are employed in the public and non-public sector in Slovenia. The main goal of the research is to determine whether (and how) the impact the demographic characteristics (gender, age, level of education, tall-high) on the employee engagement. A written survey was conducted from 1 January 2013 to 15 March 2013. For a statistical analysis, we used IBM SPSS 20 and multivariate analysis (multiple regressions). Based on the multiple linear regression (F (2, 684) =26.956, p-value = 0.000, R-square = 0.073) we found out that there is no statistical significance at 5% significance level relationship between tall of respondents and an employee engagement. Among two evaluated multiple regression models, as the most appropriate, the multiple linear regression model with two regressors (age and level of education) and sample size of 684 was used. We found out that the engagement of employees would increase if the level of education increase, but if the age of respondents increase then the engagement of employee decreases.

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Keywords: employee, engagement, demographic characteristics, multiple linear regression.

1. Introduction

The company's success mainly depends on human resources management. Therefore, for successful work in the company it is necessary to respect and educate employees who must participate in the running of the firm and at the same time they have to be motivated because only motivated, informed, satisfied and engaged employees create the competitive advantage of a modern enterprise. In the current times of crisis a new concept of employee engagement which is not entirely new has begun to gain significant weight. It is known that the British government included it in its own strategy how way to get out of the crisis because it is convinced that it cannot be found without strongly motivated and engaged employee. The purpose of this paper is to investigate whether and how four selected variables influence the dependent variable under study defined as Y-a (engagement of empoloyee). The aim of the study is to contribute the understanding of how four independent (demographic characteristics) variables (X_1- a Dummy variable for gender; X_1= 0 for male; X_1= 1 for female, X_2- a variable for the age; X_3- a variable for a tall-high of individual's, X_4- a Dummy variable for level of education; X_4= 0 for level of education-primary school or less; X_4= 1 for level of education-high school or more) impact the Y variable based on linear regression models. *This is a completely new research into the impact of the individual's tall-high of the engagement at his work.*

The main research hypothesis is that at least one independent of variables (X_1, X_2, $X_{3,}$ X_4) is statistically significant for explanation of variability in variable (Y- engagement of empoloyee).

Additional research hypothesis states that the independent variable (X_3) is statistically significantly for explanation of variability in variable (Y). The following programs were used for the analysis: IBM SPSS 20, Excel, Megastat and Gretl. We will use descriptive analysis and multiple linear regressions. Research data has been acquired through the use of a questionnaire. For data exploration using Excel, Megastat, IBM SPSS 20. We used t-test for independent samples and multiple linear regression.

2. Literature Overview

Kahn (1990, p. 694) was the first scholar to define "personal engagement" as the "harnessing of organization member's selves to their work roles: in engagement, people employ and express themselves physically, cognitively, emotionally and mentally during role performances".

Employee engagement is above all average willingness to engage the energy and commitment of all employees in everything they do in order to achieve outstanding results (http://www.dialogos.si/slo/objave/clanki/zavzetost/).

Employee engagement, also called worker engagement, is a business management concept. An "engaged employee" is one who is fully involved in, and enthusiastic about their work, and thus will act in a way that furthers their organization's interests. According to Scarlett Surveys, "Employee Engagement is a measurable degree of an employee's positive or negative emotional attachment to their job, colleagues and organization that profoundly influence their willingness to learn and perform is at work". Thus engagement is distinctively different from employee satisfaction, motivation and organizational culture (http://en.wikipedia.org/wiki/Employee_engagement). Work engagement has been defined as "a positive, fulfilling work-related state of mind that is characterized by vigor, dedication, and absorption" (Schaufeli et al., 2006, p. 702). Employee engagement is a distinct and unique construct that consists of cognitive, emotional, and behavioral components that are associated with individual role performance (Saks, 2006). Work engagement is defined as a positive, fulfilling, work-related state of mind that is characterized by vigor, dedication, and absorption (Schaufeli et al., 2002). Maslach et al. (2001) noted that engagement is characterized by energy, involvement, and efficacy—the direct opposites of the three burnout dimensions, exhaustion, cynicism and ineffectiveness.

According to Blessing White's 2013 research report, the general findings are: while engagement and intent to stay are directly correlated, the specific dynamics of retention appear to vary significantly from one region of the world to the next; the dynamics of tenure, level and age remain the same – as people grow more experienced and vested in their work, or more senior in the organization, engagement increases; while gender is not a significant factor of engagement in Western economies, large gaps in engagement levels between men and women are apparent in India, the Persian Gulf and South America (Employee Engagement Research Report Update- January, 2013).

There are empirical evidences, which show positive association between employee engagement and performance. According to the Job Demands – Resources Model, work engagement has a positive impact on job performance and employees who are engaged and perform well are able to create their own resources, which then foster engagement again over time and create a positive gain spiral (Bakker, Demerouti, 2008).

Schaufelli, et al. (2006) was found that engagement was weakly positively related with age; relationships between work engagement and gender were weak but equivocal, in the Australian, Canadian, and French samples, no gender differences were observed.

The results of the study (Rathi, 2011) demonstrated a positive relationship between psychological well-being and organizational commitment and its components, namely affective, continuance, and normative commitment.

