University College of Economics and Culture

ECONOMICS AND CULTURE

Volume 13, Issue 2

Riga, 2016

Economics and Culture 2016, Volume 13, Issue 2

e-ISSN 2256-0173

Lomonosova 1/5, Riga, LV1019, Latvia

Publisher

DE GRUYTER OPEN
Bogumiła Zuga 32A Str.
01-811 Warsaw, Poland
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ECONOMICS AND CULTURE 13(2), 2016

DOI: 10.1515/jec-2016-0020

THE IMPACT OF E-COMMERCE DEVELOPMENT ON THE WAREHOUSE SPACE MARKET IN POLAND

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Abstract. The subject of discussion in the article is the impact of e-commerce sector on the warehouse space market. On the basis of available reports, the development of e-commerce has been characterized in Poland, showing the dynamics and the type of change. The needs of e-commerce sector in the field of logistics, in particular in the area of storage, have been presented in the paper. These needs have been characterized and at the same time, how representatives of the warehouse space market are prepared to support companies in the e-commerce sector is also discussed. The considerations are illustrated by the changes that occur as a result of the development of e-commerce on the warehouse space market in Poland.

Keywords: e-commerce, warehouse, warehouse spaces market

Type of the paper: Empirical study

JEL Classification: H54, L19, L81

Introduction

The development of e-commerce is associated with the development of the logistics sector. This presents a need for new types of logistics services. The new forms of service offered by logistics companies require a properly prepared logistics infrastructure.

According to forecasts for 2016, a strong demand for warehouse space and logistics company will be generated by the e-commerce sector and automotive industries, as well as retailers and logistics operators ("Logistyka e-commerce" 2015). In the light of the development of e-commerce, as observed in recent years in Poland, the question must be asked whether the supply of warehouse space is growing enough to meet the needs of e-commerce. It is not just about the amount of available storage space. The attributes of quality of warehouse facilities are also important. Accepting the thesis that the development of e-commerce sector largely affects the quantitative and qualitative changes occurring in the market warehouse, the aim of this article is to present these changes in terms of theoretical and empirical, referring to the example of Poland. You may have noticed that the demand for warehouse space in Poland (as in other European countries) is generated primarily by e-commerce companies (e.g. Amazon). It is also worth noting that the storage facilities are changing to better fulfil the functions associated with the operation of e-commerce.

This is a review article. The impact of e-commerce on the transformation taking place on the warehouse market is still not well described in the literature, as sources are primarily reports, specialist studies, or available expertise. The data, which confirm the existence of this influence, and thus showing the changes emanate from research carried out by companies that had long been periodically examining the warehouse market, that is, Colliers, Jones Lang LaSalle IP (JLL), and Cushman & Wakefield.

Development of the e-commerce in Poland

Europe has a population of 880 million people, out of which 564 million people use the Internet and 331 million people are e-shoppers. The share of e-commerce in the European GDP was 2.45% in 2014. The

UK, Germany and France together account for about 60% of the European e-commerce market (Fig. 1) (“European B2C” 2015).

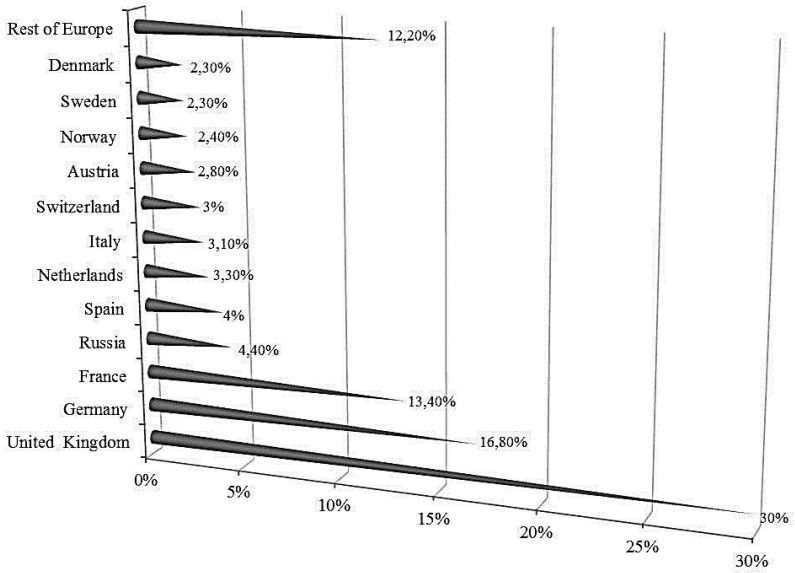

Fig. 1. Share of European B2C e-commerce market, 2014 (*Source*: “European B2C E-commerce”, Report 2015)

Over recent years, there has been a dynamic development of e-commerce market in Poland. This is associated with the general trend of development of e-commerce, which is observed in the world. The contributing factor to this growth is especially improvement of information technology and communications (ICT) and the increasing prevalence of the Internet. This is determined by, relative to the traditional trade, lower operating costs, greater impact, and greater flexibility to offer as well (Chiang, Dholakia 2003; Rodríguez-Ardura *et al.* 2008; Kabango, Asa 2015). Besides, more and more companies assume that the activity on the network is a must in present times. For some businesses (trade activities), the e-commerce route serves a supporting role in relation to traditional trade by way of an "omnichannel"; for others, it is the sole channel of distribution and sales of their products.

Poland is considered to be the fastest growing e-commerce market in Europe (Fig. 2). While in 2006 in the Polish market operated only 2,800 online stores but, in 2008, there were already 4,500 and in 2010 more than half of the more, because approximately 10 000 (“W syntetycznym” 2015). It is estimated that in 2015, the number of online shops in Poland could exceed 22,000 (“e-commerce,” 2015). It is expected that the share of e-commerce in total retail sales in Poland in 2020 will be 10% and will be 2.5 times higher than in 2014 (“Logistyka e-commerce” 2015).

Polish e-commerce is very fragmented. As much as 85% of e-shops are micro and small enterprises. For traditional shops, Internet is often a source of additional sales. Only part of the companies focuses exclusively on e-commerce. About 50% of the entities in Poland receive an average of less than 100 orders a month, and only 7.8% have more than 1,000 orders per month (Kawa 2014).

More and more Poles are convinced of the advantages of e-commerce. According to Dotcom River, this form of trade already uses 32% of Poles (“Logistyka e-commerce” 2015). Even if the data included is in such a way that the e-commerce uses every third Pole, in comparison with Western countries, it is still not much. For example, in 2013, 43.3 million Germans used online shopping (“E-commerce w Polsce” 2014). At the same time, in the last few years, the level of spending in the Polish Internet is growing at a double-digit rate, and in 2014, it reached 3.9% of the total retail sales in the country. Most often clothes, shoes, books, electronics and cosmetics are bought online. Interestingly, the limited range of traditional shops in

towns with a population of less than 20,000 makes online shopping more popular in these towns ("Logistyka e-commerce" 2015).

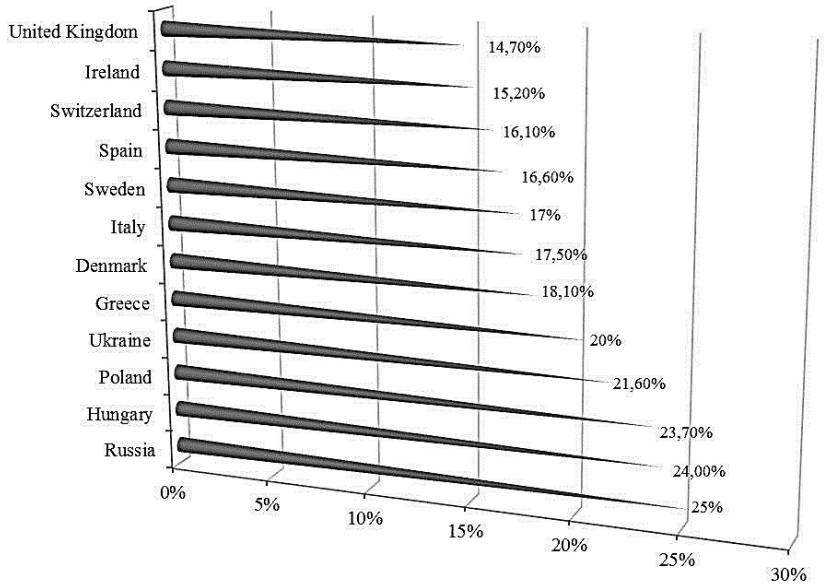

Fig. 2. Top 12 countries in terms of B2C e-commerce growth rate, 2014 (*Source*: "European B2C E-commerce", Report 2015).

The development of e-commerce in Poland affects the geography of buying. More than half of Polish Internet users (54%) buy products or services from Polish websites. Foreign online stores is currently used by 13% of the Poles and their share is still growing. The increase is due to the fact that on the one hand, more and more foreign shops have become destinations of supply in Central and Eastern European countries, including Poland. On the other hand, the Polish customers are becoming more trust in the foreign shops, therefore they are buying boldly at these stores. Besides, foreign online stores, through various forms of advertising, in a greater extent and more effectively reach the Polish customer.

Polish e-commerce is a promising and dynamically growing market. It is expected that the market value of e-commerce in Poland approaches in 2016 to 36 billion zloty and in the next five years is expected to double as well. The number of e-stores in 2016 will increase by 7% and will exceed the level of 23,500,, and more than 30,000 in 2020 (Bellon 2016).

Methodology

The problem of characterizing the correlation between the development of e-commerce and warehouse space market in the literature, both Polish and foreign, is noticed; however, it is not well described. It is more practical than theoretical and may, therefore, be the subject of various studies in the form of reports, expert opinions, case study, not a scientific consideration, especially referring to specific economic theory and management theory. This does not mean that it does not deserve attention, taking consideration of this nature. Quite the contrary, regardless of the issue that will be placed at a higher emphasis, or on e-commerce, or on the warehouse space market, it is an interesting and important issue worthy of developing theoretical studies.

The aim of the discussion is to determine the impact of the development of e-commerce on the changes occurring in the warehouse market in Poland. Changes of a qualitative nature will be analysed. The subject of analysis of such changes in the warehouse space market is the impact of the needs and preferences of the entities on the demand side of e-commerce on the scope and standards of offered

storage services. The source of the data forming the practical plane for considerations is reports characterizing the warehouse market in Poland. Reference will be data for 2013–2015.

Results

Online shopping is increasingly attracting a huge number of customers due to their advantages. The main advantages of shopping on the Internet can include comfort of shopping (open 7/24), wide selection range, and speed of carrying out the order. For the customer, it is important to have lower price compared with the traditional trade. An important factor is the ease of returns and complaints. Goods that are ordered online are 22% more likely to be returned, compared to the 10% of goods that are bought offline (Brundage 2015). It should be noted that the benefits that e-commerce offers to customers largely depend on the potential of the logistics, understood as processes of storage, transportation, inventory availability, and management of logistics processes. These relationships are shown in Fig. 3.

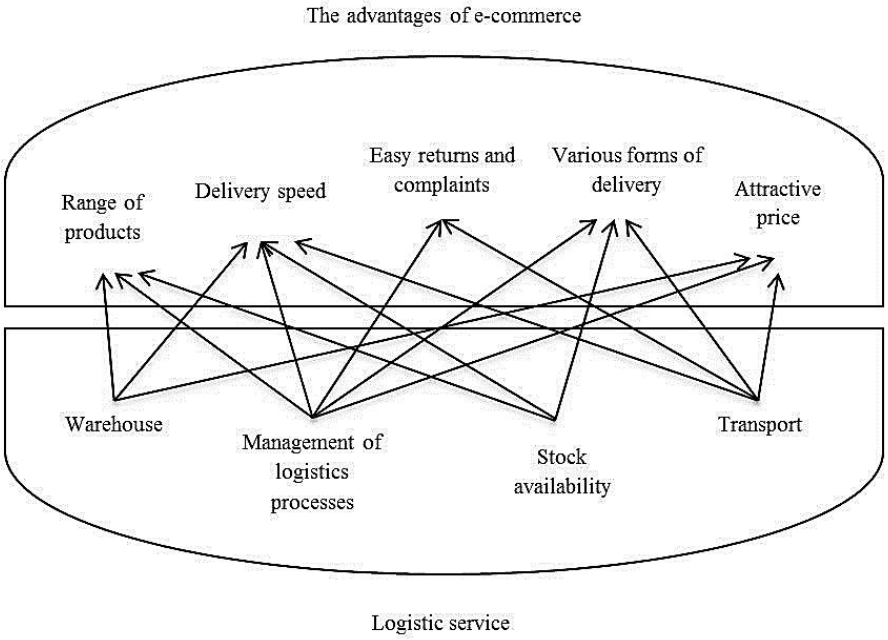

Fig. 3. Relations between the advantages of e-commerce and logistics potential (*Source*: author's compilation).

The role of logistics in the functioning of e-commerce can be seen in three basic areas: (1) transport of goods to the customer, (2) storage, and (3) goods management (forecasting supply, the flow of information, etc.).

The dynamic development of e-commerce observed in recent years in a natural way forced the logistics companies to expand their offer of support for this sales channel. It successively developed a different form of organization of logistics for e-commerce (Fig. 4). Among micro and small enterprises that dominate the logistics space, only transport is carried out on the basis of outsourcing. This form of organization of the logistics associated with the threat to the maintenance of high standards of customer service is in the event of a significant increase in sales. It prolonged delivery time and increases the risk of failure to timely delivery. Large companies, however, depending on the needs can only use transport or just storage, transport and storage, or the logistics services offered on the basis of one-stop e-commerce, although it is not yet a common practice of employing specialized logistics companies that provide a comprehensive range of logistics, including, in addition to transportation and storage solutions, accounting, marketing, etc.

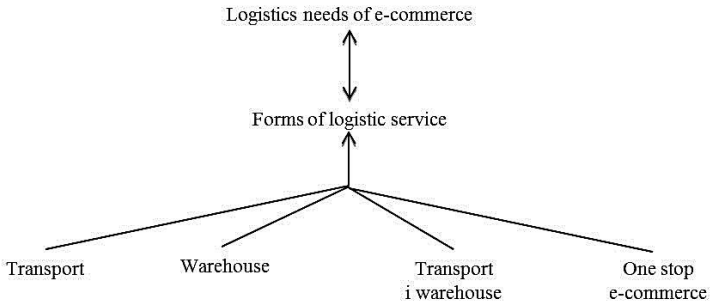

Fig. 4. Forms of logistics service of e-commerce (*Source*: author's compilation).

From the point of view of the management of logistics processes, it is important to identify the differences between the distribution of traditional methods for fixed stores and distribution in e-commerce. The main difference is identifying the recipient. There is a change of the system from B2B to B2C, and if the client is the recipient of the goods that point of receipt of the consignment may be different, due to the current customer preference. It can be a private house, but it could easily be pack station, a post office, a specific collection point. Satisfying that condition is determined by the organization of logistics. In addition, delivery, organized within the framework of e-commerce, must be quick and immediate. In the case of stationary shops, deliveries are planned and held according to the adopted schedule and therefore usually there is no time pressure. It is important to maintain the timeliness of delivery. An important issue is the difficulty in estimating demand, as well as the seasonality of sales in e-commerce. Both of these problems necessitate high flexibility in providing of free storage space.

The diversity of entities operating in the sector of e-commerce, and thus the diversity of needs and logistics operations carried out by them, affects the size of storage resources available to them (the size m^2 of space or m^3 cubic volume of storage). But it also brings in organizational and functional changes, which is attributed to storage facilities in supply chains dedicated to e-commerce sector. Observations of the warehouse space markets in countries such as Germany, the United Kingdom and the United States allow you to point out the following types of storage facilities dedicated to e-commerce (Fig. 5): (1) mega e-fulfillment centres, (2) parcel hub/sortation centre, (3) parcel delivery centre and urban logistics depot, (4) return processing centres, and (5) dot.com warehouse for online food fulfillment. The characteristics of these types of objects are shown in Table 1.

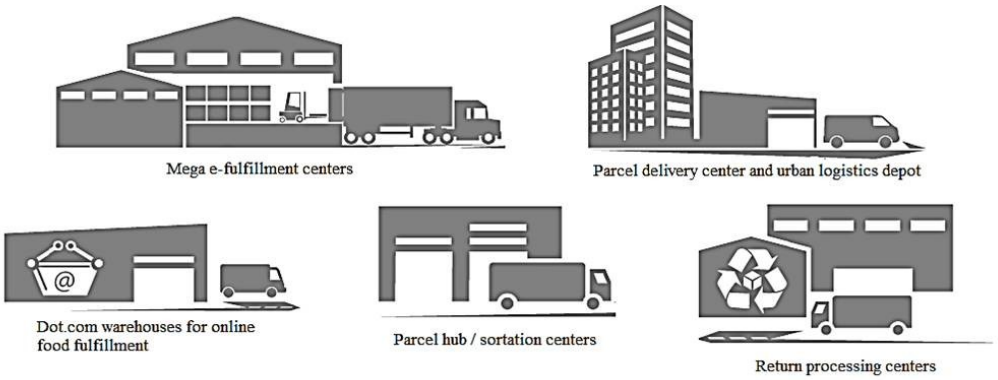

Fig. 5. Types of warehouses depending on the functions for e-commerce sector (*Source*: Logistyka e-commerce, 2015)

Table 1. Characteristics of warehouse for e-commerce (*Source*: "E-commerce boom" 2013).

Type of e-commerce's warehouses	Main building attributes	Main location attributes
Mega e-fulfillment centers	Very large – 500,000 sq ft to 1 mln sq ft+; High bay (15m) to accommodate mezzanine floors; Often cross-dock configuration; High level of employee parking to accommodate full-time and seasonal staff.	Close to parcel hub Close to large labour supply Does not need a traditional centre of gravity location.
Parcel hub/sortation center	High length to width ratio; Low site density; Cross-dock configuration with extensive loading for lorries; 360-degree circulation around the building; Highly automated internal operation involving sortation systems.	Centre of gravity location to feed local parcel delivery centres in hub and spoke network.
Parcel delivery center and urban logistics depot	High length to width ratio; Low site density; Cross-dock configuration with extensive loading for vans; 360-degree circulation around the building.	Edge of major cities and urban areas for home delivery or delivery to collection points.
Return processing centers	Typically bespoke, depending on operation	Located to return items to e-fulfillment centres
Dot.com warehouse for online food fulfillment	Specification reflects type of operation Bespoke loading provision for vans Extensive yard area for trailer and van parking and ample parking for high number of staff.	Edge of major cities and urban areas where online food order volumes are highest.

The requirements of the e-commerce sector to logistics companies, especially to developers of warehouse space, are becoming larger. These requirements apply to storage facilities, which are primarily technical specifications. Technical specification is dictated by the type of operation, which are to take place in them. Companies from the e-commerce sector are looking for the following features storage facilities ("Logistyka e-commerce" 2015):

(a) More docks in the facilities of cross-dock: The standard rate of docks stands at 1 dock / 1000 m^2, on the premises dedicated to e-commerce sector. This ratio increasingly is 1 dock / 500 m^2, which is related to the rate service of handling work and more serviced cars;

(b) More power (dual power source), more efficient HVAC systems: With an increase in employment, the effectiveness of systems should be optimized, not in relation to the type of goods, but the number of employees.

(c) Entresols: Buildings dedicated to e-commerce companies should take into account the additional space located on the mezzanine, which could be used for additional shelves or zones of picking, packing, returns handling or other activities.

(d) Larger parking for staff: Service orders online is labor-intensive process, which involves the employment of more staff than in standard warehouses, and therefore the objects intended to support e-commerce companies should be equipped with a sufficient number of employee parking spaces.

Developers of warehouse operating in Poland are familiar with the needs of the e-commerce sector. Their idea of the most important features of the warehouse dedicated to e-commerce coincides with the needs reported by this sector, which is reflected in the study made by JLL & Prologis in October 2015. According to the logistic operators, the most important features of warehouses designed for e-commerce are ("Logistyka e-commerce" 2015):

a) the flexibility to increase or decrease the leased area – as indicated by 70% respondents who are logistics operators,

b) warehouse entresols – as indicated by 50% of logistics operators,

c) a high level of security and additional social areas – as indicated 40% of logistics operators,

d) more power, equipped with automatic and intensive HVAC systems – as indicated by 40% of respondents,

e) have a large parking for employees – as indicated by 40% of respondents,

f) the high ratio of surface area to the docks – that shows 30% of logistics operators,

g) above the standard height of the light – as indicated by 20% of the respondents.

The e-commerce sector reports to the developers of warehouse space needs not only on technical or organizational and functional attributes of storage facilities. The location of free storage space is also very important to them. This is because it determines the strategies of logistics systems and customer service of e-commerce businesses.