Gibbons (2008, Ling, Norslah., Mohammed, 2013) identified eight main antecedents that are commonly found among studies about employee engagement, which are:

- trust and integrity;
- line-of-sight between individual performance and company performance;
- personal relationship with one's manager;
- career growth opportunities;
- pride of the company;
- employee development;
- nature of the job; and
- coworkers/team members.

Engagement at work is associated with positive work and individual well-being outcomes and that organizational experiences are a major contributor to levels of employee engagement. (Gonzalez-Roma et al., 2006; Hakanen et al., 2005; Langelaan et al., 2006; Sonnentag, 2003).

Very few researchers, (Koyuncu, Burke, and Fiksenbaum, 2006; Basikin, 2007; Wayid, 2011) examined the elationship between demographic characteristics and work engagement. One must question why some individuals demonstrate signs of work engagement, while others show little or no signs while working under the same or similar conditions. In Koyuncu and Fiksenbaum (2006), the demographic characteristics of age, marital and parental status, number of children, level of education, hours worked, part-time work were measured. Using hierarchical regression analysis, when personal demographics were entered as block, no significant amount ($p > 0.05$) of variance was accounted for in work engagement.

J. Swaminathan and A. Ananth (2009) found that, among the demographic characteristics, only experience ($F=4.665$; $p=0.019$) and income ($F=4.815$; $p=0.03$) has a significant influence on employee engagement, while others characteristics like gender, age and education have no significant influence. In the literature, there are mixed results with respect to age. For example, some researchers (Adekola, 2010) reported no significant difference for any dimension of work engagement, whereas others (Schaufeli et. al, 2006; Otwori and Xiangping, 2010) found weak but positive correlation between age and all dimensions of work engagement.

Vorina (2013) study shows that the engagement of employees would increase if the satisfaction with life increase.

Vorina, David, Vrabič-Vukotić (2013) study shows that if the development of ICT skills increase than also increase the employee engagement.

3. Exploratory Data Analysis

Sample. For this research we selected population - residents / in a statistical region Savinjska in Slovenia. The investigated unit were people over 15 years old employed in the enterprise or an institution. The sampling frame consisted of residents / from different places and towns in statistical region Savinjska. The sample consists of 849 respondents. The study included 403 (47.5%) men, 441 women (51.9%) and 5 respondents (0.6%) who did not answer the questions. There were 56 people (6.6%) with completed primary school level of education or less, 143 people (16.8%) with completed vocational school level of education, 301 respondents (35.5%) secondary school level of education, 159 (18.7%) of respondents who completed college, 139 (16.4%) of respondents who finished university, the number or percentage of respondents with master's degree or doctor's degree is 22 (2.6%). There were 29 people (3 .4%) who did not define their level of education. The average age of respondents is 39.01 years, standard deviation is 10.22 years. The average tall is 172.70 cm, standard deviation is 10.12 cm.

Accessories-description questionnaire. The questionnaire consists of twenty-one closed-ended questions, three questions relate to demographic data (gender, age and tall) of respondents. The questionnaire was compiled ourself but the part of the questionnaire for measure employee engagement used by the Gallupov Institute (http://www.gallup.com/strategicconsulting/126806/Q12-Meta-Analysis.aspx). Employee engagement was measured using 5 degrees Likert's scale (1-strongly disagree, 2-partially disagree, 3-just yes not, 4-mostly disagree and 5 completely agree) with 12 factors which are: I know what is expected of me at work; I have the materials and equipment I need to do my work right; At work, I have the opportunity to do what I do best every day; In the last seven days, I have received recognition or praise for doing good work; My supervisor, or someone at work, seems to care about me as a person; There is someone at work who encourages my development; At work, my opinions seem to count; The mission or purpose of my company makes me feel my job is important; My associates or fellow employees are committed to doing quality work; I have a best friend at work; In the last six months, someone at work has talked to me about my progress; This last year, I have had opportunities at work to learn and grow.

Working methods and procedures of measurement. Interviews (face to face) were carried out from 1 January 2013 to 15 March 2013. We interviewed friends and acquaintances. During the interview we were of great help of the students of the School of Economics Celje, Vocational College. Solving questionnaire took about 10 minutes. We distributed 880 surveys but only 849 were analysed. 31 surveys were highly incomplete (more than half of the responses in the questions were missing), so we excluded them from the further statistical analysis.

Used methods, data processing. The collected data were analyzed using IBM SPSS, version 20. We have also used the Microsoft tools Word and Excel. Regarding the purpose and objectives of the research we used ANOVA test and multiple linear regression.

Verification of the adequacy of the measurement instrument. For the measuring employee engagement we used the Gallup's questionnaire.

We calculated Cronbach's alpha 0.875 (Tables 1 and 2) which means a lot or exemplary reliability of measurement.

Table 1. Case Processing Engagement

	N	%
Valid	826	97.3
Cases excluded	23	2.7
Total	849	100.0

Source: SPSS 20, Author's creation

Table 2. Reliability Statistics, Engagement

Cronbach's Alpha	N of items
0.875	12

Source: SPSS 20, Author's creation

4. Findings of the Research-Test Hypotheses

The hypothesis was tested with two models of multiple linear regression. In the *Model I* we chose independent variables X1- a Dummy variable for gender; X1= 0 for male; X1= 1 for female, X2- a variable for the age; X3- a variable for a tall-high of individuals, X4- a Dummy variable for level of education; X4= 0 for level of education-primary school or less; X4= 1 for level of education-high school or more. The dependent variable (Y-employee engagement) was measured as the sum of 12 factors by Gallup.

The linear multiple regression Model I (1) with estimated parameters is:

$$\left(\hat{Y} = 37.66 + 0.032X_1 - 0.145X_2 + 0.04X_3 + 3.809X_4\right) \quad (1)$$

n = 508, R-squared = 0.074, Adjusted R-squares = 0.067, Standard Error = 8.49. In *Model I* (Table 3, 4, 5) 7.4 % of total sum of squares are explained by the estimated model. Variables X_1 (p-value = 0.5675), X_3 (p-value = 0.917) are not statistically significant.

The hypothesis 1 is accepted.

In additional Model II, we excluded the variable X_1 and X_3.

Table 3 Regression Model I: K=4, n=508

R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
0.273	0.074	0.067	8.49536	1.756

Source: IBM SPSS 20, Excel, Author's creation

Table 4 Regression Model I, F-test

Model II	Sum of Squares	df	F	P-value
Regres.	2921.940	4	10.122	0.000
Resid.	36374.245	504		
Total	39296.185	508		

Source: IBM SPSS 20, Excel, Author's creation

Table 5 Regression Model I: K=4, n=508

	Coeff.	Standard Error	t Stat	P-value
Intercept.	37.66	6.431	5.86	0.000
X_1	0.032	0.769	0.419	0.5675
X_2	-0.145	0.037	-3.89	0.000
X_3	0.004	0.037	0.104	0.917
X_4	3.809	0.790	4.820	0.000

Source: IBM SPSS 20, Excel, Author's creation

The linear multiple regression *Model II* (2) with estimated parameters is:

$$\left(\hat{Y} = 38.769 - 0.136X_2 + 3.972X_4\right) \quad (2)$$

n= 684, R-squared = 0.073, Adjusted R-squares =0.071, Standard Error = 8.62, F (2, 684) =26.956, P - value=0.000.

In Model II (Table 6, 7, 8) 7.3 % of total sum of squares is explained by the estimated model. Variables X_2 (p-value=0.000) and variables X_4 (p-value=0.000) are statistically significant at 5% significance level. The regression coefficient β_2 (β_2=-0.136) shows that if X_2, age of respondents, would increase, the regression value of engagement of employees would decrease. But, the regression coefficient β_4 (β_4=3.972) shows that if X_4, level of education would increase, the regression value of engagement of employees would also increase.Therefore, hypothesis 2 is rejected.

Table 6. Regression Model I: K=4, n=684

R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
0.271	0.073	0.071	8.62155	1.786

Source: IBM SPSS 20, Excel, Author's creation

Table 7: Regression Model II, F-test

Model II	Sum of Squares	df	F	P-value
Regres.	4007.406	2	26.956	0.000
Resid.	50693.814	682		
Total	54701.220	684		

Source: IBM SPSS 20, Excel, Author's creation

Table 8. Regression Model II: K=2, n=684

	Coeff.	Standard Error	t Stat	P-value
Intercept.	38.769	1.637	23-.682	0.000
X_2	-0.136	0.032	-4.214	0.000
X_4	3.972	0.684	5.803	0.000

Source: IBM SPSS 20, Excel, Author's creation

5. Conclusion

In this paper we presented a completely new field of research, we investigated the relationship between four independent variables (X_1- a Dummy variable for gender; X_1= 0 for male; X_1= 1 for female, X_2- a variable for the age; X_3- a variable for a tall-high of individual's, X_4- a Dummy variable for level of education; X_4= 0 for level of education-primary school or less; X_4= 1 for level of education-high school or more) and the dependent variable Y – employee engagement. In model we included a new independent variable X_3-tall of the individual's. All data are based on the author's research.

Previous studies on gender differences provided inconsistent findings. For example, Schaufeli, Bakker, and Salanova (2006) found a weak but vague relationship between work engagement and gender. Gonzalez-Morales, (2010, Wayid et al., 2011) to the extent that there was a significant difference in mean score of male and female teachers with respect to the dimension of work engagement. In our research, we do not find that there is a relationship between work engagement and gender.

Multiple linear regression Model I, with n=508 and K=4 regressors, indicated that only variables X_2 and X_4 are statistically significant. Model II, with n=684 and K=2 regressors, indicated that variables X_2 and X_4 are statistically significant at 5 % significance level. The F-test with F-statistics F (2, 684) =26.956, and P-value=0.000 shows that overall regression is statistically significant at 5 % significance level. The regression coefficient β_2 (β_2=-0.136) shows that if X_2, age of respondents, would increase, the regression value of engagement of employee would decrease. But, the regression coefficient β_4 (β_4=3.972) shows that if X_4, level of education, would increase, the regression value of engagement of employee would also increase.

We found out, that there is a positive correlation between age and work engagement such as Schaufeli et al, 2006; Otwori & Xiangping, 2010.