E-commerce is one of the fastest growing sectors of the Polish economy. Although the share of online sales in retail sales in Poland is not as large as in other EU countries, the share of e-commerce in the demand for storage is relatively high (Fig. 6).

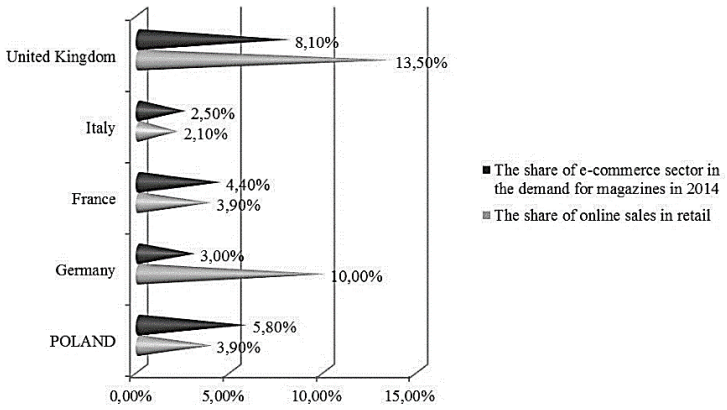

Fig. 6. The share of e-commerce in retail sales and demand for warehouses (*Source*: author's compilation based on "Logistyka e-commerce" 2015).

The supply of modern warehouses reached in 2015 in Poland, occupying nearly 10 million m^2. The net demand reached 1.47 million m^2 and a contract was additionally signed, extending for an additional 0.75 million m^2 of warehouse space ("Rynek nieruchomości" 2016). In 2013 began, so far, the biggest investment in the e-commerce sector was the result of three large transactions including Amazon, with the two largest developers Panattoni and Goodman. The objectives have been put into use in 201:

- Amazon Poznań (Panattoni) with the area of 123,000 m^2;
- Amazon Wrocław (Panattoni) with the area of 123,000 m^2;
- Amazon Wrocław (Goodman) with the area of 123,000 m^2.

These three centres are located in the Polish part of the European network of the Amazon, counting a total of 29 logistics centres (109 logistics centres all over the world). The location has been chosen so that they can serve the market of Western Europe. In terms of the technical facilities built for Amazon, they conform to warehouse facilities dedicated to the needs of e-commerce. In the logistics center in Sady near Poznań, the storage area is 91 570 m^2, while office and social area has been designed on two levels — 8

972 m^2. The object has 60 docks and has 2154 parking spaces for cars and 97 for trucks, 32 for the disabled, and 16 for motorcycles.

The share of renters of e-commerce in gross demand reached 5.8% in 2014 in Poland. Assuming that the value of e-commerce in Poland will grow at a rate of 15% per year, it can be assumed that by 2020 the companies of e-commerce sector can rent up to 700,000 m^2 of warehouse space. This means that e-commerce will become the main driver of growth in demand for warehouse space over the coming years.

Poland is a very attractive location for foreign companies in the e-commerce sector, mainly due to lower rent charges for warehouse space, as well as due to lower labor costs than in Western European countries. For this reason, it is expected that these companies will move their logistics centres from Western Europe, thereby initiating its operations in Poland. In the circle of interest will be locations such as Wrocław and Poznań, mainly due to transport costs. The location near the border, and Wroclaw and Poznań meet this condition. It gives the opportunity for the functioning of efficient distribution of products in the German market. The area of the central Poland, like Łódź, Warszawa, Piotrków and Trybunalski will be very popular among e-commerce companies representing the domestic market. Also in this case the location of logistics centres will determine the cost of the transport of the service area.

Analysing the rent transaction signed in the last few years indicates the following types of transactions:

- Direct contracts from the Internet companies or traditional networks, which have invested in a magazine dedicated to the online channel;
- Agreements of logistics operators who are engaged in handling online orders at the request of the outsourcing;
- Omni-channel transactions, where only a part of the surface is designed to handle online orders.

Estimating the impact of e-commerce on the demand for warehouse space is not easy. It is closely connected with some difficulties. Many retail chains that carry out logistics services on their own usually dedicate part of the warehouse to handle online orders. An additional complication is the fact that the size of this share varies in time and is usually not made available. Another problem is that the logistics operators working for companies in the sector of e-commerce usually do not provide information on what part of their rented space is dedicated to those companies. In turn, the courier companies usually choose to operate in their own buildings, and are therefore not included in the statistics of rent commercial warehouse space.

Conclusions

The aim of the article was to show how the development of the e-commerce sector affects the warehouse space market. The considered problems indicate that the deliberations were not conducted against the background of the scientific methodology, but are cross-cutting, pointing to individual changes. The characteristic of these changes lead to the conclusions that can be presented in two groups: general conclusions and proposals for the Polish warehouse space market.

The main factor determining the growth of warehouse space will be the further dynamic development of the e-commerce sector.

E-commerce sector will specialize their needs in the use of storage, which will be associated with logistics strategies by which the e-commerce companies will operate. These needs, however, will lead to specialization of warehouses and their equipment.

The needs of e-commerce sector to the warehouse space market will be determined by the increase in the share of purchases by mobile (m-shopping – mobile shopping) and social networking (f-shopping – Facebook shopping). To develop these forms of purchase, you may need to deliver the same day (same

day service), and the fulfillment of this condition depends on the availability of the goods, that is, from the network of warehouses.

The tenants of the e-commerce sector will be increasingly interested in the locations allowing efficient distribution of goods in cities Suburban distribution hubs will be created, but the tenants will direct their attention parallel to the existing urban logistics centres and facilities such as the small business units.

Poland is, and in the near future will continue to be, an attractive place for the location of warehouse space for the needs of e-commerce sector. Therefore, developers will invest, even on the basis of speculative investments, in facilities dedicated to e-commerce, which indicates that e-commerce will be the main driver of the market development of warehouse space in Poland.

It is expected that the division of attractive locations for foreign companies and those attractive for domestic companies will still continue. Foreign companies will choose Poznan and Wroclaw, while domestic companies will be located in central Poland. One can also assume that foreign companies will be locating in southern Poland with the intention of organizing the delivery of goods in the direction of Central and Eastern Europe.

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DE GRUYTER OPEN

JOURNAL OF ECONOMICS AND CULTURE 13(2), 2016

DOI: 10.1515/jec-2016-0016

IMPACT OF TAX RELIEF ON PUBLIC FINANCE

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Abstract Tax reliefs are optional, but a very important element of the taxation system. This element is used for different purposes by a country's government institutions. Tax reliefs are a form of tax expenditure that helps to reduce budget revenues. Tax reliefs influence individual and corporate financial behaviour and can have positive or negative effects on the economic and social factors. In the last few years, expansion of tax relief has attracted worldwide attention because of the fact that, after the global financial crisis, many countries are still suffering from fiscal deficits, and expansion of tax relief has not contributed to solving this problem. Tax reliefs are presupposed to be a fiscal policy tool of significance in various subsystems of public finances. The main aim of this article is to examine the impact of personal income tax reliefs on Lithuanian public finances. To achieve this aim, statistical information was systemized; Monte Carlo method was used to group data by horizontal rows and logical links analysed, which helped to evaluate the influence of tax reliefs on public finances. In the simulations, the Monte Carlo method helped to simulate random samples, which were then examined by adapting the conclusions of the theory of probability and mathematical statistics methods.

Keywords: tax reliefs, taxation system, personal income tax

Type of the paper: Empirical study

JEL Classification: H21, H240, H60

Introduction

Taxes are necessary for the state to carry out its functions. In practice, all taxation systems include tax reliefs, which, in many cases, are essential for defining the scope and structure of taxes by applying certain rules. Tax reliefs are often evaluated as exceptions from tax rules. On the one hand, tax reliefs are an important tax structural element, validated by national laws and international agreements (Tax reliefs, 2014; Valstybinio, 2013), while on the other hand, reliefs are one of the most criticized and controversial elements of the taxation system. Tax reliefs promote businesses, help residents generate more income, and reduce social exclusion, but tax reliefs also increase the cost of tax (a negative impact on public finances). These factors reflect the importance of the tax relief.

Tax reliefs are associated with public and businesses, and have a direct impact on the budget revenue. While analyzing tax reliefs and their impact on public finances, different authors have given different opinions and views, depending on the context in which tax reliefs are evaluated and also taking into account the economic situation. It can be argued that, in all cases, regardless of what the targets are, tax reliefs are related to the expenses in budget or unearned income. So, it is important to accurately and transparently define the goals of tax reliefs, application tools and objectives to assess the potential benefits to the budget. Various methods can be applied for calculating the number of tax reliefs that can be created to save working places, the amount of revenue that will be generated through the use of the benefits expected in the future, and its positive or negative impact on the budget, especially in the long run. It is important to understand that the assessment of tax reliefs should not become the norm and should be considered a short-term promotional tools.

Before making decisions about the application of tax reliefs (when, to whom, which type) the impact of reliefs should be evaluated by the government. Assessing the impact on public finances is not enough to assess the loss of earnings; the tax payer's behaviour plays an important role in the assessment.

The goal of the article was to analyze the impact of relief in personal income tax (PIT) on the Lithuanian

public finances. Tested hypotheses were:

H1: If the 5 percent PIT rate is increased to 15 percent, the state budget revenues would increase.

H2: If the tax-free income limit is reduced, the state budget revenues would increase.

A research was conducted to structure the statistical information by applying the Monte Carlo simulation method.

The concept of tax reliefs

Taxes are an important source of government revenue, and are a requisite for the state to execute its functions. Essentially, all taxation systems include tax reliefs, which, in many cases, are necessary for defining the scope and structure of the tax. Tax reliefs are often evaluated as exceptions from taxation rules. These exceptions are created in order to implement specific objectives, or to promote or restrict certain behaviours in social or economic policies. Therefore, tax reliefs are an important structural element of taxation that arevalidated by national laws and international agreements (Tax reliefs, 2014; Valstybinio, 2013).Tax reliefs are usually defined in two ways:

- on the one hand, the government suffers a loss of income,
- on the other hand, the tax payers' liabilities are reduced (Tax expenditures, 2010).

Reliefs are one of the most criticized and controversial elements of the taxation system. On the one hand, tax reliefs promote businesses, increase incomes of residents, and reduces social exclusion, but on the other hand, the tax reliefs increase tax expenses (which has a negative impact on public finances). This implies that tax reliefs are diverse and include various elements of the taxation system. Therefore, there is no single concept of tax relief (Bikas et al. 2014). The definitions of tax reliefs vary from evaluating tax incentives as a privilege to categorizing tax relief as tax costs (Table 1).

Table 1. Definitions of tax reliefs

Author	Definition
Vainienė R. (2000)	Tax relief is a privilege for a particular taxpayer or group of taxpayers. The tax relief is discriminatory; it applies only to certain, chosen taxpayers' category.
Bolnick B. (2004)	Tax relief is - the benefits (determined by the preferential tax rates, exemptions, etc.).
Republic of the Lithuanian Law on Tax Administration (2004)	For the taxpayer or a group of taxpayers, a law which is established for exclusive taxation which indicates conditions that are more favourable compared to normal conditions.
Swift Z.L. (2006)	Tax reliefs are tax expenditures created and applied for behavioural changes in order to encourage certain economic or social objectives.
Rigsrevisionen's (2007)	Tax benefits are a set of measures which reduce or postpone taxes for taxpayers.
Anderson B. (2008)	Tax reliefs - indicate some exceptional tax rights, regulatory conditions for a relatively small group of taxpayers.
Sudavičius B. (2010)	Tax reliefs are the exceptional tax conditions that are more favourable compared to normal conditions, and which provide the right to not pay taxes in general for a taxpayer.
Šimonytė I. (2011)	Tax reliefs (tax exemptions) are budget expenditures that are less transparent and nearly invisible.

Having analysed the different definitions of tax reliefs, three essential aspects of tax incentives can be identified:

- Tax reliefs are a part of the total taxation system.

- They are determined and regulated by law.
- Tax reliefs are expenditures resulting from tax exemptions, which take different forms.

While analyzing tax reliefs and their impact on public finances, different authors have given different opinions and views, depending on the context in which tax reliefs were evaluated and also taking into account the economic situation.

Moreover, tax reliefs are applied in various ways. The reliefs that reduce the tax rate but increase the tax payers' taxable part are most widely used to implement social policy aims. The reliefs aimed at extending the deadline for the tax or eliminating certain tax object are usually used to promote a business or regional economic activity.

The social and economic objectives achieved by applying tax reliefs have a direct impact on the budget revenues, which are known as tax expenses or unearned income. Tax expenses are generally defined as the government's estimated revenue loss resulting from tax reliefs granted to certain classes of taxpayers or activities (Guide to transparency in public finances 2012). In other words, these are a deviation from the standard tax rate.

While summing up the views of different authors, it can be argued that, in all the cases, tax reliefs are related to the budget expenditure or unearned income. So it is important to accurately, transparently and very clearly define the goals of tax reliefs, the application of tools and the object, and assess the potential impact on the budget.

The evaluation methodology of tax reliefs for public finances

EU Directive 2011/85 / EU (2011) states that each member country should publish information publicly about the impact expenditure of tax has on budget revenues. Taxation system complex analysis is an integral part of a systematic analysis of the tax reliefs and should include different recommendations related to fiscal policy, as it is reflected in the national budget. In this study, the main goal was to define the maximum budget revenue forming a part of the personal income tax (PIT) reliefs that influence budget revenues. In Personal Income Tax Law of The Republic of Lithuania (2002), many cases are defined and distinguished where personal income tax reliefs were applied. All the reliefs can be grouped into three main groups:

1. Non-taxable income (NTI); tax-exempt amount of income, additional NTI amount).
2. Reduced size of the personal income tax (individual by working people).
3. Reliefs for the purchase of certain goods or services (tax overpayment recovery accumulating a retirement pension, life insurance funds, etc.).

Since the tax reliefs are not dual, they cover many areas, and their impact on public finances depends on many factors. The impact evaluation was performed using a simulation method. The objective of assessing the impact of personal income tax reliefs on public finances was to calculate the budget loss (overruns) from the applied incentives for the period 2009–2014. It was modeled on what would be the impact if the reliefs are not applied or are applied to different volume; for this purpose, the lost income method was used. Modeling was used to evaluate one or more than one benefit-related factors. Monte Carlo simulation method was used to evaluate the potential loss of income from PIT reliefs, assuming that not all cases of reliefs were cancelled in order to receive more revenue. The theoretical basis of the Monte Carlo method consists of statistical and probability methods. In computerized simulations by means of Monte Carlo method random volumes are simulated, and then the values obtained are examined by applying probability theory findings and methods of mathematical statistics (Žilinskas, K., 2013). While using the Monte Carlo method to simulate personal income tax for possible disposalof tax reliefs, the following assumptions were used:

1. Personal income tax is the case counting probability at which the budget revenue would increase if the non-taxable income is cancelled; 15 percent tax on income, which is now subject to a reduced 5 percent income tax rate.
2. The interval that defines the potential extra income without relief limit was determined.
3. Depending on the rate, the revenues received additionally were modelled separately to increase data accuracy.
4. The results were compared with the statistical data and expert estimates.

The goal of analyzing the personal income tax benefits was to estimate the impact of reliefs on the budget. In other words, to calculate the additional amount that would have accrued to the budget if the reliefs were not applied. In order to determine the extent of PIT reliefs, relative variables were calculated, i.e., share of the amount of PIT reliefs in the total amount of PIT revenues received by state budget, in the total budget volume, in GDP.

Personal income tax relief analysis and the impact on public finances

According to the Ministry of Finance data (2015), the budget losses in 2014 due to application of PIT reliefs amounted to 367 million EUR, which is a 10.1 percent increase over budget losses from 2013. When compared with the economic growth indicators also, it showed that loss due to PIT reliefs increased in 2014 compared with 2013 (Table 2). The increase in the proportion of personal income tax relief amount could have been due to two reasons: as a result of increasing the slab of tax-exempted income (from 136 to 166 EUR / month), or an increase in the additional non-taxable income amount for each child to 60 EUR / month.

Table 2. Loss of personal income tax incentives (Source: prepared by the authors based on the data provided by Ministry of Finance LR and Department of Statistics)

	2013	2014	Change
Loss of personal income tax incentives / GDP	0.95%	1.01%	0.06%
Loss of personal income tax incentives / PIT	7.73%	8.02%	0.29%
Loss of personal income tax incentives / revenue	1.20%	1.25%	0.05%

In Lithuania, employment-related income is taxed at the rate of 15 percent (Lietuvos, 2002). However, an NTI amount is granted to the employees every month, which is 166 EUR per month or EUR 1,922 per year. Families with children get 60 EUR a month for each child, which is an additional NTI (ANTI) amount. It is argued that the NTI and ANTI reduce social isolation and help families with children. The benefits received by the employees as NTI are indicated in Table 3.

Table 3. Budget losses due to PIT incentives (Source: prepared by the authors based on the data provided by the Ministry of Finance LR)

Salary (gross) € / month.	NTI	Effective PIT rate (the ratio of actually paid PIT rate and wage) (%)	Paid personal income tax (EUR)
300	166	6.7	20.1
435	128	10.6	46.0
580	91	12.7	73.4
676	66	13.6	91.6
928 (of this amount, the NTI does not apply)	0	15.0	139.3

NTI, non-taxable income; PIT, personal income tax.

In 2014, under an employment contract, 1.3 million people were employed in Lithuania. By dividing the employees into groups based on salary, we can see that the NTI relief could be used by almost 90 percent of the employees (Table 4).

Table 4. The number of employees by salary groups (Source: prepared by the authors based on the data provided by State Social Insurance Fund LR)

Wage	2010	2011	2012	2013	2014	2014 (%)
till 290	344	349	343	277	262	20%
291–434	272	272	273	281	265	20%
435–579	249	241	249	276	284	22%
580–652	90	93	97	102	103	8%
653–941	157	184	197	220	244	19%
942 and more	73	86	100	118	143	11%
The total number of employees, thous. of people	1.186	1.225	1.259	1.274	1.301	100%

However, when assessing the real impact of the budget on the applicable NTI (the same evaluation and the benefits received by employees), it is appropriate to calculate the average number of employees who did not pay PIT, depending on their income. The analytical results show that the annual PIT reliefs amount to around 300 EUR per year (25 EUR / month.) per person, with the minimum wage of 300 EUR / month (Table 5). For those who receive higher wages, the relief amount decreases. Looking from the public financial position, the amount of NTI tax reliefs in 2014 was about 235 million EUR.

Table 5. The number of employees by salary groups (Source: prepared by the authors based on the data provided by State Social Insurance Fund LR)

Middle of range	Number of employees	NTI	Paid PIT	PIT without NTI	PIT amount of benefit per employee €/year	Annual NTI incentive, (EUR)
300	261.973	166	20	45	298.8	78.277.607
362.5	265.130	147	32	54	264.9	70.224.983
507	283.745	110	60	76	197.2	55.966.999
616	103.348	81	80	92	146.2	15.112.821
797	243.685	34	114	120	61.5	14.992.476
942	142.964	0	141	141	0.0	0
All in	1.300.846		448	529		234.574.886

NTI, non-taxable income; PIT, personal income tax.

In summary, it can be said that although the NTI relief(i.e. 166 EUR / month) seems to be a considerable amount, the real PIT relief is only an additional 25 EUR per month per person employed. It should be noted that about 20 percent of the employees in Lithuania in 2014 received the minimum wage. With an increase in income, the NTI decreased, thus reducing the employee benefits as a result of NTI. Furthermore, the analysis data of the past five years showed that there was a decline in the number of people with the lowest income and an increase in the number of people with higher income. So, the real benefits of NTI were unclear. The state should either increase the size of NTI or it should look for other ways to support the low-income group employees.

According to the PIT law, the PIT can be reduced for residents while purchasing certain goods, paying for studies, or investing in life insurance and third pillar pension funds. The assessment carried out by the Ministry of Finance regarding budget losses due to PIT returns in 2014 is similar to that of 2013.The population declared an expenditure of about 40 million EUR.

In order to have information about the expenditure that reduces taxable income, it is appropriate to analyze the expenditure structure. The analysis showed that in 2013, almost half of the total cost accounted for life insurance premiums (an increase of 8% in comparison to 2012), about 26 percent expenditure accounted for interest for mortgages, and another 23 percent covered expenditure for studies. There was a significant increase in the number of people insuring their lives. Even though, a relatively small part, contributions to the third pillar pension funds have shown a steady increase over the last 3 years (since 2010) (Table 6).