Finally, in this research, the first hypothesis was accepted: the main research hypothesis, which stated that at least one independent of variables (X_1, X_2, X_3, X_4) is statistically significant for explanation of variability in variable Y-engagement of employee. The additional hypothesis, that that independent variable (X_3) is statistically significantly for explanation of variability in variable Y was rejected.

In further research it would be interesting to include in the multiple regression model other independent variables such as, (BMI- body mass index, marital status…).

Employee angagement = f (-age,+level of education)

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VEZA IZMEĐU POLA, GODINA, NIVOA OBRAZOVANJA, VISINE POJEDINACA I ANGAŽOVANJA ZAPOSLENIH

Rezime: Ovaj rad izučava vezu između demografskih karakteristika i angažovanja zaposlenih na prikladnom uzorku od 849 ispitanika, zaposlenih u javnom i privatnom sektoru u Sloveniji. Osnovni cilj istraživanja je da odredi da li (i kako) demografkse karakteristike (pol, godine, nivo obrazovanja, visina) utiču na angažovanje zaposlenih. Istraživanje je sprovedeno u periodu od 1. januara. do 15. marta 2013. godine. Za statističku analizu koristili smo IBM SPSS 20 i multivarijacionu analizu (višestruku regresiju). Na osnovu višestruke linearne regresije (F (2, 684) =26.956, p-value = 0.000, R-square = 0.073) smo otkrili da ne postoji statistička značajnost na nivou 5% značajnosti, između visine ispitanika i angažmana zaposlenih. Među dva ocenjena modela višestruke regresije, kao najprikladniji, višestruki linearni regresioni model sa dva regresora (godine i nivo obrazovanja) je korišćen, i uzorak od 684. Saznali smo da će se angažovanje zaposlenih povećati ako se povećanja nivo obrazovanja, ali ako se starost ispitanika povećava, angažovanje zaposlenih opada.

Ključne reči: zaposleni, angažovanje, demografske karakteristike, višestruka linearna regresija.

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BRAND SENSITIVITY AMONG CHILDREN IN SERBIA

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Abstract: Children's spending rises steadily and ubiquitously, while the range of products which they independently buy, or initiate the purchase of, expands at a constant pace. The role of brands becomes increasingly important since children represent a highly brand-sensitive consumer segment which is usually mostly responsive to global brands. Nevertheless, little is known about significance of brands for children in European developing countries. The results of this study conducted in Serbia indicate high levels of concordance in the brands preferences between Serbian children and their global counterparts. However, selection of brands by Serbian children is not influenced by celebrities' and peers' opinion, which differs from the practices of children in more developed countries.

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1. Introduction

The children's market changes persistently and therefore requests new approaches and frameworks in order to apprehend the complex setting of children's consumer socialization. Raising awareness of the importance of this consumer segment is dominantly owed to the fact that children's spending worldwide has reached an unprecedented level, at approximately USD$170 billion, and for the most part it is discretionary (Euromonitor, 2006). Moreover, time span of childhood is compressing (a phenomenon known as "kids getting older younger" [KGOY]), implying earlier rejection of products targeted to children, faster transition through stages of consumer socialization and involvement in adult world prematurely (Kurnit, 2004).

The foregoing peculiarities of the children's market have been observed and extensively investigated in developed countries (e.g., McNeal, 1992; Roedder-

John, 1999; Siegel, Coffey, Livingston, 2001), while there is still a paucity of studies on this matter in the emerging markets. Beyda (2010) called attention to the sparse representation of developing countries in the contemporary body of studies and argued that both scholars and practitioners would benefit from better understanding of emerging children's markets through comprehensive research.

This study failed to find any research related to children's consumption and brands choices in Western Balkan countries; therefore, it could be asserted that these issues have not induced almost any interest in scholars thus far. Present research was placed in Serbia, the most populated Western Balkan country (Eurostat, 2006), with the population of children standing at approximately 1.02 million (Statistical Office of the Republic of Serbia, 2011). With respect to the similarities in cultural values and consumption patterns among Western Balkan countries (Inkei, 2009), some outcomes of the present study could be pertinent for the discernment of children's consumption behavior in the whole region. This research endeavors to grasp the attitude of Serbian children towards brands and to identify main actors that influence this attitude.

2. Literature Review

In the recent subject literature there has been consensus among scholars that children's responsiveness to brands has reached a remarkable level (Lachance, Beaudoin, Robitaille, 2003; Yarrow, O'Donnell, 2009). Children are conscious of brands before they start primary school, and at the ages of 5–6 they are able to name multiple brands in various product categories (Roedder-John, 1999). With regard to the fact that children are heavy consumers of food and clothes, it is most probable that they will adopt and develop preferences toward particular brands in these two specific product categories.

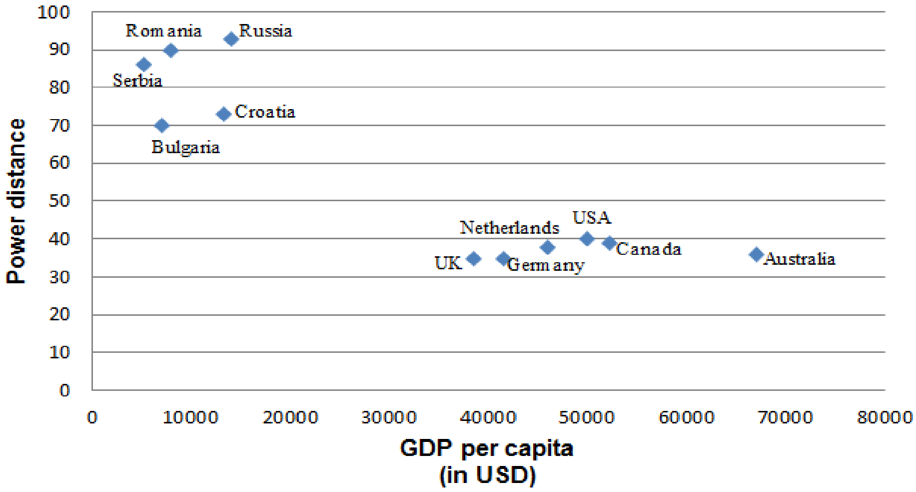
McNeal (1992) states that children are aware of brands and influence purchases of cookies, cereals, fruit juices, ice cream and plenty of other food items, which was confirmed in subsequent studies (Bachmann, Roedder-John, Rao, 1993; Powell, Langlands, Dodd, 2011). Brands proved to be important attribute concerning children's preferences of certain food products (Dibley, Baker, 2001; Robinson et al. 2007; Salvy et al. 2012). Regarding the apparel brands, some studies suggest that brand names on clothes and sport shoes are considered to be part of the social interaction process and can affect children's acceptance by the reference groups (Lachance, Beaudoin, Robitaille, 2003; Clarke, 2005). They also play significant role in children's perception and expression of ideal self-concept (Rhee, Johnson, 2011; Opoku, 2012). In terms of specific brands, some results indicated that the most wanted jeans brands among children globally were *Levi's* and *Diesel*, while in the case of sneakers *Nike*, *Puma*, *Adidas* and *Reebok* were the most wanted (Lindstrom, Seybold, 2003).

A broad range of studies has recognized three variables to be of crucial importance for children’s socialization, namely parents, peers and media (Moschis, Churchill, 1978; Ji, 2002). Accordingly, these variables shape children’s behavior in consumption to a great extent, including their awareness and attitude towards brands. While parents and media determine children’s overall consumption, it was ascertained that peers exerted dominant influence on children’s fashion brands’ selection and peers’ opinion becomes progressively relevant with children age (Valkenburg, Buijzen, 2005; Roper, La Niece, 2009). Furthermore, there are some indications that celebrity endorsers add to the persuasiveness of an advert and enhance children’s purchase intention towards the advertised brand (Ross et al., 1984; Martin, Bush, 2000; Clarke, 2005; Boyland et al., 2012; Chan, Ng, Luk, 2013).

However, it is noteworthy to mention that majority of studies concerning children's responsiveness to brands has been conducted in Western cultures, while some authors (Erdem, Swait, Valenzuela, 2006; Gbadamosi et al., 2012) highlighted that consumption choices cannot be understood without considering the cultural contexts in which they are made by the consumers. Indeed, de Mooij and Hofstede (2002) pointed out that culture was more appropriate and potent predictor of consumer behavior than GDP, especially when the differences in consumer behavior among countries with converging national wealth were examined. Nevertheless, economic status of a country cannot be neglected when considering its national culture, given that there is evidence that richer countries have cultures which differentiate them from less economically developed ones (Minkov, Hofstede 2012). Several studies (Friedman, 1990; Chang, Arkin 2002; van Kempen 2004) established that consumers in low income countries tend to express their status through brands more than consumers in wealthier countries. Similar findings are observed at the individual level, given that adolescents from lower income families are more brand sensitive than adolescents originating from middle and upper classes (Belk, Mayer, Driscoll, 1984; Isaksen, Roper, 2008; Roper, La Niece, 2009). It appears to be rather challenging task to establish comprehensive framework which could enable the comparison of consumers' brands choices among various countries, due to diversity and complexity of factors that determine a culture. Even though certain efforts towards this aim have been made thus far (e.g. Erdem, Swait, Valenzuela, 2006; de Mooij, Hofstede 2011), the role of a culture in children's behavior in consumption remained understudied, ergo it needs to be investigated more thoroughly; since it is of crucial importance for all participants in the business arena in this specific age market across the globe.

Stemming from an extensive review of the literature, it could be observed that some authors used attribute “power distance” in order to distinguish and explore consumers' brands choices in the international market (e.g., Roth, 1995; Palumbo, Herbig 2000; de Hung, Chan, Tse, 2011). The power distance can be defined as “the extent to which less powerful members of a society accept and expect that power is distributed unequally”; therefore, in large power distance cultures, individuals express their social status through the use of proper brands (de Mooij, Hofstede, 2011). The differences in GDP per capita and the power distance scores for selected countries are depicted in Figure 1.