Table 6. E**xpenditure reducing taxable income structure** (Source: prepared by the authors based on the data provided by State Tax Inspectorate)

Type of expenditure	Expenditure reducing taxable income structure (%)				Structural change 2013 and 2012 (%)
	2010	2011	2012	2013	
Residents paid life insurance premiums	33.92	35.91	41.12	49.41	8.29
Residents paid interest on loans granted for housing construction or purchase	40.20	39.81	35.75	25.75	−10.00
Residents paid contributions over the past year for their studies	23.22	22.54	21.87	22.85	0.98
Residents covered the loans for studies	0.09	0.13	0.20	0.32	0.12
Residents paid the premiums to the additional voluntary pension funds	0.77	0.98	1.03	1.67	0.64

To summarize, it can be said that only the PIT benefits related to expenses that reduce the taxable income in terms of public finances can be regarded as very useful. The reasons for this deduction are as follows:

1. Residents are encouraged to accumulate for their future, to invest in life insurance, provide for their own housing, and have access to higher education.
2. Reduces the "shadow" (or declared income).

The PIT loss of 5 percent due to the rate of individual activities income is not very significant. In 2014, it amounted to about 20 million EUR. It should be noted that PIT losses on these preferences almost halved in 2014 as compared to 2013. In 2013, these losses amounted to 53 million EUR (Table 7).

Table 7. PIT taxable individual activities income in 2013 (thous. EUR) (Source: prepared by the authors based on the data provided by State Tax Inspectorate)

	Taxable income amount	Rate	PIT	PIT 15 %	Difference
The agriculture-related individual activities	150.813	0%	0	22621898	-22621898
The agriculture-related individual activities	189.484	5%	9.474.209	28422627	-18948418
Individual activities income received in the pursuit of other activities	742	0%	0	111.325	-111.325
Individual activities income received in the pursuit of other activities	113.669	5%	5.683.462	17.050.386	-11.366.924
Individual activities income received in the pursuit of other activities	137.242	15%	20.586.374	20.586.374	0
Individual sports activity income	33	0%	0	4.994	-4.994
Individual sports activity income	10	5%	515	1.546	-1.031
Individual performing activities	2.278	5%	113.895	341.686	-227.791
Individual Foster Family activities (by Foster Family Law)	135	5%	6.745	20.236	-13.490
Total	594.407		35.865.201	89.161.072	-53.295.871

PIT, personal income tax.

Most of the above-mentioned reliefs are for individuals engaged in agricultural activities.

PIT reliefs in Lithuania are not regarded to only a reduction in tax rate. NTI was evaluated by recalculating the possible budget disposals of the PIT preferences using the Monte Carlo method, which reduced the rate of PIT and personal NTI. For recalculating the amount of PIT that could be obtained from the budget in the absence of NTI, first the effective tax rate and PIT base were calculated. PIT base is

calculated as the average salary multiplied by the number of employees and the effective tax rate. The simulation showed that the increase of rate (while reducing NTI at the same time) would result in receiving PIT in the range of 806–892 million EUR in the budget for 2014. It is important to note that the Monte Carlo simulation shows that by eliminating the PIT benefit, the probability of receiving such PIT revenue could be 71 percent. Thus, the reliefs' destruction of the wage market would affect 29 percent (in case of failure). By evaluating the probability and deducting PIT base, it can be said that the budget losses from NTI were between 160 and 221 million EUR. It is 14–75 million EUR less than the estimated loss when calculated by applying income method. Influence of elimination of NTI on income is shown in Fig.1. The second hypothesis was confirmed.

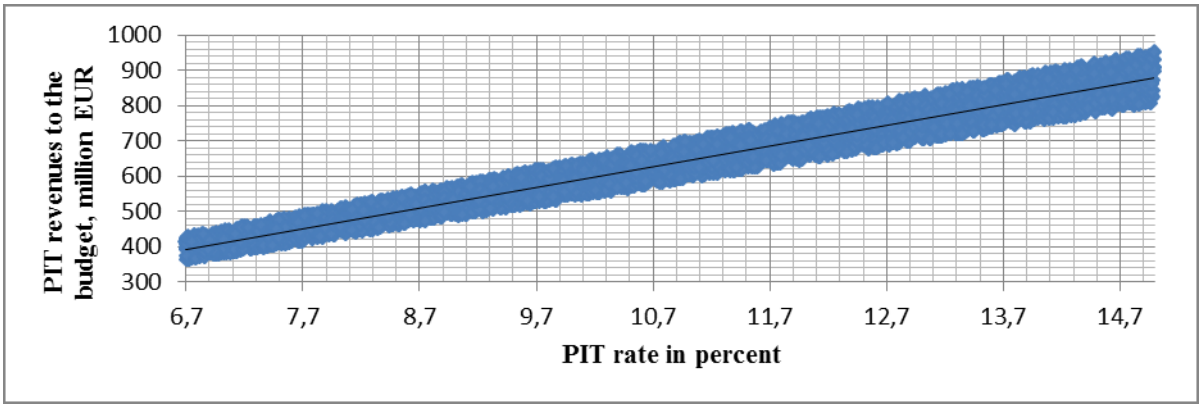

Fig. 1. PIT revenues without NTI (Monte Carlo simulation method, source: prepared by the authors)

Instead of a reduced 5 percent PIT rate, the 15 percent rate was applied in the Monte Carlo method to find the probability of 74 percent, which indicated that the elimination of the preferential tariff is likely to be 26 percent less than the estimated loss of income method. Collecting PIT income (applying 5 percent PIT rate), the revenue from PIT in 2014 could be from 38 to 46 million EUR. This was 7–15 million EUR less than the loss calculated by applying the income method. Monte Carlo simulation results are presented in Fig. 2.

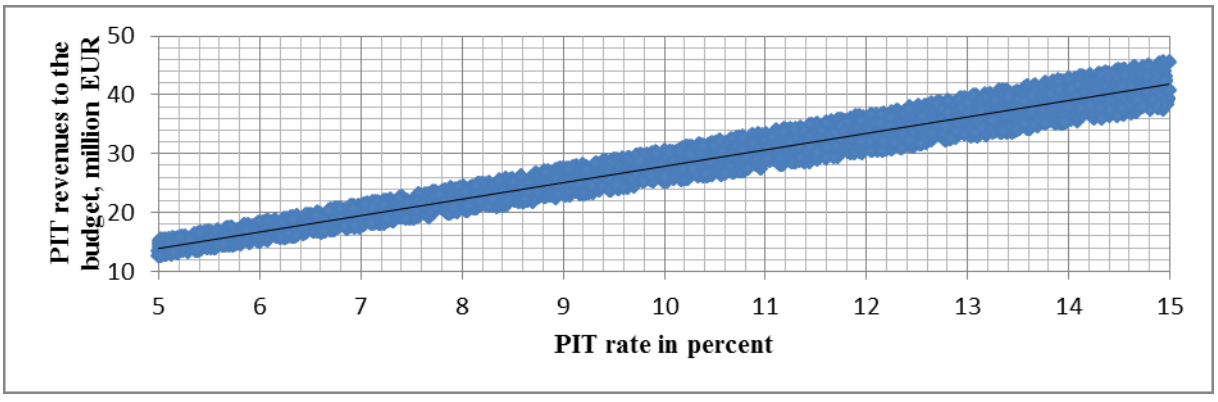

Fig. 2. PIT revenues depending on PIT rate (Monte Carlo simulation method, source: prepared by the authors)

The probability of collecting more revenue was 74 percent. It was assumed that cancelled incentives associated with 5 percent rate would provide 28–34 million EUR higher income to the budget. It was 19–25 million EUR less than the loss calculated by applying the income method (53 million EUR). The first hypothesis was confirmed.

Also, the amount of additional revenue in 2014 budget that would result from the standard PIT rate of taxation of goods and services that are non-taxable was calculated. The possible additional PIT income

and the cancellation of tax-free income incentives would generate21–22 million EUR. Simulations have shown that the probability that it would increase the revenue was 98%.

The assumption was that the budget of the cancelled incentives related to 0 percent rate could increase from approximately 20.6 to 21.6 million EUR (Fig. 3).

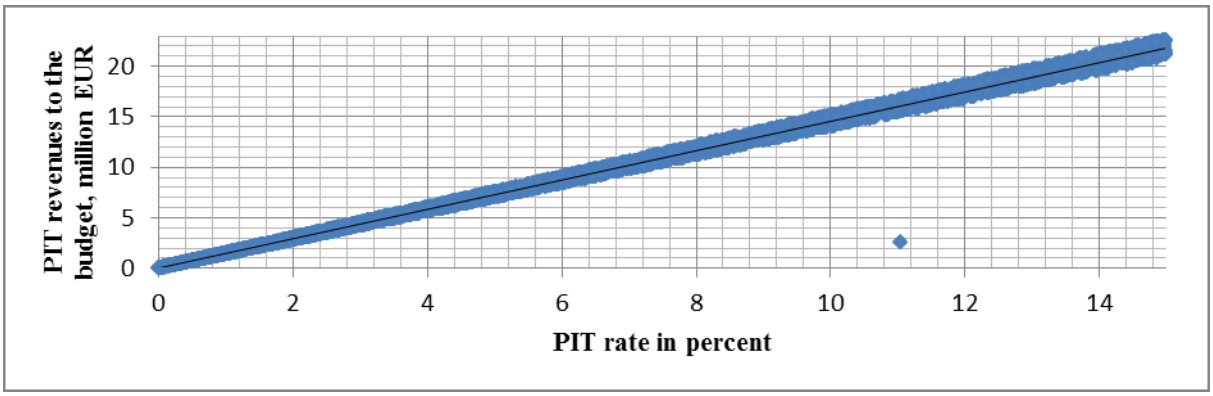

Fig. 3. Additional PIT revenues cancelled of 0 percent incentive (Monte Carlo simulation method, source: prepared by the authors)

Thus, state budget can loose 209- 277 million EUR of PIT revenues because of tax reliefs. Using the Monte Carlo method, which helps to assess probabilities (changes in the labour market), it was estimated that the loss of revenues from PIT would be from 51 to 119 million EUR; significantly lower than the loss calculated using the income method (328 million EUR).

Conclusions

NTI amount results in income tax progressivity, but the real benefits are questionable. Income growth trends suggest that in the year 2014, out of the total employed population, only one-fifth of the workers were able to get reliefs while the remaining employees did not apply for NTI. Public finance, the NTI and ANTI make the largest share (67 percent) of the total PIT losses because of reliefs.

The biggest budget losses are calculated on NTI (235 million EUR).

The expenditure reduces the taxable income in order to promote fiscal transparency, as residents are interested to declare their income. It also encourages residents to save for their retirement, to insure life, to seek higher education and to have mortgages. The loss of cost reducing taxable income is 5.5 percent of PIT due to the losses in reliefs.

PIT losses due to 5 percent rate from individual activity income in 2013 could be between 20 and 53 million EUR. The largest losses result from the reduced PIT rate applicable for agricultural activities, involving individual activities and other activities.

Through the Monte Carlo method for the evaluation of possible changes in the labour market, it was estimated that abolishing the PIT reliefs would bring in an additional 209–277 million EUR to the budget in the year 2014.

Due to the reduced 5 percent rate reliefs, the loss of revenue in 2015 could be around 53 million EUR, and the personal income on non-taxable goods and services would be about 40 million EUR.

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JOURNAL OF ECONOMICS AND CULTURE 13(2), 2016

DOI: 10.1515/jec-2016-0017

PEDAGOGY OF FINANCIAL EDUCATION AMONG COLLEGE STUDENTS

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Abstract. The level of economic thinking and financial culture of population should be considered one of the most important components of society's economic life quality. Here, a key factor is economic and financial socialization of an individual, which can be achieved mainly by modelling appropriate training process technology to promote and ensure financial awareness at the early stages of training in high school and later on in colleges and universities. This paper focuses on one of the options of a unique subject matter (course) in Financial Education, for which testing started in 2008 and is successfully continuing in the Department of Business Management of Neri Bloomfield School of Design and Education (Haifa, Israel) against the backdrop of a multicultural environment. The study shows the dynamics of the formation of the main teaching methods of the new course. In parallel, we analysed the results of the final examinations of students to further adjust the content and pedagogy of the educational process. The results once again confirmed the urgent need to improve the financial literacy of students in accordance with the challenges of economics and culture in the twenty-first century.

Keywords: Pedagogy of financial education; college students; multicultural environment in Israel

Type of the paper: Empirical study

JEL Classification: A2

Introduction and Literature Review

The need to revitalize young individuals' activities in the financial sector should be recognized as one of the major challenges of the modern society in the field of higher education. In this regard, various aspects of a phenomenon known as financial education are widely studied in the scientific literature. This paper discusses some of them.

A. This problem is the focus of international organizations such as the World Bank, Organization for Economic Cooperation and Development (The Case for Financial Literacy in Developing Countries 2009), (Xu, Zia 2012), and the European Commission (Habschick *et al.* 2007), which concentrate their attention on the interdependence of financial education and sustainable economic development. In almost all countries, special government programs are developed and implemented to promote financial literacy, for example, in Australia (Australian Securities and Investment Commission 2011); in Canada, (Orton 2007), etc. In Israel, in the year 2012, under the Ministry of Finance, in a special unit of financial education, a document was developed to discuss the national strategy to promote financial education in Israel (National Strategy to Promote Financial Education in Israel 2012).

B. The epistemological foundations of financial education are studied, including:

- the essence and content of financial education in the context of financial capability (Reifner, Schelhowe 2010; Sherraden 2010) among youth (Johnson, Sherraden 2007);
- the relationship between financial literacy and financial socialization (Gudmunson, Panes 2011; Solheim et al. 2011), as well as financial education and economic development in the context of the study of such phenomenon as "financially educated" person (Hogarth 2006);
- ways of optimal transformation of knowledge into practical activities in the financial sector (Kiviat, Morduch 2012).

C. A whole series of publications examine the issue of financial literacy among young people (Sami *et al.*

2008; Lusardi *et al.* 2010), considering college students as a separate group (Chen, Volpe 1998; Volpe *et al.* 2002; Chen, Volpe 2002; Mandell, Klein 2009; and Stoll, Pumpe 2009). In these publications, the authors have specifically analyzed the data on financial literacy among Israeli college students (Sharabani 2013).

Summarizing the results of the literature review, we can see that, despite the abundance of scientific and methodical literature on this problem, from our point of view, there is a clear lack of research on such an important component as the Pedagogy of Financial Education, and, in particular, with regard to higher education. Concerning the known scientific publications, the exceptions are:

1. The trainers' manual of International Labour Organization (Financial Education for Youth 2011) clearly substantiates a detailed structure of the curriculum related to young people aged 15–29, that is, the life stage when a transition from financial 'dependence' to financial 'independence' occurs.

2. One of the publications provides a comparative analysis of the curricula on the basis of 100 educational institutions – members of the Association to Advance Collegiate Schools of Business (AACSB) (Bianko, Bosco 2011).

It is due to the lack of research in this direction that the author chose Pedagogy of Financial Education as the object of analysis. But before we proceed towards a direct presentation of the nature of the object under study, I would like to note the following: Today, we can say that almost all higher education institutions, regardless of their specialization, make serious efforts to promote financial education, mainly by highlighting certain issues and topics in various courses.

But this situation cannot be considered satisfactory. In our view, this is due to the fact that all hitherto existing financial education is basically 'superficial'. There is an urgent need to make the process of promoting Financial Education that is holistic in nature, and this can be achieved only through the implementation of a special course in the learning process. We favour an approach whereby such a course would be comprehensive and include all kinds of components, the mastery of which will subsequently contribute to the development of optimal behaviour in individuals in the financial sector of public life.

We evaluated this approach in the Business Management Department of our educational institution, acting under the auspices of Consul for Higher Education of Israel. Our choice was not accidental, as the specified department awards Bachelor's Degree in Education (BEd) within their Business Management Program. Additionally, our college specializes in training teachers for teaching economy and management subjects in high school. Recently, a course 'Financial Education' was added to the list of courses for teaching, and has been started as a pilot course in some Israeli schools.

In this department, there are special academic groups, where the majority of students are ethnic and religious minorities (Arab Muslims, Arab Christians, Druze), and a minor part is Jewish. In these groups with multicultural background, on our initiative and with the approval of management, a pilot project on introducing the course "Financial Education" into educational process was launched for the first time in 2008. The course title was dictated by the specifics of our college, which issues Teaching Certificates along with awarding academic degrees. In some cases, other variants of the course title are possible: 'Household Financial Management', 'Financial Behaviour', 'Personal Finance', etc. A very similar project has been launched in the United States in Kent State University by implementing a personal financial literacy elective course 'Me and my Money' within the undergraduate program (Stolle, Dumpe 2009).

In this article, we would like to share with readers the experience gained in this area. The specified course outgrew the scope of educational experiment and today has become an integral part of the educational process.

Methodology

First, we used the scientific methods of observation, generalization and abstraction, which allowed us to design a model of educational experiment, as well as to visualize the learning process in the initial stage of developing a study course.

Second, the process of introducing a new course in the educational process was under constant monitoring, which involved active dialogue with the students and also a quantitative measurement of the results achieved. To this end, we chose the method of measurement of the results of the final examinations, where students, as a rule, tend to concentrate more, and their answers reflect the greatest confidence. Thus, the examination data for 301 students were processed. This approach allowed us to actively adjust the content and teaching methods of the educational process in each subsequent study group.

The next important element of the educational process is the final control of knowledge acquired by students. In most cases, we developed multiple choice questions for the examination. Further ahead in this paper, we offer our readers an opportunity to acquaint themselves with some of the typical questions from our bank of questions of our Financial Education course.

Results

Principles and Content of Financial Education among College Students

Our vision of the mission of Financial Education in colleges can be summarized as the need to prepare students to successfully embed themselves in the financial sphere of public life. Hence, the starting point of construction of the Financial Education system should be to identify those social roles that young people have to play, for objective reasons, in the economic and financial sphere of public life. The following 'roles' should be recognized as social: 1) a household owner and taxpayer, 2) a manpower in the labour market, 3) a reasonable consumer, and 4) an entrepreneur.

The structure of the course was elaborated on the basis of refined social roles performed by young people. As already mentioned, we support the approach which assumes that any course promoting Financial Education is inherently complex and must include economic, financial, social and legal components of life that are, to some extent, related to the nature of financial behaviour of the individual. It is clear that such an approach can be a 'trap', since it is very difficult to 'construct' a course covering all aspects of this particular field and, at the same time, not to turn it into a universal course, such as a simple set of knowledge of banking, finance, entrepreneurship, etc. It is known that modern higher schools suffer much from a lack of training hours. Therefore, it is very important to identify and include the most pressing issues in the course.

Visualization of Learning Process in the Course 'Financial Education'

Achieving positive and desired results from teaching the course of Financial Education is largely predetermined by the use of appropriate tools in order to optimize the perception of educational material by the students, the vast majority of whom, as known from educational psychology, sometimes prefer a visual type of perception in the learning process. At the same time, in the scientific literature, a wide range of tools are recommended. The most recognized mapping tools are mind map, concept map and argument map (Biktimirov, Nilson 2006; Bouzdine-Chameeva 2009; Davies 2011). Different versions of Ishikawa cause-and-effect diagrams (Ishikawa 1985) are also widely used. The decision on which tool to use is not so significant, but the process of transmission of educational material by visual means is important. Towards the end of this paragraph, we have illustrated the various uses of visual aids in teaching the course of Financial Education. At the beginning of the course, we demonstrate to the students the conceptual logical model of this subject, developed on the basis of system analysis (Fig. 1).

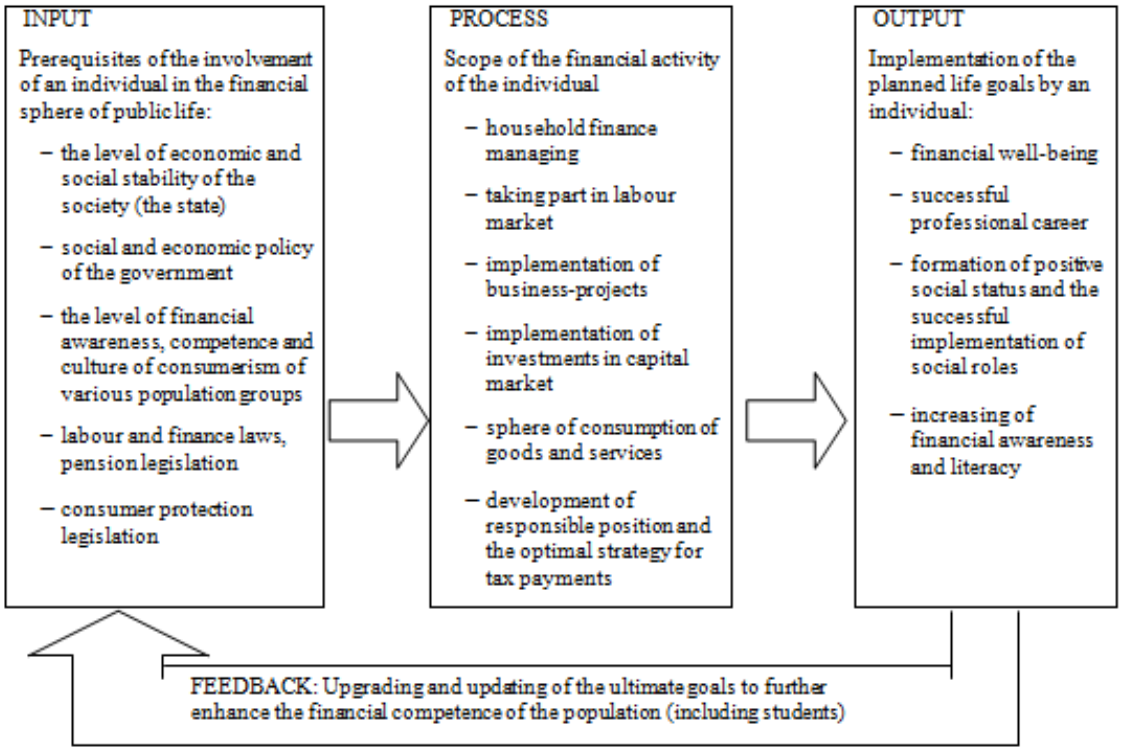

Fig. 1. Conceptual Model of Studying the Course Financial Education

Additionally, we demonstrated to the students the options of logical models on selected topics to illustrate the training material. Possible elements of personal finance planning are presented in Fig. 2.