Figure 1: Power Distance and GDP Per Capita for Selected Countries



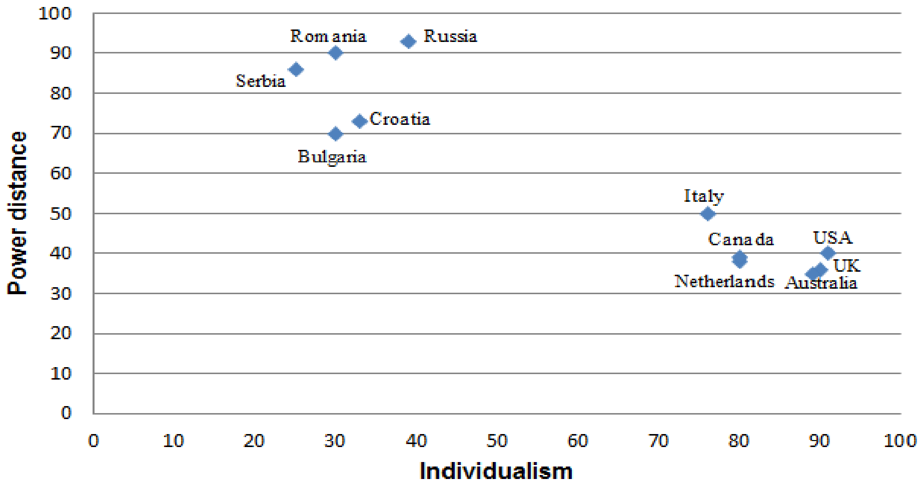
Source: http://geert-hofstede.com/countries.html and http://data.worldbank.org/indicator/NY.GDP.PCAP.CD

It could be discerned in the chart that Eastern European countries tend to have both lower GDP per capita and power distance scores than Western European countries, the USA, Canada and Australia, which could influence disparities in children's brands choices between these two groups of nations.

The second important dimension, in order to distinguish and explore consumers' habits in the international market, appears to be individualism (e.g., de Mooij, 2000; Manrai et al. 2001; Cho, Jin, Cho, 2010). Individualistic cultures are “I” and “me” focused, where a person is expected to take care of herself and her family. On the other hand, in collectivistic cultures people identify with a group and tend to praise group interests more than their personal achievement (Luthans, Patrick, Luthans 1995; de Mooij, Hofstede 2002). The power distance and individualism scores for some countries are presented in Figure 2.

Collectivism in cultures usually highlights conformity to group norms and social acceptance, implying higher reference group influence (Opoku 2012) and brand requests (de Mooij, Hofstede, 2011). Eastern European countries are characterized by high power distance and low individualism scores, adverse to Western countries, delineated by lower power distance and higher individualism scores.

Figure 2 Power Distance and Individualism for Selected Countries



Source: http://geert-hofstede.com/countries.html

3. Research Methodology

The research was conducted on 979 primary school students from five cities in Serbia. The age in the student sample varied from 7 to 13 years, with an almost equal number of female and male respondents included in the study. Student participants originated from five cities across the country: the capital – Belgrade, the second most populated city – Novi Sad, the third most populated – Niš, and two Western Serbian middle-sized towns – Šabac and Valjevo (Table 1). The age structure of the sample closely resembled the children's population of Serbia (Census in Serbia: age and gender). For instance, 43.5% of the participants in the survey were aged 7-9; whereas the percentage of this age segment in the overall children population aged 7-13 was 43% (i.e. 43.5% vs. 43%). Nevertheless, gender structure of the sample slightly less accurately reflected the population composition, given that the sample included approximately 4% more female respondents than it was their actual share in the population aged 7-13 (53.4% vs. 49.1%).

In order to overcome ethical challenges that are usually involved in children’s research (predominantly related to acquiring permission for access to children; Isaksen, Roper 2010; Davis 2010), the survey was undertaken in six primary schools (two in the capital and one in each of the other cities), subsequent to gaining a principal’s concession. The self-administrated survey was completed during the school hour, while it took approximately 15–25 minutes to respond to all questions. Convenience sampling was adopted and one class was chosen from each of seven grades in every investigated school.

Table 1 Demographic Characteristics of the Sample

Characteristic	Frequency	Percent
Age (years)		
7	128	13.1
8	144	14.7
9	154	15.7
10	141	14.4
11	127	13.0
12	130	13.3
13	155	15.8
Gender		
Males	456	46.6
Females	523	53.4
Town		
Belgrade	388	39.6
Novi Sad	134	13.7
Nis	157	16.0
Valjevo	148	15.1
Sabac	152	15.5