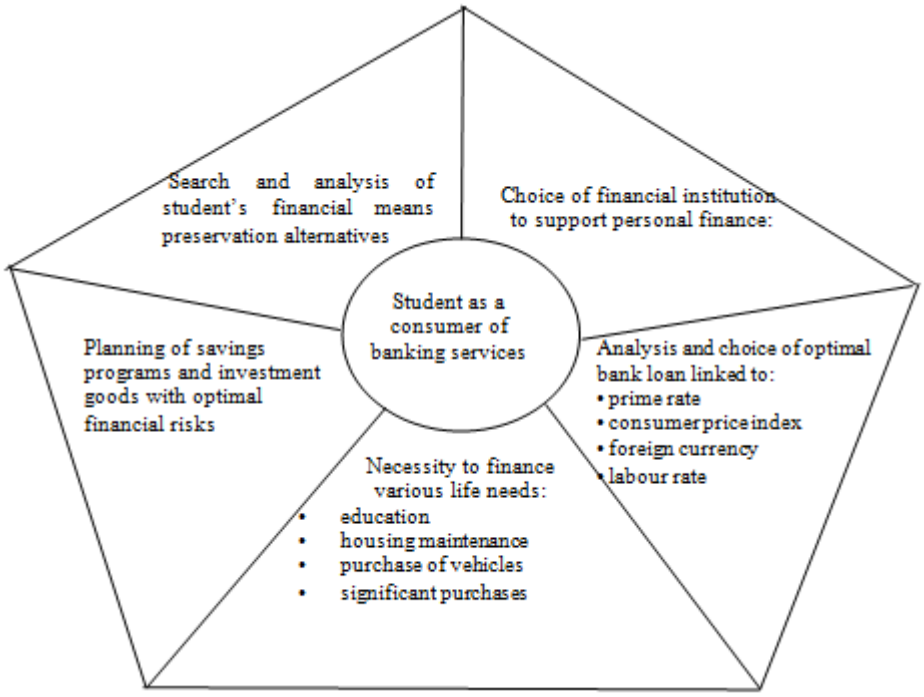

Fig. 2. Possible elements of planning personal finance

Elements forming optimal pension strategy are presented in Fig. 3.

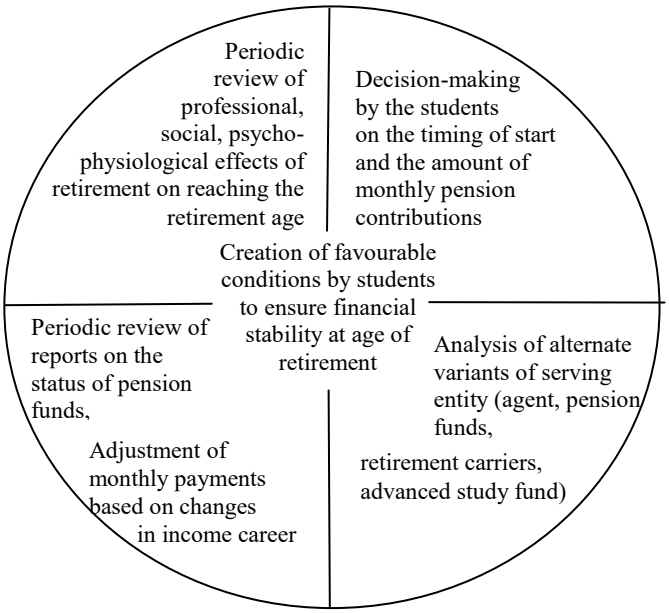

Fig. 3. Elements of an optimal pension strategy developed by the student

Components required to introduce an individual to entrepreneurship are presented in Fig. 4.

Fig. 4 . The necessary components for familiarizing the individual with entrepreneurship

Only visualization of the educational material, for all its importance, does not necessarily solve all the problems of teaching. To achieve the desired results, it is necessary to select appropriate instructional teaching resources.

Instructional Methods in the Teaching of the Course

Due to the fact that neither in Israel nor in other countries there is a universally accepted textbook for the course of Financial Education, as is available for similar courses of Micro and Macroeconomics, Financing, Audit, Accounting, Organizational Behavior, Management and such, we have to provide each student with the appropriate theoretical and practical material on all topics, including case studies to be analyzed at lectures as well as theoretical and visual materials. All the materials are distributed to the students. At the same time, in the learning process, special attention is given to the selection of specific teaching techniques. First, we present several major points that need special attention and adjustment in order to achieve a successful economic adaptation.

Designing the Culture of Household Management in the New Economic Environment

We recommend to each youngster to learn how to plan their family incomes and expenses. Of late, computer software for managing and controlling the family expenses, and home accounting have becomes available in the market. These softwares enable the creation of records detailing the list of incomes and expenses. It supports tables, including subjective tables, family members and bank accounts. There is a chart that shows operations by percentages. This form of accounting is very realistic for young people, especially when there is a lack of tradition regarding management of family budget.

The Student (Youngster) and the Country's Banking System

One needs to explain to youngsters the importance of the country's banking system. We are ready to give 'tips' that relate to cash flow, how to use cheques, credit cards, etc. Furthermore, youngsters need to learn saving plan conditions and possibilities of getting loans for studies and additional needs. Youngsters must also acquire knowledge in the following fields:

- What is the meaning of choosing 'the right bank' or 'the wrong one' for youngsters?
- How to create an optimal saving plan?
- What are nominal, effective and realistic interests?
- What is the meaning of the Bank of Israel interest and prime interest?
- How to use the right for 'overdraft' and to act rationally with this right?
- How to save bank commissions?
- How to register for a loan to finance studies?

Acquiring Habits for Renting a House or for Purchasing the First Home

Planning for the Purchasing Process

We find that the search for a house is at the top of the student's pyramid of priorities, especially if we talk about a young couple, and it is a very complex issue.

A. How does a potential residence fit with the location of the college and of occupation at present?
B. In which area do they prefer to live?

Only after a youngster answers these questions can he make a decision regarding purchasing a house. Nonetheless, if we talk about purchasing a house, he must plan it from an economic point of view and make the following decisions:

- In which bank is it preferable to organize the mortgage and bank loan?
- How to create an economic plan for purchasing a house?
- Which type of loans to choose from for purchasing a house?

Development of Wise Consumer Habits Amongst Youngsters

Today, among youngsters, there is a prominent feeling of buying things 'with no money' meaning that people buy products by using credit cards or via the Internet. In this situation, it is very difficult to buy rationally.

'I buy this product because it is excellent.'

This stands out in the youngsters' thoughts. They need to buy according to the principle:

'We buy a product that is necessary for the household at this time.'

In addition, we present a few more 'tips' for the youngsters' economic 'survival'.

Don't think that you will be young forever. Care for the 'Golden Age' (retirement) from your young age.

Don't exaggerate while evaluating your economic situation, examine it realistically. It means that it is more preferable that people around think you are 'a miser' comparing with the situation when you get warning letters from the bank every month. It is better to live in a regular home without overdraft than in a villa with an overdraft and limited account.

Determine for yourself and keep a few warning points regarding your financial condition, which you can't break.

Teach yourself how to design clear financial goals in life (studies, creating a family, purchasing a home, car, travelling abroad, etc.) according to your economic situation.

Keep a strict discipline regarding documents that relate to the family economy, and don't throw away any document before the expiry date that is marked on it. You need to remember that a document isn't only piece of paper, but it is a proof with legal meaning regarding different subjects.

The next important element of the educational process is the final control of students' knowledge carried out during the final examination. In most cases, we are developing examination questions on the principle of multiple choices. Some of the typical examination questions of our Financial Education course from our bank of questions are presented in the Appendix.

Conclusions

In order to achieve substantial progress in further promoting financial awareness, there is an urgent need to improve the level of financial literacy and competence of the society. As a result, the financial security of the population will increase significantly, especially when it comes to college students. To do this, you must make the process of financial education systemic in nature, and not a one-time measure. Such a process should be organically woven into the system of continuous economic (financial) education, and include various forms of formal and informal education through the media and popular literature for a

wide range of readers, and also directly through the formation of a coherent system of financial education in secondary schools and higher education institutions (universities and colleges).

Despite the fact that, in recent years, higher education institutions have turned their attention to the promotion of financial education, the results of surveys indicate a lack of effective steps. The main reason, in our view, lies in a non-systematic approach to this issue. For example, college students study a variety of issues in a scattered and fragmented form within various training courses. Apparently, the maximum effect can be achieved only through the implementation of specialized courses of Financial Education into the study process.

Here, it is important to avoid a situation where the new course will be a mechanical repetition and return to the concepts that the student has studied in various academic disciplines of economic and financial orientation. It is necessary, in the process of teaching this course, to focus not so much on mastering conceptual apparatus in the field of financial knowledge (which in itself is also important) by the students, but on the formation of modern financial thinking and contributing to effective use of financial instruments in everyday reality for the successful settling and solving of financial operations during their contact with various organizations and individuals.

Acknowledgements

Support for this work was provided by the MOFET (Research, Curriculum and Program Development for Teachers and Educators) Institute in Israel and Neri Bloomfield School of Design and Education, Haifa, Israel.

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Appendix

Typical exam questions (Multiple Choice) in subject matter "Financial Education"

1. According to the norms that are customary in the world, a family, that takes mortgage, can afford itself to plan repayment extent of the monthly average payment of (82%):
   A. 25% of monthly family income.
   B. 10% of monthly family income.
   C. 35% of monthly family income.
   D. 20% of monthly family income.

2. What are preferable ways to cancel the overdraft of a customer's bank account? (6%)
   A. To arrange a loan with the help of a bank clerk.
   B. To close current bank account.
   C. To reduce the expenses extent of the family budget.
   D. Answers A and C are the correct answers.

3. Any type of credit card is not designed for (82%):
   A. For expensive purchasing deal.
   B. For reducing expenses of family economy.
   C. Using instead of cash.
   D. For withdrawing cash.

4. In Israel, payment for the bank account overdraft is carried out (63%):
   A. On 15 of month.
   B. On 28 of month.
   C. On the quarter last day.
   D. Answers A and B are the correct answers.

5. Banks in Israel determine loan interest rate based on (94%):
   A. PRIME interest.
   B. Management opinion.
   C. Israeli government decision.
   D. Answers A and C are the correct answers.

6. During the mortgage loan arrangement, a customer must clarify the following parameters (75%):
   A. Interest rate for loan (mortgage).
   B. Monthly repayment sum.
   C. Israeli government decision.
   D. All parameters.

7. One can keep the value of money in the following ways (38%):
   A. Keeping the money in a safe at home or under the tiles.
   B. Keeping the money in bank current account.
   C. Depositing money in savings plans and Short Term Deposit.
   D. Answers B and C are the correct answers.

8. While choosing a bank it is preferable that the consumer will pay attention to (57%):
   A. What kind of status the bank is willing to give the customer.
   B. Branch location.
   C. Branch accessibility.
   D. Amount and type of commissions which are determined in the bank.

9. What factors should be considered while making a decision about investing in stocks? (88%)
   A. Investment profitability.
   B. Extent of endangering the investment.
   C. Investment liquidity.
   D. All the answers are correct.

10. A student works as a waiter in a restaurant. At the end of month the restaurant owner calculates the salary and includes into the salary the tips that the waiter received. What is the most accurate statement? (70%)
    A. Wrong, because tips are not considered as part of the waiter's salary.
    B. Right, because the waiter received tips by using the assets (tableware, equipment, furniture) of the restaurant owner.
    C. Right. As tip is calculated as the restaurant income and is registered in the cash register, it is considered as part of the salary.
    D. Answers B and C are the correct answers.
11. A wage which is paid to a worker is considered as (100%):
    A. A support of governmental institutes for the citizen.
    B. A support for the worker in order to pay current payments of the family economy.
    C. A payment for work that the worker has done during the month for the employer.
    D. All answers are correct.
12. Which of the following statements for convalescence pay is right? (50%)
    A. For a person who wants to go on vacation to the Dead Sea, Eilat or Turkey.
    B. For covering expenses in order to keep the worker's health.
    C. Every worker who is employed in the organization more than a year deserves it.
    D. Answers B and C are the correct answers.
13. A factory worker stays overtime upon the request of a manager. In this case (88%):
    A. He is paid a payment for overtime in his monthly salary
    B. He is paid a bonus.
    C. He is paid 13th salary (additional salary).
    D. He is not paid, on the contrary, as a punishment it will be reduced from his daily wage.
14. Compensations are paid when dismissing a worker as a result of (88%):
    A. A request of the worker himself.
    B. An initiative of the employer himself.
    C. Benefits which are paid in connection with the dismissal from work according to labour laws in Israel.
    D. This is a payment that is paid selectively to different sectors.
15. Every Israeli citizen pays either way (38%):
    A. Income tax.
    B. Purchase tax while purchasing electric appliances.
    C. National insurance premiums.
    D. Answers B and C are the correct answers.
16. Which statement of the following ones regarding pension is right? (44%)
    A. Kind of saving money.
    B. Sum that is paid to a worker by an employer according to his will and economic laws.
    C. Type of a mandatory savings that each individual must organize.
    D. All answers are correct.
17. A life insurance premium of the Israeli citizen is paid by (100%):
    A. The citizen.
    B. By the state.
    C. By national insurance institute of Israel.
    D. All answers are correct.
18. Decision making as regards to business opening is most worthwhile and right for (94%):
    A. Someone who is unemployed and a pensioner.
    B. Someone who is willing and preparing to get support from his family members.
    C. Someone who has liquid money on his bank account.
    D. Someone who has a special business idea.
19. Which of the following documents is used in business? (100%)
    A. Invoice.
    B. Receipt.

C. Order and delivery note.
D. All answers are correct.

20. According to Israeli national insurance laws, a salaried employee is considered as work accident injured person in case of (82%):
    A. Being injured while playing football with friends.
    B. Work accident.
    C. Professional illness.
    D. Answers B and C are correct.

21. In Israeli economic life, every citizen in a certain age plays the following roles (75%):
    A. Labour force and entrepreneur.
    B. Child, parent and close relative.
    C. Consumer and individual in household.
    D. Answers B and C are correct.

22. Individual is considered as a wise consumer if at the time of buying products or services he acts according to the principle to buy (94%):
    A. Each one of the good products.
    B. Only basing on the family members, friends and work colleagues advices.
    C. Only when there are actions and cheaply.
    D. Only that the family needs.

23. In order to save electricity, it is preferable (38%):
    A. To purchase electric appliances with G sign (of product energy consumption).
    B. Based on the electricity company, to adjust central air-conditioning to 26˚.
    C. To often clean sun-heated water tank glasses.
    D. Answers B and C are correct.

24. What action presents the higher degree of satisfaction of the customer? (82%)
    A. He thanks for the discount.
    B. He smiles at the end of purchasing.
    C. He leaves a tip for the seller.
    D. He comes back for a second purchasing at the same store.

25. A consumer bought salads in supermarket and noticed that the weight includes the packing also. Is it legal? (19%)
    A. Of course.
    B. The supermarket has to subtract the weight of package from the total weight and charge only for salad itself.
    C. If there is a sign – it is permitted.
    D. It depends on what you bought. If humus, it is permitted, if eggplants – it is not allowed.

26. A consumer bought a train game for children, with a picture of a huge train. Inside the package was a tiny train. The salesperson says the near the picture there is a note “for demonstration only”. (63%)
    A. It might be considered as a deception.
    B. So what? On commercials all are models and in the real life they are not.
    C. Only in children games a different law is applied, and therefore it is not a crime.
    D. The law is different regarding the Israeli products that are designed for export.

27. What is “shrinking packaging”? (44%)
    A. A Phenomenon when product packages shrink as a result of heat around it on the shelf.
    B. A phenomenon when product packages shrink in relation to their advertisement.
    C. A phenomenon when producers leave a big product package, but reduce its content.
    D. Answers A and B are the correct answers.

The letter with (*) means the right answer.
(x%) means that x% of students answered correctly.

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JOURNAL OF ECONOMICS AND CULTURE 13(2), 2016

DOI: 10.1515/jec-2016-0018

THE MUTUAL RECIPROCITY OF EDUCATION, NON-FORMAL CULTURAL EDUCATION AND SOCIAL CAPITAL

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Abstract. Human knowledge and creative potential has become one of the most important driving forces of humanity progress. In the context of the twenty-first century, in order to create a high-quality culture environment, it requires a paradigm shift in education – the transition to education, which stimulates the imagination, intuition, emotions and creative ideas and develops critical thinking. Non-formal education and the skills and knowledge gained in it is still in evaluation and recognition phase in Latvia. It is still developing; therefore, it is important to create a clear understanding of the importance and social role of non-formal cultural education. The paper aims to explore the role of non-formal cultural education in strengthening social capital as well as to identify what social capital indicators can be attributed to non-formal cultural education programmes. The topicality of the study is determined by the fact that non-formal cultural education and social capital in the context of Latvia are little explored areas, as well as there is lack of research on mutual reciprocity. The study uses qualitative research methodology. Research analyses non-formal cultural education programmes of 10 subordinated institutions of Latvian Ministry of Culture (museums, theatres, concert institutions and opera) and on the basis of 19 in-depth and semi-structured interviews. Study contains new, theoretically based evaluation model of social capital and characterizes of indicators in the context of non-formal education. The study confirms that there is a mutual reciprocity between social capital and non-formal cultural education programmes, and these programmes have a positive and supportive role in strengthening both the individual and collective social capital.

Keywords: education; non-formal cultural education; social capital

Type of the paper: Empirical study, Theoretical paper

JEL Classification: I29; Z19

Introduction

Human knowledge and creative potential has become one of the most important driving forces of human progress. Cultural and art education is experiencing increasing pressure in relation to the variety of objectives to be achieved in addition to the task of ensuring knowledge of the arts. The importance of personal creativity development is increasingly appreciated in the field of education. Not without reason the word 'learning' has become a key word for the twenty-first century. It is important to promote public involvement and active participation in cultural processes that promote lifelong self-development. Not only educational institutions deals with it but also cultural institutions, such as museums, theatres, opera and other cultural organizations, that offers a variety of non-formal educational activities and programmes for children, young people and adults. The above-mentioned trend is more and more spreading out in Latvia, as the time in which we live states that in order to create qualitative culture environment, it requires a paradigm shift in education – the transition to an education that stimulates imagination, intuition, emotions and creative ideas develops critical thinking. Non-formal education and the assessment and recognition of the acquired skills and knowledge are still under development in Latvia; therefore, it is essential to create a proper understanding of the social role of the non-formal cultural education and its significance not only in personal life but also for the country, in general.

Society is composed of individuals, and there is reciprocity, with social capital elements as a result of it –

such as mutual relations, trust, informal network, cooperation; therefore, one of the most successful and valuable research tools is non-formal cultural evaluation in the context of social capital. Although there are still relatively few publications and studies on this form of capital in Latvia, the concept of 'social capital' in the world over the past 20 years has become one of the most common terms used in social studies. Not only many scholars have focused on this research, a significant contribution to social capital research has also been made by the World Bank.

The topicality of the study is determined, that is, the non-formal cultural education and social capital in the context of Latvia are little explored areas as well as there is lack of research on mutual reciprocity.

Main research question of the study is: whether there is a mutual reciprocity between social capital and non-formal cultural education in cultural organizations and which social capital elements, such as a set of indicators, refers to non-formal cultural programs. According to the key question of the study, the main goal is to investigate the significance of non-formal cultural education in strengthening social capital.

The study uses qualitative research methodology. Empirical part of the study includes 19 in-depth and semi-structured expert interviews of 10 subordinated institutions of the Latvian Ministry of Culture. The verification of study indicator model of social capital improves non-formal cultural education programmes that have a positive and supportive role in strengthening social capital in the individual and the society level.

Literature Review

Non-formal cultural education. In the Latvian education policy, policy planning and cultural policy documents have a clear distinction borders between formal and non-formal educations, but the terms 'non-formal cultural education' and 'non-formal cultural education programs' are not clearly defined. There are references to terms such as 'non-formal education', 'the informal education', 'adult education' and 'lifelong learning', which creates a fragmented impression and don't describe cultural institutions' educational programs. At the same time, in cultural policy documents, formal and non-formal cultural educations have an essential role in avoiding of public social degradation and in strengthening the importance of cultural institutions. Cultural education is mentioned as a long-term investment in creating human capital and social networking, what contribute to people's social and communication skills development, cooperation, social coherence, intergenerational communication and social integration (Law on Education (1998); Cultural Policy Guidelines 2014–2020 'Creative Latvia' (2014); National Development Plan 2014–2020 (2012); Sustainable Development Strategy of Latvia 'Latvia 2030', 2010).

By analysing the characteristics of non-formal education (goals, time, content, systems and control mechanisms), it can be concluded that non-formal education is much broader in activities than formal education (Smith, 2001; UNESCO. International Standard Classification of Education, Memorandum on Lifelong Learning, 2000) and the required skills, knowledge assessment and recognition of non-formal education are still in process of recognition. Therefore, it is essential to create a proper understanding of what is non-formal cultural education and explore its role in human life and in country as a whole.

Social capital. In the scientific literature, it often has an opinion that it is difficult to express summarizing conclusions about social capital because the approach to measuring and theoretical bases is different, sometimes even opposite. Generalizing the concept of social capital, it can be classified into two main groups or theoretical models.

Amongst the first group of theorists are Bourdieu (1986; 1989), who accentuates social capital as one of the forms of capital (in addition to the economic, cultural and symbolic). This model emphasises access to resources and balance of authority in society and stresses availability of political and economic resources through social contacts and networks (neo-marxism). The field of Bourdieu's theoretical analysis is individual behaviour and social structures reproduction as the result. Consequently, the social capital is viewed as an individual property as a resource that expand or limit his options.

The second theoretical model emphasises social norms and the abilities of individuals in condition of free market economy (the neo-liberal paradigm). The most outstanding representatives and theorists of this model – Coleman, (1966, 1990, 2013), Putnam (1993, 1996, 2000) and Fukuyama (1995) – defined it as a phenomenon that occurs in social interaction and social networks. Thus, social capital is a property and resource of social group rather than individuals. It affects groups and shows its quality. This direction of researchers sees social capital as a phenomenon with a positive value – it promotes the development of social groups. This approach is related to the civil society concept and ideology of communitarianism. Other source of theoretical impact is the economic theory, what arise in the 1960s of the past century and introduced the concept of 'human capital' (Tzanakis, 2013; Daugavietis, 2015; Igaune 2012).

Authors of both theoretical models recognised that social capital in the production and reproduction is essential in cultural norms, which are rooted in traditions. In theory and research literature, the social capital attributed to the social development promoter strength; it can be an important resource of community, regional, national economic, political and social development (Woolcock & Deepa, 2000; Lin, 1999).

Education, non-formal cultural education and social capital. By analysing a considerable amount of literature and sources, it can be concluded that there are some studies on education in conjunction with the social capital, but not directly attributable to research and theories about reciprocity of cultural education (formal and informal) with social capital. Therefore, in order to analyse non-formal cultural education and social capital interconnections, first, intercommunication between education and social capital must be assessed, mutual relevance and impact must be evaluated, but the conclusions about the non-formal cultural education has been taken over from the conclusions of education in general, especially, because the fundamentally social capital theoretical basis is rooted in Coleman's (2013) research carried out in 1988, which are amongst the first that in the context of social capital describes circumjacent environmental background (family; friends; social groups, such as sports and art clubs; etc.) essential role of the children success in school, as well as shows ambient environment as the important instrument in promotion of healthy, open personality, and illustrates the human and social capital in the operation and effects at the individual level. Coleman demonstrated strong correlations between parents' educational level (which is the main element in creating human capital) and a children's potential to build a strong social capital (Dijkstra, Veenstra and Peschar, 2004).

Similar to Coleman, Bourdieu (1989) associated social capital with individual or human capital. This is a resource of particular individual or a group and can regarded as productive, if it helps to increase the well-being of an individual or a group. Just as human capital, it can't be fully used. Likewise, the cultural education – both formal and informal levels, which in addition to the rules that are learned and transferred to the family, creating a cultural capital – which is Bourdieu's main object of the investigations, closely interacts with social capital.

Although studying and measuring social capital traditionally focuses on the impact of the economic aspects and benefits, there are also a number of work of scientists and specialists that studied the mutual interconnections of education and social capital, which emphasise the importance of education in strengthening social capital.

Putnam (1993) found that comparing social capital with economic success reveals a strong link between higher education for individuals and social capital. The income of higher educated individuals was higher, but social inequality in US states with high social capital is lower than that in others. Similarly, Harvard University study (Glaeser, Laibson & Sacerdote, 2002) particularly discovers and highlights education as one of the key measures of social capital. By analysing social capital of community, it is concluded that individuals who work in jobs related with other people evaluate higher socially close and trusting relationship and devote more time to social relations at work and outside of it. The study also deals with education and ethnic homogeneity factors that are closely linked with formation of social capital. Higher education is correlated with higher levels of social capital, whilst the greater ethnic diversity mitigates it.

Two researchers of the World Bank (Knack, Keefer 1997) who conducted a study on the impact of social capital on growth arrived at similar conclusions. The study use indicators of trust and civic norms from the World Values Surveys for a sample of 29 country market economies. The study confirms that trust and civic norms and civic norms are stronger in nations with higher and more equal incomes, with institutions that restrain predatory actions of chief executives and with better educated and ethnically homogeneous populations. From which follows that the higher level of education is due to the trust, which is one of the most important indicators of social capital.

Another US scientist sociologist, Heller (1996), carried out a research on the state of Kerala, southern India, which in long term has showed the highest and most favourable figures of education, life expectancy and other areas. A study of several years showed that in this state, the main conductive element for developing social capital was state policy and guidelines, which created conditions that helped the different social groups to organise their collective interest. By researching the high educational performance, it was concluded that the state of Kerala education institutions operate at the same time as community centres and here, in addition to formal education, a variety of state-supported non-formal forms of learning, such as different interest clubs and craft classes, including a variety of cultural opportunities were also available. It shows that educational institutions become more effective if there is active and informed participation of other members of the community (parents, local groups, etc.). Heller emphasised that in a society where parents and local group show active interest in children's education and success, the teachers are more accountable for their work, but pupils get better grades and better used school equipment. In turn, the public who engage in non-formal forms of learning becomes more cohesive, favourable and supportive.

In 1997, Higgins and Loynes' study of outdoor learning opportunities in summer camp in Scotland where in addition to a summer internship training was also offered non-formal education opportunities showed that it is very effective to synthesise formal and non-formal cultural educations. This synthesis has positive impact on students' social capital; it forms fundamental values of life and personality strengthening, contributes interest to involve in various cultural and social organizations, and so on. The study points the fundamental role of the non-formal cultural education as ancillary in formal education and emphasises this mutual reciprocity as important instrument in strengthening social capital of young people

Similar to Loyn, two British sociologists Fester and Umberstone (2006) stressed non-formal learning environment as an autonomous field of training, which, within social integration, significantly enrich the environment of formal learning. Special emphasis is on mutual reciprocity and role of non-formal learning to expand citizen level of involvement and connection. Non-formal learning is also mentioned as strong instrument of social integration.

Iranian sociologist Sadegh Bafandeh Imandoust (2011) explored the continuing impact of social capital in 450 branches of the Iranian Payam-e-Noor University. He has concluded that, first of all, a focus on social capital allows authorities to consider the importance of non-material assets in social policy; second, researcher believes that the open distance education can affect the quality and quantity of beneficiaries and social capital in country. A focus on social capital allows for a closer examination of capacity of individuals and groups for making linkages amongst themselves and with organisations at the local or national level. Researcher stresses that this study opens new horizons for role of open distance learning in strengthening of social capital in individual and entire country level.

Similarly, Pelše (2007) studied the social capital development of Zemgale district in Latvia as one of the important recommendations put forward lifelong learning system. Pelše stressed that by strengthening and developing such forms of non-formal education establishment, local authorities will gain more knowledgeable citizens who will be able to use this knowledge in their daily and economical activity, generating additional income in their households and in the local districts. It would also affect the psychological climate improvement in the local community. The study also highlights the significance of non-formal education and close and consistent networking importance, because increasing social capital of individuals will focus more on areas around the educational institutions, which will participate in this

process. It will be less pronounced in distant places, because the programme accessibility barrier requires greater initiative from an individual. Pelše concluded that the state can speed up the formation of social capital by supporting a variety of education institutions (also non-formal) in which social capital originally formed.

By resuming analysis of variety of authors, it can be concluded that education, and especially, non-formal education including non-formal cultural education, is in close, mutual reciprocity with strengthening of social capital. By contrast, breaking down the barriers between formal and non-formal educations is the next step in order to promote interaction and synergies between the different learning environments.

Methodology

The survey is based on qualitative research methodology. Developing the theoretical base of paper was used in the analysis of theoretical literature and secondary sources (various researches, legislation research related to education, non-formal cultural education and social capital, etc.).

Research include analysis of 37 non-formal cultural education programmes of 10 subordinated institutions of the Latvian Ministry of Culture (Art Museum RIGA BOURSE; Museum of Decorative Arts and Design; ARSENĀLS Exhibition Hall; Literature and Music museum; The Latvian National Symphony Orchestra; Latvijas Koncerti; Latvian National Opera and Ballet; Daile Theatre; Latvian National Theatre; M. Chekhov Riga Russian Theatre) – from October, 2014, till May, 2015.

Empirical part of the study includes 19 in-depth and semi-structured expert interviews with non-informal cultural education programme makers and managers. All experts were asked questions based on the guidelines developed by the interview. The key criteria for the selection of respondents for interviews were raised by the following factors: (1) represents one of the above-mentioned Ministry of Culture subordinate institutions; (2) personally involved in the creation and development of non-formal cultural education programme; (3) personally involved and works in direct contact with the non-formal cultural education programme visitors.

Results

As the terms ‘non-formal cultural education’ and ‘non-formal cultural education programmes’ are not clearly defined neither in the Latvian education policy nor in policy planning and cultural policy documents, in this study, the term ‘non-formal cultural education’ is defined as individual creativity, talent cultivation and obtaining knowledge and competences in the culture field outside the formal education, regardless of age and level of education. Whilst ‘non-formal cultural education programmes’ are ongoing educational programmes in cultural institutions, they are not included in the formal educational forms.

Education as such and non-formal education, in particular, including non-formal cultural education, is in close, mutual reciprocity associated with the strengthening of social capital. An individual can increase their capital in culture field by taking advantage of resources such as identification, communication, connections, prestige, dignity, identity, knowledge, education, well-being, self-realization and self-confidence.

Social capital is an important and promoting resource in strengthening political and social development of communities, regions and states.

Social capital is generally understood as interpersonal (also inter-group, inter-institutional) network volumes and quality, together with related social norms. Social capital arises as the result of mutual relations between individuals. This is an existing or potential resource set, associated with long-term, more or less institutionalized relations networks, which are characterised by mutual familiarity, trust and interaction.

Study authors in analysing non-formal cultural education programs use the theories of both the models,

because culture consumption includes both individual and group impact.

Cultural education both in formal and non-formal aspects, as well as cultural consumption, is an integral part of the accepted norms of society, networking and civic participation, which is an important aspect of strengthening social capital. These social benefits are linked to each other and complemented by other cultural impact indicators, such as knowledge and skills, strengthening self-confidence, promotion of cultural competence as well as cultural education.

Studying similarities of social capital and education primarily have to be seen by human capital analysis model and explored mutual reciprocity between these two forms of capital.

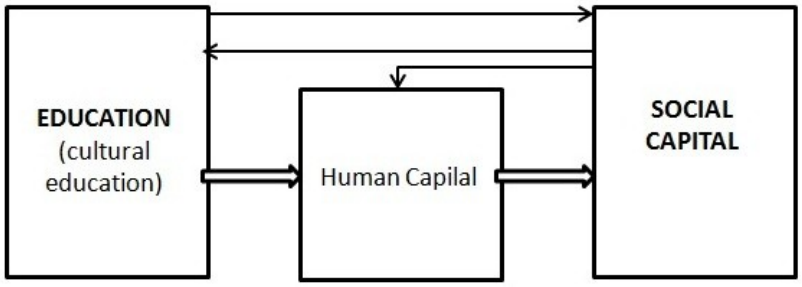

Fig. 1. The importance and the impact of education in the context of human and social capital (Source: authors' compilation)**.**

Figure 1 shows that, originally, education (including non-formal cultural education) forms and influences the human capital, the result of which further generates the social capital. However, there is an opposite movement – feedback, social capital has a direct impact on education, as well as education has a direct impact on social capital. In the time when the human capital ties are limited in one direction, the social capital has a direct impact on education and education has an immediate impact on the social capital. The reciprocity (interaction) of education, human capital and social capital is undeniable and strong. But, at the same time, it is crucial to highlight the main differences: the human capital is impacted by the supply of education, but the social capital differs only in the matter that even though it is mainly determined by the social environment (social networks), educational opportunities that clearly put the social capital theories in a dominant position and give much wider interpretation and research opportunities are equally significant. In this context, human capital means human abilities, but social capital means people's contribution, with whom in reciprocity we are doing work and solving problems.

Although in the area of the social capital (mainly in the economic and regional development aspect) there has been many research conducted and there exists a wide theoretical basis, the most significant problem of the social capital is that there is no unity about how to evaluate it, which is dictated by its multidimensional character. Traditionally, two valuation approaches are used: counting the number of the groups and measuring the participation in them or using questionnaires and interviews to obtain data on trust and civic activities, but the results mainly have descriptive nature, based on the specifics of the social capital theory and its characteristic indicators.

By analysing the theoretical notion, it can be concluded that the social capital is a multiple element phenomenon whose measuring requires various indicators. Therefore, based on the theories used in the research, examining the analysed literature and sources (Bullen & Onyx, 1998; Coleman, 2013; Fukuyama, 1995; Gordon & Beilby-Orrin, 2006; Igaune, 2012; Matarasso, 2000; Reeves, 2002) in the non-formal cultural education context, the authors have developed their theoretically justified evaluation model of the social capital that consists of 10 elements (participation, participation in networks, interaction/reciprocity, trust, social norms, the commons, tolerance of diversity, personal empowerment, attitudes to government, demographic information) that relates to the defining of the social capital and can be used as their characterising indicators. As a result, this study offers a theory-based and developed social capital assessment model of non-formal cultural education programmes (Fig. 2).

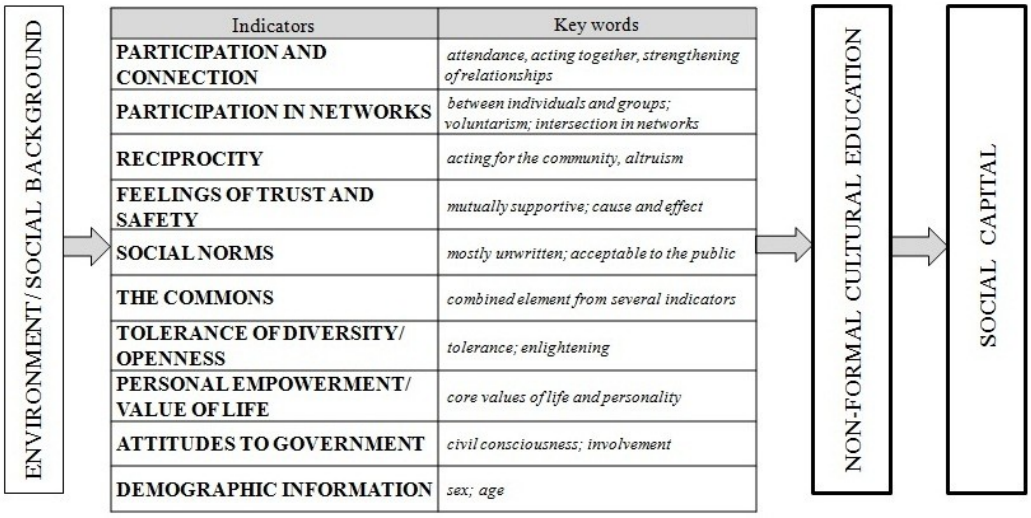

Fig. 2. Social capital analysis indicators in non-formal education (Source: authors' compilation)**.**

By exploring the social capital theories, each of the chosen elements in figure are marked with a specific theoretical background, but often one indicator results from another and they overlap. For example, the social capital is considered as both an intersection and a link in relationships between individuals and between groups. Also participation – both individual and in groups – in the context of the social capital is closely related to trust, reciprocity, social norms and so on. For this reason, there aren't strictly defined definitions that can be brought forward for each of the indicators, but it is possible to outline the essence and view it in the context of non-formal cultural education.

The model was tested in 10 institutions subordinate to the Ministry of Culture of the Republic of Latvia analysing 37 non-formal cultural education programs during the period from October 2014 to May 2015.

Conclusions

Museums, concert halls, theatres, opera, libraries and other providers of non-formal cultural education, creating and offering its educational programmes, undoubtedly have become an integral part of public cultural education component. These programs have not only educational but also a socially important role and functions and are in constant development and interaction with significant processes in society. Non-formal cultural programmes provide an opportunity for traditional cultural institutions to ensure a new dimension to their scope and profile and help to reach cultural users in attractive and intelligible language, to attract young visitors with innovative methods.

Strengthening of the personality, which happens when an individual engages in various social activities, including non-formal cultural education programs, allows oneself to receive the benefits, such as increasing satisfaction with life, boosting potential of own intelligence and a variety of practical and creative skills. Strengthening of personality and improving the quality of life are one of the most important elements in the context of social capital.

One of the social capital theory postulates considers that the level of trust is affected in the most direct way by the level of education. The more educated and more interested is the society, the more actively with the higher level of confidence it responds to the strengthening of social capital. So there is reciprocity between the institution and its visitors in mutual trust reinforcing direction.

Summarising the non-formal cultural education programme analysis developed by the authors' and social capital assessment model of the subordinate institutions of the LR Ministry of Culture confirms that elements of social capital such as participation, participation in networks, interaction/reciprocity and trust as contributing factors are inherent to the discussed non-formal cultural education programmes.

Mentioned programmes contribute to the personal empowerment and development of the individual; promote tolerance and understanding of other cultures, tolerance of diversity, and, in certain conditions; and serve as educational and strengthening tools of social norms. However, indicators such as age, gender and attitude toward the government are not so significant in the context of non-formal cultural education. According to the theoretical model and the conclusions after the experts' interviews, it can be assumed that there is a mutual social capital and non-formal cultural education programme reciprocity amongst the observed cultural organisations and that these programmes have a positive and a contributory role in strengthening the social capital of both the individual and the society.

Practically, all of the non-formal culture education programmes of the institutions in Latvia analysed in this research are their own initiative and self-realisation. For the moment, there are no laws or regulations that would impose non-formal education in cultural institutions as a mandatory requirement. Without doubt, there is a setting that these institutions should more or less carry out an educational function, but there is no determination of the volume, depth and amount of this function in policy documents. From that it is possible to draw conclusions that previously described and analysed non-formal cultural education contribution to the education and strengthening of the society and is based on the leaders of the institution and the initiative, inspiration and creative abilities of their team. Therefore, it would be advisable to continue the research in the field of non-formal education in order to strengthen the appreciation of the acquired skills and knowledge and recognition on a national level, as well as to create a correct understanding of the significant role of non-formal education in a wider context. As there is little research about social capital in the context of Latvia, this multidimensional and important phenomenon should be promoted to be studied in all of its varieties.

Various cultural institutions, analysed in this research, have showed interest about the research results and see an opportunity to gain additional in communication with the state, local authorities, project funds and other institutions, in order to strengthen and emphasise the value of non-formal cultural education in socially significant processes.

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JOURNAL OF ECONOMICS AND CULTURE 13(2), 2016

DOI: 10.1515/jec-2016-0015

FUEL PRICES AS A FACTOR OF SHAPING PROFITABILITY OF ROAD TRANSPORT IN POLAND

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Abstract. The goal of this article is to determine the relation between the price of fuel and the profitability of the company. For this purpose, the article defines the profitability of transport enterprises and points the source of the impact of changes in fuel prices on the profitability of companies in the road transport sector. The case of the ABC transport company shows the relationship between the costs incurred for the purchase of fuel and the cost of transport activities. To test the theoretical assumptions, case study method was used.