With regard to the peculiarities of the researched age group, the construction of the survey involved discussion with teachers in order to ensure that the language and length of the questionnaire were appropriate for the audience. Furthermore, pertaining to the fact that children of different ages vary in their concentration span and reading abilities (Miller 1990), three different questionnaires were developed. For all three instances a thorough explanation of how to fill in the questionnaire was provided at the beginning and the researcher was present during the whole time in the classroom to give additional information if needed. It was particularly stipulated that there were no right and wrong answers. Furthermore, anonymity of participants and confidentiality of obtained data were guaranteed. Since young children prefer visually presented information (Peracchio 1992), the questionnaire for the children aged 7–8 (first and second grade) was in color, and consisted of 25 questions mostly offered in the “yes/no” format, represented with happy and sad faces. The questionnaire designated for children aged 9–11 (third to fifth grade) contained 40 questions, numerous illustrations and was prepared in a black and white format. Finally, the third questionnaire, composed for children aged 12–13 (sixth and seventh grade) included 42 questions, less graphical elements and – as opposed to the previous two which were written in Cyrillic – was written in the Latin alphabet. At the end of each of the questionnaires the subject was thanked for participating in the survey and there was a maze game (adjusted to the children's age), intended to occupy children who were faster than their peers in filling the questionnaire. The survey structure and procedure entirely complied to the conclusions established by Baxter's study (2012) – why children found fulfilling questionnaires in marketing inquiries to be fun: short questionnaire length (38-items in her study), the use of visual elements, the inability to be "wrong", and having an adult present to assist when needed. The questionnaire was completed by 979 out of 987 recruited students. Eight questionnaires were incomplete, and therefore they were considered to be invalid.

4. Results

Brands that children choose in many product categories are reckoned to be the aspect of the consumption behavior that is particularly interesting for marketing researchers and practitioners. Based upon the literature review and foregoing findings, brands of three groups of products were selected for the analysis – sweets, sneakers and jeans. Sweets were examined in terms of product categories, highlighting the importance of brand only for the youngest age cohort (7–8 years old), as understood to be the heaviest consumers of these items of all respondents. In all three instances, a series of multinomial logistic regressions (MLR) was run, specifying brand as dependent variable and children's age and gender as explanatory variables.

The first regression model questioned whether children's age and gender affected children's fondness towards particular kinds of sweets – chocolate, chocolate bar or cookies. Gender was excluded from the second stage of analysis subject to its insignificance in the overall model prediction (p = 0.178). The final model, with the age of children as the only predictor, was statistically significant (χ^2 = 24.331, p = 0.000), and it attained a classification success rate of 31.3%. Results implied that older children preferred both chocolate (Wald = 16.039, p = 0.000, Exp(B)=1.221) and chocolate bars (Wald = 20.837, p = 0.000, Exp(B)=1.259) to cookies. For the youngest respondents (aged 7–8), inclination towards specific sweets brands was examined also. The survey included six brands – three international (*Milka*, *Twix* and *Kinder egg*) and three national (*Krem bananica* – chocolate bar, *Jaffa cakes* – biscuit and *Plazma* – cookies). Findings ascertained significant differences between girls and boys on this matter (χ^2 = 14.165, p = 0.015): females opted for *Bananica* and *Plazma* more frequently and males gave preferences to *Jaffa cakes* and *Twix*. The origin of brand (national or international) has not been a significant criterion for the differentiation of boys' and girls' sweets choices.

Jeans could be deemed as one of the most universal parts of children's clothes. In the second serial of MLR it was investigated whether children's gender and age (for respondents older than 8) affected which jeans brand they would prefer. Children should quote their favorite brand of the three brand categories that were taken into consideration: (1) *Tiffany* and *Legend* – domestic jeans brands, moderately priced, cheaper than foreign brands; (2) *Levi's* and *Diesel* – global jeans brands, present in Serbian market for a long time, asserted to be moderately expensive; and (3) *Replay* and *Miss Sixty*, not long present on the market and not widespread, perceived as fashionable and high-priced. In this case there was a significant (χ^2 = 56.390, p = 0.000) relationship between the dependent variable and the set of independent variables with the overall classification success rate of 61.2%. According to the Wald criterion, older age was significantly associated with favoring *Replay* or *Miss Sixty* over both other brands categories (*Levi's* or *Diesel*, Wald = 16.483, p = 0.000, Exp(B) = 2.749; *Tiffany* or *Legend*, Wald = 14.666, p = 0.000, Exp(B) = 2.548).

With regard to gender, it could be observed that boys were almost three times more likely to prefer domestic brands to *Levi's* or *Diesel* (Wald = 11.737, p = 0.001, Exp(B) = 2.773), while girls gave preferences to *Replay* or *Miss Sixty* compared to both other categories of brands (*Levi's* or *Diesel*, Wald = 4.266, p = 0.039, Exp(B) = 0.109; *Tiffany* or *Legend*, Wald = 9.369, p = 0.002, Exp(B) = 0.039).

On the matter of sneakers brands, respondents were asked to quote their favorite brand. Of the stated brands, four of them were distinguished as widespread: *Nike*, *Puma*, *Adidas* and *Reebok*, for which analysis was carried out. The full model with age and gender as predictors was statistically significant (χ^2 = 46.519, p = 0.000), indicating that the predictors, as a set, reliably distinguished between children who preferred each of four brands. The overall classification success rate was 58.8%. Grounded on results of the MLR, several conclusions were drawn: (a) increases in age made children more likely to choose *Nike* over *Puma* (Wald = 29.355, p = 0.000, Exp(B) = 0.656), *Adidas* (Wald = 3.827, p = 0.050, Exp(B) = 0.830) and *Reebok* (Wald = 13.866, p = 0.000, Exp(B) = 0.592); (b) being a male almost doubled the likelihood that *Nike* would be preferred to *Puma* (Wald = 6.815, p = 0.009, Exp(B) = 0.565) or to *Reebok* (Wald = 5.417, p = 0.020, Exp(B) = 0.407); (c) older children are 26.7% more likely to favor *Adidas* to *Puma* (Wald = 4.772, p = 0.029, Exp(B) = 1.267); and (d) older children are 30% less likely to choose *Reebok* over *Adidas* (Wald = 4.505, p = 0.034, Exp(B) = 0.713).