Keywords: fuel prices, the profitability of road transport companies, the share of fuel costs in the profitability of companies

Type of the paper: Theoretical paper, Case study

JEL Classification: M21

Introduction

At this time, market of road transportation services in Poland is facing economic problems similar to other European countries. One of the elements that affects the level of profitability of a transport company the most is fuel price. From the economic point of view, the costs incurred during the process of purchasing the fuel are an important part of the companies' budget. In general, the fuel prices play a huge role in the overall financial planning of the company. In order for the company to reach the breakeven point, the cost of the fuel must be lower or equal to the income of the company that occurs during the physical year.

Furthermore, this article reviews the impact that fuel prices have on the profitability of the company. Fuel price component not only measures the profitability of the company but can also determine the path of the development.

The goal of this article is to determine which relations are formed between the price of fuel and the profitability of the company. The article also answers the questions to what extent the fuel cost influence the profitability of the company?

The article describes a case of the ABC company. The analysis of this case allows looking in a practical way at the use of indicators of profitability and also contributes to the search for new directions of research and development in economy.

The relationship between the price of fuel and the profitability of transport companies in Poland

From the point of view of economics of transport, higher profit is generated by lower fuel prices. According to this statement, the question arises: What level of profitability is satisfactory for transportation companies and how the price of fuel compared to an operating profit can be called effective? In the cost structure of transportation activities (excluding salaries and the cost of purchase and maintenance superstructure, but these, even though high, are occasionally), fuel price is one of the most cost absorbing elements. Fuel prices are also an important component of the budgets of companies operating in other sectors of the economy. Because, in general, transport is not only a stimulator of the economy but often the flywheel economic activity.

In order for the company to pursue the main purpose of transportation activities, the purchasing of the fuels should be considered as a primary element. It is a key component of the gain. The functioning of carriage without the fuel is completely impossible. Fuel prices are very important not only in terms of

achieving profit but also they

- Control the rate of flow of materials and services,
- Affect the shape of the price of the final product and services,
- Shape the demand and supply of transport services,
- Affect the efficiency of freight and passengers,
- Delimitate the income dynamics of transport companies,
- Are often the determinant and the reason for the cessation of transport operations.

It is important to understand how the carriage of goods in Poland is formed. This is an important factor, especially if one takes to consideration the level of profitability of freight at the national level (macro). The structure of transported goods is the result of transportation defined as profitable – in this case, economically justified (for companies). Structural approach of goods transported by road in Poland are presented in Table 1. The data in Table 1 are the percentages of recognition of the volume of cargo transported by land, whereas the quantification of freight over the years 2003–2013 is shown in Fig. 1.

Table 1. The structure of freight transport by road transport by group of goods in 2013. (source: author's compilation based on 'Transport wyniki działalności w 2013', 2014)

Type of transported goods	Share (%)
Metal ores and other mining and quarrying products	29.2
Production of other non-metallic materials including lime, cement, gypsum and building materials	13.4
Food, beverages and tobacco products	9.9
Secondary raw materials and waste	8.4
Products of agriculture, hunting, forestry, fishery and fishing	6.5
Wood and products of wood and cork (not furniture), articles of straw, paper and paper products	6.1
Metals and fabricated metal products (except for machines and devices)	5.1
Chemicals	4.1
Coke and refined petroleum products	3.2
Coal and lignite, oil and natural gas	2.3
Transportation equipment	1.8
Machinery, equipment, electrical and electronic equipment	1.5
Empty containers and packaging	1.4
Furniture and other finished products	1.2
Textiles and garments, leather and leather products	0.3
Others	5.6

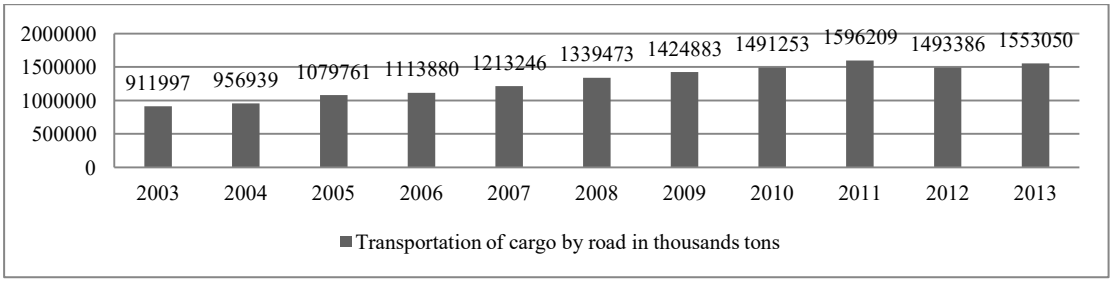


Fig. 1. Transportation of cargo by road transport in thousand tonnes. (source: author's compilation based on 'Transport wyniki działalności w 2013r', 2014)

There are two aspects in which profitability of transportation and the level of profitability of transport companies should be considered. First is the supply, where profitability is understood as the ability to

increase the revenue by the company based on internal factors (such as infrastructure and suprastructure of the company meets the needs of the market) and external factors, such as fuel prices. The second aspect is the issue of demand. Demand for transport services, in fact, generates dynamic changes in the profitability of the company.

The cost of fuel has a big impact on the level of profitability of the company. Profitability itself helps determine the financial results of the company. If the result is positive, the company is profitable; if the result is negative, the company is facing deficit (Bednarski, 2001). Profitability plays a huge role in determining whether the project will bring profit or loss. At this time, one must define breakeven point. That breakeven point allows a transportation company to determine how much work should be put into the project for the incurred costs to be covered by 100%, so everything that the company reaches above the threshold should be called profit (Engelhardt, 2014). At the same time, one can use the catalogue of formulas to calculate the breakeven point of the company. The choice, however, depends on the accuracy of the result, which the enterprise wants to get. Catalogue of profitability's ratios is shown in Table 2.

Table 2. Catalogue of profitability's ratios (source: author's compilation based on Engelhardt, 2014)

No.	Type of ratio	Quotient	Value of percentage
1	Profitability ratio 1	The financial result/datum	–
2	Profitability ratio 2	The financial result/datum	×100
3	Sales profitability ratio	Financial result/revenues	×100
4	ROE	Financial result/capital	×100
5	ROE total 1	Net result/equity total	×100
6	ROE total 2	Net result + interest/total capital	×100
7	Net profit margin equity	Net result/equity	×100
8	Gross profit margin equity	Result before tax/equity	×100
9	Return on equity capital	Net profit/share capital	×100
10	ROE DC	Return on permanent capital/fixed capital	×100
11	Return on assets	Financial result/assets	×100
12	Net profit margin assets	Net profit/total assets	×100
13	Gross profit margin assets 1	Result before tax/total assets	×100
14	Gross profit margin assets 2	The result before tax + interest/total assets	×100

The main component of profitability ratios is always the financial result. The financial result should reflect/be based on/contains the difference between the achieved revenue and costs incurred during the period (Formula 1).

$$W_{\mathrm{f}} = P - K \tag{1}$$

where

W_{f} is the financial result in the period

P is the revenues in the same period

K is the costs during the same period

By using the formula 1 and taking into account other internal and external factors, one can determine the basic types of financial result (depending on the data used):

- Gross profit,
- Net financial result,
- Financial result of economic activity,
- Financial result from operations, that is, EBITDA (operating financial result before interest, taxes, depreciation and amortisation)

- Financial result EBIT (financial result, taking into account internal and external costs and other income)
- EBTEI financial result (financial result resulting from company's strategy, it does not contain, as the occurrence of extraordinary events, which can not be predicted)
- Financial result EBT (financial result before taxes including company events that do not occur frequently and are associated with the risk of doing business)
- Financial result from the sale,
- Financial result of manufacturing services and so on.

In most enterprises, the threshold of profitability and the level of profitability is determined by the use of at least a few indicators. This is due to the fact that it is possible to conduct the analysis of profitability based solely on the final results (net profit). At the end, the final profit is affected by many factors and events.

To originate the relation between fuel prices and the level of profitability of Polish road transport companies, one needs to take into consideration the data on changes in fuel prices over several years. This allows you to notice/understand the impact of fuel prices and the actual share in the cost structure of the company. To see the dynamics of changes in the prices of motor fuels in Poland in the years 2009–2014 refer to Fig. 2.

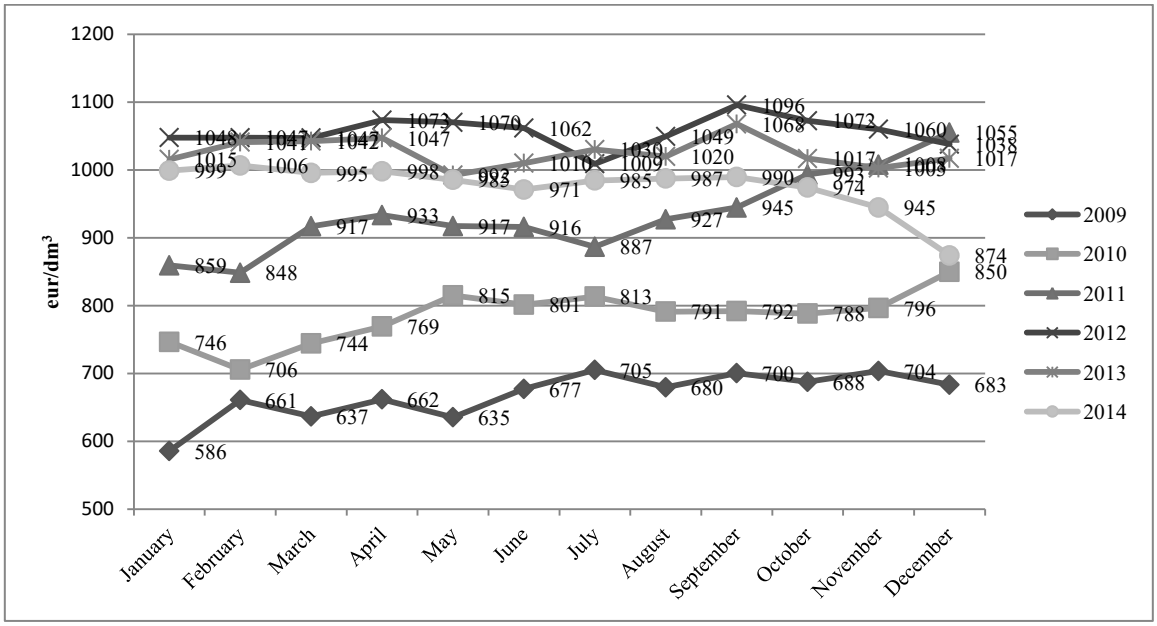


Figure 2. Decomposition of wholesale fuel prices in 2009–2014 (source: author's compilation based on PKN Orlen 2009–2014).

One should keep in mind that the Polish zlotys depends on the price of the dollar. Because the dollar is accounted for transactions involving the purchase of crude oil, the relation between the fuel prices and the profitability of the transportation company depends not only on the current exchange rate of the dollar but also on the relation resulting from seasonality (fuel in Poland is more expensive during the holidays). This relation is also impacted by factors related to the legal situation in the conduct of the transport business, economic and political situation – especially in the purchase and supply of crude oil, taxes, employment in the oil sector and other external factors related to the transport sector of the economy.

In the strict sense, the relationship between the price of fuel and profitability can, therefore, be demonstrated by Fig. 3.

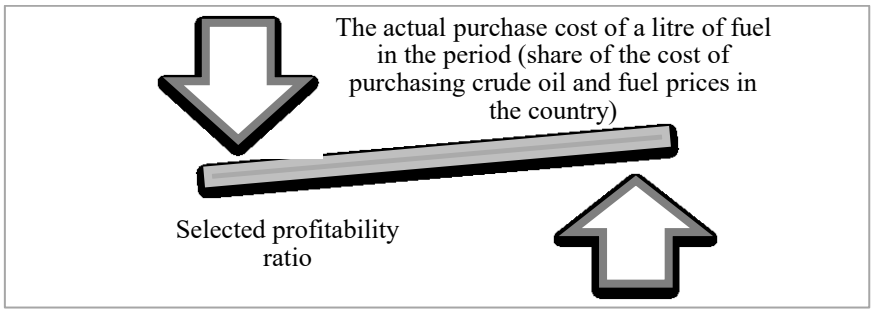


Figure 3. Schematic relationship between the price of fuel and the profitability of transport companies (source: author's compilation)

In the relation between the price of fuel and the profitability, there is an obvious phenomenon of proportional changes. If the price of fuel drops, the profitability of transport company increases. In other words, the income earned above the profitability rate determines the level of the profit of company.

The share of fuel costs in the profitability of transport companies in Poland

Road transportation in Poland is a branch with the largest market share amongst all modes of transport. The Polish market does not differ in its structure from other European countries. Issues related to costs of transport activities are also similar, especially in terms of the impact of fuel costs on the profitability of the company. It is worth mentioning that the road transportation has the largest presence within the other sectors of transport. Bimodal transport system in the vast majority consists of road transportation (delivery and drop off) and other modes of transport. The share of road transportation in the transport market is presented in Fig. 4.

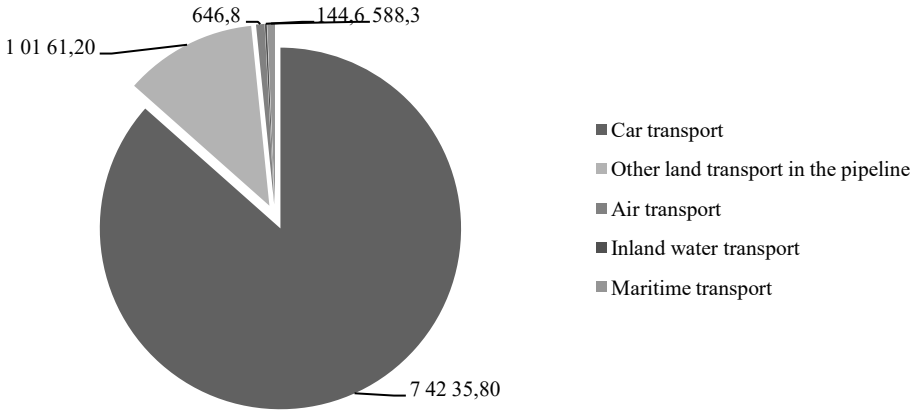


Figure 4. Revenues of transport enterprises by mode of transport (source: author's compilation based on 'Transport wyniki działalności', 2013).

The revenue/profit/income earned per vehicle per kilometre is one of the best kept secrets of transportation companies; it is hard to distinguish how much and for what the company receives the most revenue. Mainly, all of it depends on how much and where the carrier transports. However, based on the collected data, one can conclude that the common rate for transporting a full load trailer-type semi-trailers is approximately 1.10 euro/km. For carriers, this is the rate that is sufficient to cover the cost of transportation per kilometre. It is common that the employer will not get the whole load, and then the rate is lower. To take advantage of this solution, the company should conduct the partial load transfers more often. The company can wait for an order from the shipping or use another forwarding or keep track of freight exchange, where you can find the same order. Over the past few years, in Poland and other European countries, toll recorded an increase in prices. This caused a decrease in the desire to borrow (for

investment and working capital) and leases by transport companies. As a result of the increased tolls, an intensive search for the possibility of reducing operating costs has begun. Cost incurred per vehicle per kilometre in the period from 2009 to the present time has increased on an average by around 27%, which is illustrated in Fig. 5.

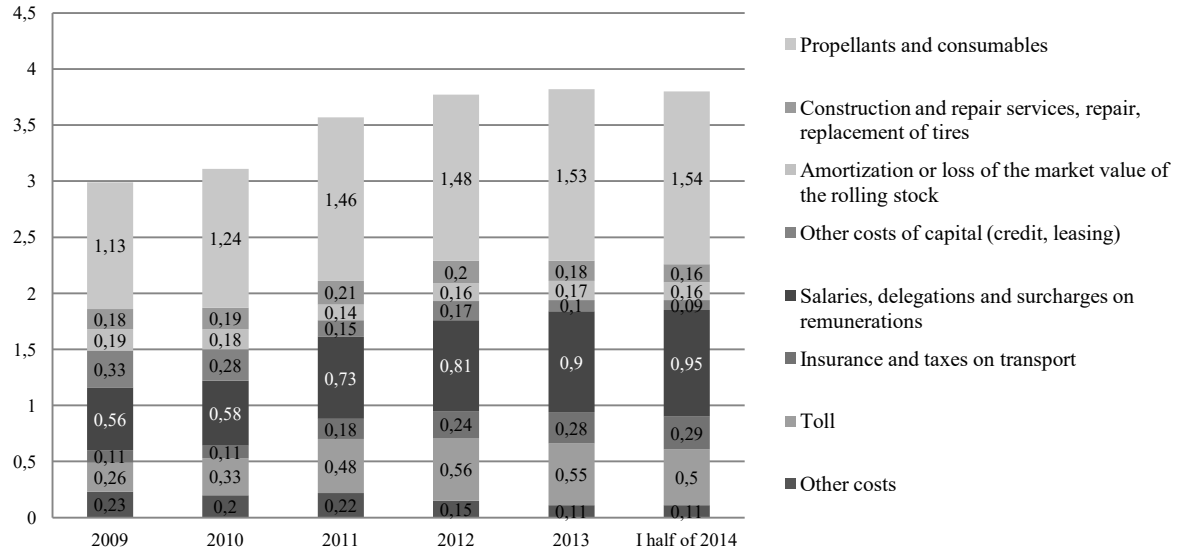


Figure 5. The structure of the cost of one vehicle kilometre for rolling over 12T in the years 2009–2014 (source: author's compilation based on Instytut transport samochodowego, 2015)

It is estimated that the share of fuel costs in the profitability of transport companies is more than 50% of the cost of that activity. As already mentioned, the transport sector has the possibility of doing business with the purchase of fuel. Therefore, despite the high share of fuel costs in the operating results, company does not have the ability to reduce these costs. Such a high share of fuel costs can not only limit the development of the core business but also contribute to a number of other significant problems in terms of competitiveness, cooperation and problems of outsourcing - the use of subcontractors service becomes unprofitable.

The impact of diesel prices on the profitability of the company ABC transport – Case Study

The ABC Transport company is a medium-sized transport company, which employs 10 drivers and 5 support staff members, that is, 2 porters, 1 mechanic and 2 office workers. The company was founded in 1993, and its headquarters are located in Mysliborz, near the border crossing in Krajnik Dolny (approximately 55 km). Currently, its fleet consists of 10 Scania tractors with trailers type semi-trailers. The company provides its transportation services in Poland and abroad. The most common transfers are conducted between Poland and Germany, Germany–Poland, and also within Polish territory, conducting domestic orders. Occasionally, the company provides its services between Poland and Netherlands, Belgium or France. ABC Transport is based in Hamburg and provides services to Polish transportation companies, giving orders from Germany to Poland. Orders generated in the country as well as abroad are executed by their own employees/shippers. The boss, who is also the owner of the company, provides all the support to the drivers. All the instructions and schedules are prepared and managed by the co-owner and chief decision-maker in financial matters. In addition to their own cars, the company's assets include a building, in which there is an office. The company also owns a parking lot area of 25 acres. The parking lot is designated to accommodate the space for the trucks and utility building that is used as a workshop. It also contains a small concierge desk, where the guard stands.

To determine the profitability of the company described in the case of ABC, the following assumptions

have been made:

- zł, average exchange rate of the euro in 2009
- 32 l/100 km, an average combustion of diesel fuel by trucks laden
- 29 l / 100km,- an average combustion of diesel fuel by trucks without cargo
- + 20% of total kilometres driven on empty
- 50% of full 'kilometres' driven by motorways (in Germany)
- 0.183 euro cents per kilometre motorway in Germany
- 11% of all freight, rate of pay for employees
- 20% straight-line depreciation rate
- 19% the amount of income tax

The calculation is based on the data from years 2009–2014. This is the basic data (revenue and capital), which allows to view the use of indicators of profitability, as shown in Table 3.