Finally, we were interested in discovering whether children opt for certain brands based on their peers' opinion or on the celebrities' brands selection. Hence, they were asked: "Would you rather buy clothes and brands that your friends wear?" and "Do you observe which brands celebrities wear?" The majority of children (68.5%) negated that their friends' choices had any impact on their brands selection, regardless of children's age (χ^2 = 7.062, p = 0.315) and gender (χ^2 = 0.221, p = 0.638). A greater part of participants responded negatively (63.9%) to the second question too, irrespective of age (χ^2 = 4.830, p = 0.305) and gender (χ^2 = 0.023, p = 0.879) again.

5. Discussion and Conclusions

Beside product categories that children choose to buy, equally important are brands which they select in that process. The analysis related to jeans and sneakers brands confirmed results reported by other researches. First, as advocated by some scholars (Handa, Khare, 2011), purchase of branded clothes denotes a trend towards fashion consciousness, and our results concerning jeans brands reflect that girls are more concerned with fashion clothing than boys, which is also recognized in the subject literature (Yarrow, O'Donnell, 2009). With regard to sneakers brands, Serbian children demonstrated the same preferences as children from other countries (Lindstrom, Seybold, 2003; Beyda, 2010), implying universal acceptance and popularity of four analyzed brands. It could be concluded that older children prefer *Nike* to all other brands of sneakers and they prefer fashionable jeans brands. In the case of sweets, it may be advocated that the type (e.g., chocolate or cookie) is more important than brand itself.

The insignificance of peers' and celebrities' opinions for children's brand selection is in contrast to general belief on this matter as well as to preceding outcomes of studies undertaken on this matter (Ross et al., 1984; Lachance, Beaudoin, Robitaille, 2003; Clarke, 2005; Boyland et al., 2012). However, a rather controversial result that children did not take into consideration peers' opinions and behavior regarding the brands that they would buy, has occurred in some of the previous research also. For example, Roper and La Niece (2009) concluded that children younger than 12 were unaware how much their friends influenced their consumption, even though the researchers established that this impact was significant. Furthermore, Rozin, Riklis and Margolis (2004) found no correlation between children's food and TV programme preferences and the preferences of their friends. Similarly, in the study conducted by Valkenburg and Buijzen (2005) majority of parents appraised that their children did not notice the brands that children's friends appreciated. Since the research questions in our study was: "*Do you prefer to buy the same clothes and brands as your friends do*?" and "*Do you notice what brands celebrities wear?*", it may be argued that children were not able to provide correct self assessment on these matters or that their peers' and celebrities' opinions were just the some of the factors which shaped their brands choices. Nevertheless, from the perspective that Serbia is a country with highly collectivistic and large power distance culture, it was expected that Serbian children would be more aware of peers' and celebrities' brands selections. It could be assumed that children have not yet been fully conscious of the concept of status and the ways of its manifestations, but this observation needs to be tested in some future studies.

Several limitations of this study should be noted. First, it should be acknowledged that non-probability sampling has been used for the collection of data for this study, which restrains drawing some general conclusions. Further studies in this field should adopt random sampling procedures and take into account both urban and rural children populations, in order to allow making of better conclusions. Future research may consider investigating children's attitudes towards brands by obtaining responses from children and their parents at the same time. Third, some matters which are revealed in this research request further investigation. Specifically the lack of celebrities' and friends' influence on purchasing behavior should be examined more thoroughly in subsequent studies. However, some insights about children's behavior were acquired and they could be a valuable benchmark for some larger studies that would deal with the same issues. Finally, with a continuous rise in the number of children in developing countries, better comprehension of their consumer socialization process and behavior, related to locally specific circumstances, becomes indispensable and increasingly relevant.

Acknowledgments: This study was a part of a wider research project that addressed various research topics, including children's behavior in consumption, the effectiveness of integrated marketing communications and marketing positioning strategies aimed at children.

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Sažetak: *Dečija potrošnja raste stalno i ravnomerno, dok se asortiman proizvoda koje samostalno kupuju ili čiju kupovinu iniciraju konstantno povećava. Uloga brendova postaje sve važnija, s obzirom na to da deca predstavljaju segment potrošača koji izraženo i obično najviše od svih drugih reaguje na globalne brendove. Ipak, malo se zna o značaju brendova za decu u evropskim zemljama u razvoju. Rezultati ovog istraživanja koje je sprovedeno u Srbiji pokazuju visok nivo usklađenosti preferencija srpske dece i njihovih globalnih vršnjaka, kada je reč o brendovima. Međutim, na izbor brendova srpske dece ne utiču poznate ličnosti i mišljenja njihovih drugova i drugarica, što se razlikuje od uobičajenog ponašanja dece u zapadnim zemljama.*

Ključne reči: *brend, deca, moda, hrana, vršnjaci, poznate ličnosti*

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