Table 3. Business details of ABC Transportation necessary to calculate the profitability in euro (source: author's compilation)

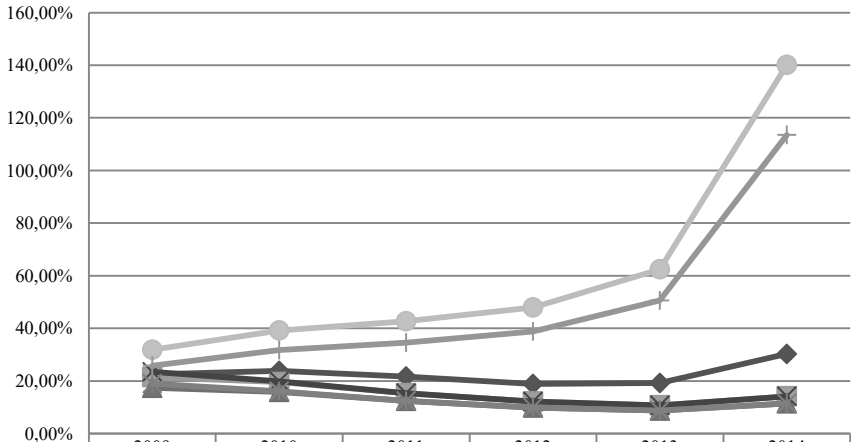
No.	years	Revenue	Gross profit	Net financial result	The value of fixed assets	Equity capital	Foreign capital
1.	2009	1,018,270.00	282,513.92	228,836.28	886,142.86	1,203,942.493	112,095.24
2.	2010	1,016,400.00	298,951.84	242,153.13	762,333.33	1,502,894.355	26,380.95
3.	2011	1,018,490.00	272,554.19	220,768.89	638,523.81	1,775,448.519	0.00
4.	2012	1,061,500.00	246,739.26	199,858.80	514,714.29	2,022,187.781	0.00
5.	2013	1,029,600.00	244,137.65	197,751.50	390,904.76	2,266,325.429	0.00
6.	2014	1,002,320.00	398,140.17	303,207.82	267,095.24	2,640,656.071	0.00

Equity is the total value of equity from January 2014 with the financial results net each year, whilst foreign capital was a loan, which in 2010 were fully repaid. Repayment of loans had no major impact on the growth of the financial result. The biggest impact was on amortisation of the means of transport in 2013.

Profitability ratios in the period 2009–2014 are presented in Table 4 and Fig. 6.

Table 4. Profitability ratios of ABC Transport in individual years (source: author's compilation)

Years	Sales profitability ratio (%)	Ratio of gross profitability of total capital (%)	Net return on equity ratio of total (%)	The gross rate of return on equity (%)	Ratio of net return on equity (%)	Gross return on assets (%)	Profitability ratio of net assets (%)
2009	22.47	21.47	17.39	23.47	19.01	31.88	25.82
2010	23.82	19.55	15.83	19.89	16.11	39.22	31.76
2011	21.68	15.35	12.43	15.35	12.43	42.69	34.57
2012	18.83	12.20	9.88	12.20	9.88	47.94	38.83
2013	19.21	10.77	8.73	10.77	8.73	62.45	50.59
2014	30.25	14.18	11.48	14.18	11.48	140.15	113.52



	2009	2010	2011	2012	2013	2014
Sales profitability ratio	22,47%	23,82%	21,68%	18,83%	19,21%	30,25%
Ratio of gross profitability of total capital	21,47%	19,55%	15,35%	12,20%	10,77%	14,18%
Net return on equity ratio of total	17,39%	15,83%	12,43%	9,88%	8,73%	11,48%
The gross rate of return on equity	23,47%	19,89%	15,35%	12,20%	10,77%	14,18%
Ratio of net return on equity	19,01%	16,11%	12,43%	9,88%	8,73%	11,48%
Gross return on assets	31,88%	39,22%	42,69%	47,94%	62,45%	140,15%
Profitability ratio of net assets	25,82%	31,76%	34,57%	38,83%	50,59%	113,52%

Fig. 6. Comparable rate of profitability of the company ABC Transport (source: author's compilation)

The ABC company notes an increase in profitability despite the increase in fuel prices and road tolls. This is because the company implemented a new transport routes to new territories that previously were unsupported. Despite the fact that the loans amortised and the adjustment of the rolling stock to European requirements occurred, the company was capable of developing further. The ABC company can consider breakeven as a satisfactory result because the company shows a profit of 30% over the period of 5 years, based on the data from 2014.

Conclusions

The question raised in the article, despite its popularity and continuous research and analysis on the subject, is still valid. The term of market volatility of transport services through the prism of profitability of companies dictates the pace of development. Based on the data contained in the article, one can come to following conclusions:

1. The price of oil in world shaped fuel prices in the country.
2. Fuel prices in Poland shape the dynamics of changes in the market of road transport services.
3. The relation between the price of fuel and profitability are not only based on the nature of the transaction. The relation goes much further, because the prices also affect the pace of development and achieving a profit by the company.
4. The share of fuel prices in the profitability of companies is seen in the light of the overall costs of the company. The cost of fuel is estimated as approximately 50% of operating expenses.
5. Determination of the level of profitability, which the company considers to be satisfactory, requires the use of at least a few indicators, because changes occur during the course of actions aiming at achieving the goal.
6. Final profitability ratios should compare in similar period.

The topic of the fuel has been thoroughly investigated all over the world, including Poland. However, the savings and the cost reduction components have still many unexplored areas. Fuel price is dependent on

external factors affecting the country like demand and supply; therefore, the reduction in fuel price is hard to achieve. Still, from a practical point of view, the price of fuel is an important factor that is stimulating development of the company. For that reason, the research in regards to the impact of the fuel prices should continue. However, the full exploration of the topic is still in a distant future.

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JOURNAL OF ECONOMICS AND CULTURE 13(2), 2016

DOI: 10.1515/jec-2016-0019

ARE EMPIRES STRIKING BACK? A POLITICAL AND CULTURAL COMPARISON OF THE EUROPEAN UNION AND RUSSIA

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Abstract. The article is a position paper focusing on the current standoff between two regional powers, the European Union and Russia. Following a series of crises, in particular the annexation of Crimea by the Russian Federation in 2014, the relationship between Russia and many of its neighbours has significantly deteriorated. This shift has led to various geopolitical opinions, often opposite and seemingly irreconcilable. A holistic and historical approach to this new reality leads some to question the validity of the current world order through the prism of the anachronistic concept of Empires. Subsequent to a review of definitions, the author analyses historical characteristics and political factors of the two territories on focus: the European Union and Russia. There are two outcomes of this study: On the one side, the European Union has become an organisation that shares many characteristics of an Empire, but several key elements exclude it from this political construction. On the other side, the geopolitical actions of Russia have shaped the position of the country into a structure that bears many of the artefacts of an Empire with key essential features. The conclusion of this argument states that the European Union is not an Empire by design, despite many resembling features; whilst Russia lives in an anachronistic paradigm of an Empire, without having the means of being one.

Keywords: Empires; Russia; European Union

Type of the paper: Position paper

JEL Classification: F5, International Relations, National Security, and International Political Economy

Introduction

The European Union is an economic and a political entity inhabited by more than 500 millions citizens, living in 28 independent yet interrelated countries. In a little more than 50 years, the group of countries have integrated in various domains, beyond free trade. Many opponents of this construction, from various political backgrounds, often vilify the European integration of their nation as a loss of sovereignty and do not hesitate to epitomise the association as a new form of imperialism.

On the Eastern flank of the European Union, the Russian Federation has recently launched a series of actions that reminds some observers of the USSR. From massive military parades to frequent flights of nuclear bombers near the borders of neighbouring countries, a tempting parallel could be drawn between Russia's new attitude and that of the USSR. The paradigm sustaining this parallel is based on the return of Imperial politics.

The aim of this argument is to analyse the elements at stake in order to shed light on possible consequences of the current situation. Is the European continent confronted again by a 'Great Game', in which Empires challenge each other? We shall analyse the historical and political factors characterising each entity: The European Union and Russia. The findings of this article are that an Empire as a political construction has all but disappeared; only the European Union may now be associated with such a structure, and often by its opponents, but lacks the design to be so. Russia, following the fall of the Soviet Union, has become a Nation-state without the means to reclaim the title of Empire.

The Beginning of the End

The end of the First World War and the Versailles treaty are often considered the beginning of the end for the Empires in Europe. Whilst the war started in the Balkans following the retreat of the Ottoman Empire,

its conclusion saw the disappearance of the central Austrian-Hungarian Empire. On the eastern side of the continent, the Tsarist Russian Empire disappeared with the abdication of Nicholas II in February 1917. The two remaining European Empires, France and the United Kingdom, would see their decline a generation later, after the Second World War (Conte, 1992).

An Empire ('an aggregate of nations or people' according to the Webster dictionary) is a political organisation centred around one figure (an Emperor or Empress), but without cultural, linguistic or religious homogeneity (Kerr, 1922). Unlike a King, an Emperor could govern very different groups of people without having to harmonise his/her realm. Wars would lead to treaties and new wars to new treaties, shifting territorial control from one court to another. Beyond the governing elites of territories, the daily lives of the residents and commoners went mostly unchanged over time. The rise of Empires had allowed economic and cultural developments of entire regions without the extremism of nationalism. Whilst the language of the Empire's capital was often imposed in administrative acts, local dialects were not only tolerated but also enjoyed as part of a meshing amongst the population that would be hard to imagine today (Fabry, 2015).

Once Empires disappeared, populations defined their identities with new criteria, filling the void of the Empire. Following precedents such as the creation of France after its 1789 Revolution, many countries became nation-states unified around a common language and occasionally a unique religion. Often, the lives of minorities became precarious. In an apparent paradox, the dominant cultures of Empires were often minorities numerically, hence, forcing a constant balance of power in the governed lands. By the end of the 19th century, the ethnic Germans and the Hungarians represented only 24% and 20%, respectively, of the inhabitants of the Austrian-Hungarian Empire (Redlich, 1929). In the Ottoman Empire, many Grand Viziers were from Albania. Once the Empires fell out of fashion, newly created nation-states often saw dominant cultures as synonymous with the majority of the population. For instance, 80% of the Austrian population belongs to the Austria cultural group, the Turkish majority represent 90% of the inhabitants of Turkey, and Hungary has become one of the most homogeneous countries in Europe with near 98% of its population claiming to be Hungarian. Some minorities in hard-to-access areas managed to keep their specificities, but many others were either forced to assimilate to the dominant culture or move out of the country (Shapovalova, 2016). The forced movement of large numbers of people became a landmark of the 20th century in Europe (Marrus, 1985).

A New Type of Empire? The European Union

The post-war era has seen the emergence of the European Union as a substitute for the Empire (Langer, 1962). Many opponents to the European Union construction see this creation as a loss of soveinty and assimilate such imperialist development as negative (Front National, 2016). Contrary to traditional Empires, however, membership in this Union is based on values and, most importantly, is voluntary (Harari, 2014). With its Parliament, its Commission, its Court of Justice and its bureaucratic operation and culture, it has all of the artefacts of the structure of an Empire. The European Union not only tolerates minority languages, but it actively promotes multi-linguism by translating mountains of documents every day as well as through its popular student exchange program, Erasmus (European Region Action Scheme for the Mobility of University Students). It goes without saying that its leadership is elected. Every 5 years, the Parliament members are elected by universal suffrage; member countries nominate all non-elected officials, often following a public hearing. The European Commission, similar to European Union's Cabinet Government, is composed of 28 members, each appointed by their country of origin. The whole commission is approved by the Parliament and the President of the Commission (currently Jean-Claude Junker from Luxembourg) is chosen from the political party at the Parliament, which secured the majority of the votes. More than once, 'commissioners' proposed by member countries have been publically rejected by the Parliament. Finally, the European civil servants (bureaucrats) amount to a small number, a bit more than 50,000. This is about the same number of civil servants employed by the city of Paris, a city of 2M when the European Unions counts more than 500M inhabitants. The recruitment is

public, following solid screening and testing. Quotas ensure that all countries are represented. The increasingly powerful Court of Justice ensures that the rule of law, rather than nepotism, is the foundation of the organisation. European treaties trump any national regulation, hence creating a meta-culture with power over sovereign states.

Of course, not everyone in Europe is happy with this situation. Many voters support political parties that are vocal against what they feel is the abandonment of key sovereign artefacts such as laws, customs or currencies. The so-called 'Euro-sceptic' parties comprise up to 100 MPs in the 751-strong European Parliament. Not surprisingly, the United Kingdom feels most uncomfortable with the organisation and has carefully opted-out of many harmonised processes such as the Schengen border-free treaty or the Maastricht's creation of a single currency, the Euro. A planned referendum in 2016 in the country is meant to clarify what sort of political structure the British wish to live in: a sovereign 'United Kingdom' which resembles a small Empire or a 'simple' member in a 500-million Economic Empire, the European Union? (BBC, 2016)

Russia, the Fallen Empire

Russia followed a different path. It actually ceased to be an Empire in for a short period of time beginning in 1917. In October 1917, the Lenin-led Bolsheviks arrested Kerensky, the head of the provisional government, and rapidly signed the Brest-Litovsk peace treaty with Germany, hence sacrificing many of Russia's lands. The Bolsheviks lost the Baltic countries and recognised the independence of Ukraine. Countries such as Belarus and Ukraine enjoyed brief autonomy from the Russians before joining the newly created USSR in 1922. Following the 1941 invasions and war victories, the USSR governed 15 republics by 1945, with a population as diverse as Chukchi 'Eskimos' in the extreme north-east near the Bering Strait, Kirghiz mountaineers and Estonian office workers. The USSR, willing to differentiate itself from the Tsarist system, was careful not to appear as a new Russian empire, hence creating a new Soviet culture (Carrère d'Encausse, 1992). Whilst Russian was still used as the governing language and lingua franca amongst the population, local languages were not only tolerated but also promoted. Many talented linguists were sent across the territories to record, structure and ultimately save local languages (Pavlenko, 2014).

The fall of the USSR followed the same steps as the fall of other Empires. Owing to ever-increasing expenses at the fringe of the Empire to stabilise its borders and maintain loyalty to the central government, the dominant population suffered whilst the administrated lands were treated comparatively well as to prevent them from considering independence. For jobs of equal position, salaries in Soviet Russia were notoriously lower than those in other republics. Medical treatments were also of a much higher quality in satellite countries of Eastern Europe than in the USSR itself. For instance, life expectancy in Russia in the 1960s and 1970s (a period of peace) was two years less than that in Estonia and 4 years less than that in the Czech republic (World bank, 2016). When the Baltic countries declared independence in the summer of 1991, followed by other republics including Boris Yelstin's Russia, the Empire ended. In December 1991, Mikhail Gorbachev, the President of a now extinct Soviet Union, resigned (Dumetz, 2014).

Besides the renewal of former USSR-controlled countries' independence, these 15 new countries also enjoyed the rediscovery of their own cultures and languages. In most of these countries, Russian became at best a second language, mostly a third one. Today, some 94.1 % of all EU-28 students at high-school level are studying English as a foreign language compared with less than one-fourth (23.0 %) studying French, whilst less than one-fifth were studying Spanish (19.1 %) or German (18.9 %). English is studied by 69— 82 % in Romania, Estonia, Latvia, the Czech Republic, Lithuania, Bulgaria and Slovakia, rising to more than 90 % in Poland showing a clear shift in countries where Russian was a compulsory foreign language during most of the Soviet era. Today, Russian is only studied by 3% of EU students, but this varies greatly from one country to another. As was the case in many nation-states in Europe, the language of the numerically dominant group became the official language. Minorities and immigrants had to adapt or leave. The countries where Russian is most studied nowadays are those with large population of ethnic

Russians: 66% of Estonian students, 57% of Latvian students and 33% of Lithuanian students chose Russian as a foreign language (Eurostat, 2016).

Russia had to face an entirely different challenge: recreating a national identity. The task was difficult because throughout three generations, the Soviet culture had profoundly replaced the Russian one (Gottlieb, 1994). The past 25 years have seen significant hesitance toward building a cultural identity in Russia, unlike many of its neighbours, which either re-established their traditions (middle Asia) or decided to join a community of countries (EU). In Russia, the pendulum of culture swung widely from East to West. Whilst the 1990s are remembered bitterly by many Russians because of harsh material conditions for the population, this post-Imperial hangover was also a rich period of cooperation with other countries such as the United States (International Space Station, nuclear weapons eradication program, support of scholars' trips to the USA, etc) and Europe (TACIS programme, creation of Erasmus Mundus, opening of a Russian representative office at NATO's HQs, etc). Russia was invited to join the G7 (hence becoming the G8 – Group of 8) in 1997, although the GDP of the country was very distant from its counterparts. Whilst the lowest of the seven, Italy, had in 1997 a GDP per capita of $29,000, Russia's at that time was only $3,500, almost 10 times less. The 1900s under the leadership of a then Western-friendly V. Putin (see his early interviews) saw a return of Russian culture; people slowly became proud to be Russian again. The economic development strategy based on exporting raw materials (mostly oil and natural gas) to Europe paid off when the price of those commodities rose. Russia was suddenly rich, and its soul-searching was also bearing fruit. A new doctrine emerged, based on the remains of Russia's history, from Tsarist times to the Soviet era.

A New Tsar?

The political system in Russia is a presidential one and the bicameral parliament bears in reality neither power nor autonomy. The president handpicks the members of Government and loyalty to him is far more needed than political backing or technical competence. However, many saw the re-election of Vladimir Putin in 2012 as a major shift in the direction the country would then follow (Favret, 2012). It is safe to label this shift as the emergence of a new doctrine (Zevelev, 2014). Convergent signs pointed at a coming change of direction: the military conflict in South Ossetia with Georgia in 2008, the resignation in 2011 of the liberal Minister of Finance Alexey Kudrin and the arrest of political activists Pussy Riot (Gessen, 2014). Key political players of the country, first of all, the president, would now display a more conservative, inner-centred and assertive behaviour (Kolesnikov, 2015). The absence of a valid political alternative to V. Putin and the party 'United Russia' and also an increasing reduction of media freedom (RSF, 2016) allowed this new approach to become mainstream not only amongst politicians but also amongst the media and the cultural world. Often, the members of those circles are the same, with a good number of mediatised artists now members of the near-monopolistic party 'United Russia' (Reuter, 2009).

Rather than the political details of this new doctrine, our interest lies in the vision of the role of Russia in its 'near abroad'. It is revealing that the Russian authorities have repeatedly proposed to solve the Ukrainian crisis with representatives from the United States, European Union and Russia itself. The spirit of the Teheran conference in 1943, ahead of the famous Yalta conference, appears to be alive in the Russian Ministry of Foreign Affairs. Russia is now insisting on keeping control on its zone of influence and is communicating that the country is ready to negotiate a new map of the region (Mäkinen, 2016). Whilst the United States officially kept a low profile, it is only natural to observe the European Union as the main opponent of this vision and the European extremist parties as the main supporters. To no surprise, Russia got cosy with their supporters recently, organising conferences with representatives of those political parties and even providing financial support to some of them such as France's Front National (Turchi, 2014. Mestre, Monnot, 2015).

One way to ease the relations between Russia and the 'West' (e.g. the EU, the United States and Japan) would be for the latter to recognise the emergence of the new Russian Empire. Western countries could likely easily level their relationship with Russia by simply accepting the concept of zone of influence in

the backyard of Russia. The recognition of Russia's essential role in a multi-polar world is the unfettered goal of many advisors and insiders of the Kremlin (Lavrov, 2008). Such return to an Imperial paradigm presents undeniable benefits not only to Russia but also to other countries. The creation of a new buffer zone around the country composed of neutral countries such as Finland, Georgia or Ukraine would ease tensions, providing a cordon between North Atlantic Treaty Organisation (NATO) countries and Russian lands (Mearsheimer, 2014). Russia's assertive stance would ensure that local minorities in multicultural countries such as Ukraine and Moldova, in particular the Russian speakers, would be protected from persecution (Allison, 2014). A new world order with the 'Russian World' as a key player is seen by many as a welcome path to stability (Makarychev, 2014).

Russia has been actively following this path throughout the past decade. The country itself has transformed remarkably in the past 10 years. Not only has the standard of living risen but the structure of the State has also become closer to its Imperial past than to regular Western nation-states. The country's power has become more centralised than before, with regional governors and even the Federal Duma becoming rubber stamps of Kremlin decisions (Demchenko, Golosov, 2016). The annual television speech by Vladimir Putin (he continued the tradition when Prime minister) has become the sole political programme of the government. Courts are notoriously linked to the administrative power and corruption remains as problematic as it has ever been (Rochlitz, 2014). Minorities are legally protected, and various religions enjoy the title of being 'recognised by the State'. Some republics, such as Chechnya or Tatarstan, are now managed very locally, with a strong degree of autonomy from Moscow as long as the loyalty of their leaders is unquestioned (Zabyelina, 2013). Russia has even enlarged its realm by signing military agreements with controversially independent regions such as South Ossetia and Abkhazia, a move very much mirroring the Protectorate status of the 19th and early 20th centuries (Asmus, 2010). Finally, Moscow has been active in the annexation of Crimea, a peninsula where the Russian Black Sea Fleet is located; the region is populated by a majority of Russian speakers but has been an administrative autonomous region of Ukraine since 1954 (Teper, 2016).

Amongst the countries of 'near abroad', Russia has used all of its might to create a feeling of existentialist threats to Russian speakers outside of Russia. This effect is feeding the construction of a much-needed identity. With the use of a powerful state-controlled and well-financed media empire that includes Russia Today (RT) and Sputnik International, the vision of the Kremlin has now been heard throughout the world much more loudly than before (Nimmo, 2016). The country has multiplied the bilateral agreements with middle Asian former USSR republics, and its army is now open to citizens of CIS countries. Russia still has not met its recruiting needs, however, and less than 400 foreigners joined the Russian armed forces during the past 10 years (Stratfor, 2015). Even though, in a few years, the Russian armed forces might count on Kirghiz or Uzbek legions, much like how the tsar could always expect fidelity from the Don Cossacks (Gressel, 2015). All of these processes were carefully engineered, and the result clearly resembles an embryo of an Empire (Saccarelli, Varadarajan, 2015).

Reality Principle

However, we are in the second decade of the 21st century and most countries, at least in Europe, believe the time of Empires is gone. The countries that could belong to a buffer zone between Russia and the European Union are now independent, with vigorous democratic institutions. Most opt to remain outside of Russian protection when given the option. Estonia, Latvia and Lithuania – countries that used to be integral members of the USSR – are now active members of the NATO, a military organisation; the European Union, a free-trade political union; the Euro-Zone, a monetary union and the Schengen area, a border-free territory of 25 countries. Other former Warsaw Pact members such as Poland, the Czech republic, Slovakia, Hungary, Romania and Bulgaria all joined the European Union and NATO (Dumetz, Gáboríková, 2016). Serbia and Montenegro, two countries with many historical, religious and military links to Russia are now officially candidates to join the European Union.

Creating much havoc and despite Moscow's wrath, the new Ukrainian government signed the Eastern

Partnership, a European Union association and free trade agreement, in June 2014, leading the way to further economic integration between the 42M Slavic country and the economic bloc (Park, 2014). Moldova, Georgia and Azerbaijan, three former USSR republics, completed talks and signed this agreement laying the path to stronger cooperation with the 28 members of the European Union (Knott, 2013).

A few other countries, however, decided to keep a close relationship with Russia. Belarus has pulled-out of the Eastern Partnership discussion in 2011 in order to deepen its already strong cooperation with Russia (Bosse, 2013). With determination, Russia has created the Eurasian Economic Union with three former USSR countries (Belarus, Kazakhstan and Armenia), but none of them are openly enthusiastic about it and the union is mostly symbolic even now, with customs controls still active at the borders (Tarr, 2015). Countries such as Kyrgyzstan or Uzbekistan, although very dependent on Russia, are hesitant in joining (Peyrouse, 2015. Schmidt, 2014).

Russia today has in appearance many of the artefacts of an Empire but lacks essential features to claim such title, starting with the recognition from the rest of the world (Babones, 2015). The suspension of Russia from the G8 following the Crimean annexation was a strong symbolic sign of the denial of other world powers to acknowledge the country to be part of this elite (Debaere, 2015). Since the fall of the USSR, the country also lacks an exportable ideology such as communism or simply an attractive political programme such as the European Union often associated with a prosperous union of democratic nations living in peace.

The economic aspect is also failing Russia to pretend to the qualification of an Empire. The fundamental data of Russia do not indicate a prosperous country; the Human Development index is #57 (neighbouring Libya), the GDP per capita is similar to Croatia and the male life expectancy ranks #122 at 63 y.o., 20 years lower than countries such as Japan, the United States or Germany. In comparison, all the Central and Eastern European countries that joined the European Union enjoyed a steady economic and life expectancy increase over the past 20 years (Glenn, 2015). Unlike former empires such as France or Great Britain, Russia in the 21st century would be unable to access riches found in colonies, the countries in the 'near abroad' being mostly underdeveloped with few resources useful to Moscow. Thus, the country is forced to drain its own resources to finance its status (Karatnycky, Motyl, 2015). The current expansionist attempt of the Russian leadership and its consequences have direct impact on the well-being of the population (Mironov, 2015). The devaluation of the Russian ruble, the embargo against fresh produces from Europe or the travel restrictions imposed by the Kremlin could lead to social and political unrest amongst the Russian middle class (Dreger et Al., 2016). Russia will soon have to make painful choices: the continuity – at any cost – of its ambitions, or the return to more humble objectives.

Conclusion

Whilst the constitutive theory confirms the independence of a State only through the recognition of other countries, it is hard to imagine a country unilaterally declaring itself an Empire nowadays (Kumar, 2013). The European Union is a new model of cooperation between nation-states bears some resemblance with an Empire. Being democratic and based upon voluntary membership, the 28-member strong organisation, however, does not have many prerogatives in sovereign functions such as taxation or defence. The position of Russia is different. Without any doubt, Russia would wriggle if other nations were to consider it an Empire again. However, the means are missing to such hypothesis. With a limited number of allies in its reach, a lack of political rationale to attract foreign population and a weak economic leverage, the country enjoys a regional influence that is short of Imperial might. Empires strive when they mingle with fellow Empires and do not cooperate well with mere independent countries.

To find stability and prosperity, perhaps Russia should choose a national identity that does not necessarily involve its neighbours but instead concentrates on its own characteristics. In its quest to readmission into the councils of major powers, Russia blinded itself in the belief in an anachronistic status, that of an

Empire. It is time for Russia to say farewell to its illusions of an Imperial realm and accept becoming a country comfortable within its own borders.

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ECONOMICS AND CULTURE 13(2), 2016

DOI: 10.1515/jec-2016-0008

LEGAL ASPECTS OF THE IMPLEMENTATION OF EUROPEAN UNION'S COMMON COMMERCIAL POLICY: LITHUANIAN EXPERIENCE AND PRACTICE

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Abstract. The Common Commercial Policy is the essential basis of the European Union (hereinafter – the EU), which, in particular, is a free trade area between the 28 Member States with a common external customs tariff and a common foreign trade policy as well as common trade rules with the third countries. Implementation of this policy is characterized by the fact that it is based on an exclusive competence of the EU, which after the Treaty of Lisbon (2009) became even more apparent. Therefore the countries of the EU should follow the same legal principles and rules in the regulation of their foreign trade, that is to apply the uniform EU rules on the calculation of customs duties and determination of the customs origin of goods, customs valuation and tariff classification of goods (Common Customs Tariff). However, implementation of these provisions is always experiencing stress due to the different interests of the EU Member States and the different national practices, especially when the administration of customs duties is actually implemented only at the level of individual EU Member States. Therefore the aim of the article is to assess the implementation of the EU's CCP from the perspective of the EU Member State (Lithuania) and to describe existing discrepancies which may serve as an obstacle for the development of common regulatory regime for import customs duties in the EU or hinder its main economic goals in international trade. Analysis of relevant scientific problems is mainly based on the comparative method (comparison of the practice of the national courts in the Republic of Lithuania and the Court of Justice of the European Union in disputes related to the functioning of the EU's customs union) and generalization of professional experience (national and EU judicial practice). The research leads to the conclusion that a uniform implementation of Common Commercial Policy and the Common Customs Tariff, as its main element, is not fully ensured on the practical level from the perspective of certain Member States (i.e. Lithuania).

Keywords: international trade, customs law, EU's Common Commercial Policy, the Union Customs Code

Type of the paper: Empirical study

JEL Classification: F13 - Trade Policy: International Trade Organizations; K39 – Other: Customs Law

Introduction

Topicality of the research. International trade is an essential element for the economic growth, increasing employment and prosperity of each country's. This is important for both the European Union (hereinafter - EU) and its constituent 28 Member States. Since the establishment of the European Community, its founding treaties have provided the regulations, which were aimed to develop and implement a Common Commercial Policy (common foreign trade policy). This policy was and is seen as one of the most important in order to create the conditions for the functioning of the customs union and common market (Craig, de Burca 2011). Effective implementation of this policy not only helps to ensure the proper functioning of the single internal market in which the free movement of goods between the Member States is ensured, but also contribute to the achievement of fiscal targets as customs duties (import taxes) are one of the main foreign trade regulation measures and are attributed to the EU's own budgetary resources. Thus, the proper and uniform administration of the customs duties in the EU Member States is essential to the financial stability of the EU. Since 1 May 2004, Lithuanian Republic has also joined the EU and has started to implement its trade relations with third countries according to the requirements of the EU Common Commercial Policy, which means that foreign trade should be regulated and governed uniformly and unanimously, using common legal provisions and rules (Leal-Arcas 2008).

This implies the existence of unified legal provisions and the rules governing the regimes of EU foreign trade with the third countries, which includes both the EU internal law (establishing a Common Customs Tariff of the EU), as well as bilateral and multilateral agreements with third countries. The aim of this legal regulations is to secure liberalization of the international trade and customs duties (Leal-Arcas 2011).

As it is emphasized in scientific literature (Herdegen 2013; Lyons 2008), in this respect the mechanism of interaction between the EU and the Member States, is original - the one and only such formation in the world, as the legal system of the EU, regulating integration of international trade, is one of the responses of EU Member States to the challenges of globalization.

Accordingly, it should be noted that the Treaty of Lisbon, which has entered into force on 1 December 2009, has significantly increased the role of the EU in this area (see. Article 207 of Consolidated version of Treaty on the Functioning of the EU, 2012). According to the Treaty of Lisbon, all the aspects of Common Commercial Policy of the EU are included into the sphere of exclusive competence, and the institute of mixed agreements is applied only to the limited extent for the legal relations, related to the regulation of foreign trade in the EU and its Member States (Leal-Arcas, 2010). In this context and on the basis of insights, formulated in the legal doctrine, the main problematic aspects, affecting legal regulation of Common Commercial Policy after the Treaty of Lisbon, remains concentrated on the relationship between the EU law and national law, which regulates various aspects of Common Commercial Policy, such as, for example, determination of customs duties and application of Common Customs Tariff. These problems, linking them with the emerging practices of national courts (taking the example of the practices, pursued in the Republic of Lithuania), are analyzed and discussed in other sections of this article.

The Aim of the Research is to assess the implementation of the Common Commercial Policy of the EU from the perspective of the EU Member State (Lithuania) and to describe existing discrepancies which may serve as an obstacle for the development of common regulatory regime for import customs duties in the EU or hinder its main economic goals in international trade.

Research Hypothesis: existing judicial practices in the Member States of the EU (i.e. Lithuania) doesn't match with the practice of the Court of Justice of the European Union on the application of the EU Common Commercial Policy rules related to the determination of customs origin of goods, customs valuation and tariff classification of goods.

Applied Research Methods: analysis of relevant scientific problems is based both on theoretical (analysis and synthesis, systematic, comparative) and, in particular, empirical methods (statistical analysis of data, analysis of documents, generalization of professional experience, – practice of the courts of Lithuanian Republic in disputes with customs authorities and practice of the Court of Justice of the European Union in judicial cases related to the implementation of Common Commercial Policy of the EU).

The Results of the Research. From the perspective of certain EU Member States (i.e. Lithuania), the uniform implementation of Common Commercial Policy is not fully ensured on the practical level. The research highlights that significant differences between national practices and practices for the application of relevant EU law, which is formed by the CJEU, were detected In order to solve these problems, it is necessary not only to improve merely the mechanism of interaction between national courts and the CJEU, but also to change the existing national legal regulations and to establish specific new rules in the national legislation EU law, that would be more specific and comply with the interpretations of the EU law provided by the CJEU. Solving of these problems may also include certain revisions on the EU level, such as the concretization of the provisions of the Union Customs Code (2013) (Art. 1, para. 1) on the determination of applicable law.

Literature Review

General Insights on the Common Commercial Policy of the EU (Common Customs Tariff.) The authors, examining the problems of legal regulation of international trade in the EU (e.g. Leal-Arcas 2011), identifies certain regulatory concepts of unilateralism, bilateralism/regionalism, multilateralism/plurilateralism. From an EU perspective, based on the concept of unilateralism, the EU, in its sole discretion (unilaterally), imposes the liberalization measures for international trade, which are covered by the Generalized System of Preferences (hereinafter – GSP). Based on the provisions of GSP, the EU does not apply customs duties to goods, imported from individual developing countries. The multilateral dimension of the Common Commercial Policy (hereinafter – CCP) includes the

implementation of multilateral WTO agreements. The bilateral (regional) dimension of the CCP means that the EU, using the instruments of the CCP, develop economic and trade relations with the third countries through bilateral preferential agreements creating free-trade zones. Since 2009, the Treaty of Lisbon has increased the EU Parliament's role in this field, simplifying the EU's foreign trade policy, moving away from the concept of mixed international agreements, which belonged to the competence of both the Community (EU) and its Member States (Woolcook 2008) and limiting requirements to ratify these agreements in national parliaments; Devuyst 2011; Broberg, 2011). Currently, all major international trade agreements in the EU belong to its competence and must ratified by the Parliament of the EU and the Council (Radžiukynas 2011; Leal-Arcas 2011). At the same time it should be emphasized that in its jurisprudence the CJEU has pointed out (see cases International Fruit Company NV and others v Produktschap voor Groenten en Fruit, 1972, paras. 14-18; Douaneagent der NV Nederlandse Spoorwegen v Inspecteur der invoerrechten en Accijnzen, 1975, para. 16; SPI and SAMI v Amministrazione delle Finanze dello Stato, 1983, para. 19) that the EU has replaced the Member States and has taken over their obligations with regard to the GATT agreement and other major international treaties on the issues of customs duties (for example, Agreements on the tariff classification of goods, the establishment of the World Customs Organization (hereinafter – WCO) and etc.).

The main legal regulations, outlining the scope of the EU's CCP are set in the Treaty on the Functioning of the EU, that is in its Article 207. In accordance with the provisions of this Article in all of the EU Member States, the regulation of foreign trade and the related provisions of the customs law falls within the exclusive jurisdiction of the EU institutions (Eechaut 2011). Currently extensive customs law rules, related to the EU's trade with the third countries and its tariff regulation instruments (based on taxation using customs duties) are also set in the sources of the EU legislation, i.e. in the Union Customs Code (Regulation (EU) No 952/2013 of the European Parliament and of the Council, 2013; hereinafter - the Union Customs Code), which is directly, fully and universally applicable in all the EU Member States. It should be emphasized that these rules of customs law constitutes the main element of the Common Commercial Policy in the EU and traditionally includes such aspects as tariff classification of imported goods for customs purposes, determination of customs origin and customs value (Barnard 2010; Moussis 2015). On the other hand, as noted by the authors both at the national level in individual EU Member States (for example in Lithuania by Radžiukynas and Belzus (2008)), and at the EU level (Lyons 2008) different level of organization of the customs control and the differences in the national legal regulations (which *de facto* could be liberal or more restrictive) leads to the objective discrepancies in the actual implementation of customs law while applying customs clearance procedures to the imported and exported goods and controlling their classification, origin and value. As it is noted by Limbach (2015), this may distort the uniform implementation of CCP or even create an unfair competition between the Member States in order to increase customs tax revenues obtained by the Member States and thus hinder the functioning of the single internal market of the EU. For this reason, problems of the classification of goods for customs purposes, determination of customs origin and customs value in the Member States of the EU is seen as an extremely important to the development of the CCP and relevant EU law.

Tariff classification of goods. The rapid increase of international trade has led to unification and simplification of international nomenclature, used for the tariff classification of goods for customs purposes. The legal framework for this process was established by the international Harmonized Commodity Description and Coding System Convention (hereinafter – Harmonized System or HS convention), signed in Brussels on 14 June 1983. Each country, which has ratified the HS convention (Lithuania joined it on 1 January 1995), undertook the responsibility to comply with the basic classification rules for its application as well as obliged to take into account all the notes, regarding the interpretation of its certain sections, headings and subheadings and not to modify the content of its sections, their headings and subheadings (Law of the Republic of Lithuania on the ratification of Harmonized Commodity Description and Coding System Convention, 2003).

It should be emphasized that the HS Convention provides only a general rules on the creation of Harmonized System for the tariff classification of goods. Meanwhile, the multipurpose nomenclature of

goods, where each position is encoded using the six-digit digital code, is further detailed and explained in the Harmonized System Explanatory Notes (hereinafter – HSENs), which were developed by the WCO. On the other hand, the attention is often drawn on the compatibility of HSENs with the EU law and, specifically, its accordance with the Combined Nomenclature of the EU, enshrined in Council Regulation No. 2658/87 on the tariff and statistical nomenclature and on the Common Customs Tariff 1987 and its subsequent amendments (Commission Regulation No. 1101/2014 on the tariff and statistical nomenclature and on the Common Customs Tariff, 2015). While the Combined Nomenclature of the EU was prepared on the basis of the Harmonized System, incorporating its rules into EU law, the research carried out by individual authors (Weerth 2008) shows that in practical terms, they don't coincide completely. This reveals two problems; firstly, what is the legal power of the HSENs in the process of classification of goods for customs purposes in the system of EU law? Secondly, is it possible to apply the HSENs directly in the national legal system of the EU Member States on the basis of provisions of the Article 1, para. 1 of Union Customs Code (2013)) as an international arrangements which provide different regulations than the customs rules of the EU?.

According to Einhorn (2012) and Lux (2007), the HSENs explanations are not legally binding and should be qualified as the so-called "soft law" sources of law. Nevertheless, the modern doctrine of international economic and customs law (Wolffgang, Kafeero 2010) recognizes that such legal sources may have a practical effect. The practical effect of the HSENs, for example, unfolds when they are applied by the World Trade Organization (WTO) in order to settle the trade disputes between states and to interpret their international obligations on trade in goods (Einhorn 2012) or by the judicial authorities in the EU in order to ensure the uniform application of EU customs law (Lux 2007) This means that the explanations provided in the HSENs has a specific legal significance to the individual states and the EU, which has joined the HS Convention (Wolffgang, Ovie 2008). However, this raises the practical question how to deal with the situations when the provisions of HSENs and the Combined Nomenclature of the EU do not correspond to each other.

Rules of origin. Other important international dimension, which is essential for the legal regulation of customs duties, is the legal institute of customs origin of goods. The legal basis of it is a special Annex of the World Trade Organization (hereinafter – WTO) Agreement that is Agreement on Rules of Origin. It contains general provisions for determining the customs origin of goods that is the state, which is considered the country of origin of goods for customs purposes. The types of customs duties – regular (conventional) or reduced or preferential, – which should be applicable to the imported goods are determined by this legal factor (Terra, Wattel 2012 Lux 2002). Based on the concept of origin, preferential measures provide for the granting of preferential tariff treatments to goods originating from certain countries, groups of countries or territories (a reduced duty or zero rates) (Jisoo 2015). In general, in order to prove certain customs origin in the EU, special origin certificates are required and are mainly used for preferential treatment purposes: certificate EUR.1, EUR.2, or Form A, invoice declaration (Terra, Wattel 2012). Consequently, the application of rules on customs origin of imported goods is considered to be an exception to the general rule of non-discrimination in international trade, as the application of such rules justifies certain discrimination of imported goods (Leal-Arcas 2011). However, rules for the determination of customs origin of goods in the EU law (for example, the Community Customs Code, Article 17 ("Preferential origin of goods)) are formulated quite abstractly. This circumstance essentially creates a complex legal administrative system for the determination of customs origin of imported goods, which further leads to the additional costs for importers (exporters) and adversely affects the development of international trade. This is also related to the fact that the rules on the proof of preferential customs origin are usually stricter, especially regulating customs origin of goods, the production of which has included the use of products, originating from the number of countries (Audet 2007). Thus, in this case, it is essential for the EU law to ensure the uniform determination of customs origin of goods in the Member States and, in this context, to provide uniform provisions on the distribution of the burden of proof between the importers and customs authorities.

Customs valuation of imported goods. In its practice the CJEU has ruled that the functioning of a customs

union requires uniform determination of the value of goods imported from third countries so that the level of protection effected by the Common Customs Tariff is the same throughout the whole Community (cases Hauptzollamt Bremerhaven v Massey-Ferguson GmbH, 1973, and Kommanditgesellschaft in Firma Gebrüder Glunz v Hauptzollamt Hamburg-Waltershof, 1982).Therefore, it was an urgent and difficult task is to develop a reasonable system, which could be suitable for all goods (products), for each country, for each type of transactions and could be easily applied. The main customs valuation principles were set at the WTO level only in 1994 by the General Agreement on Tariff and Trade (hereinafter – GATT) and its Article VII. However, the most important document for customs valuation of goods is the Agreement on the Implementation of Article VII of the GATT 94. According to the Agreement on the Implementation of Article VII of the GATT 94 (Law of the Republic of Lithuania on the ratification of Agreement founding World Trade Organization and its Annexes, 2001), the transaction value should be used to the greatest extent possible in ascertaining the customs value of goods. This primary basis for the valuation of imported goods is defined as the price actually paid or payable for the goods when sold for export to the customs territory, subject to specific qualifications and adjustments (the same provisions are enshrined in the Article 70 of the Union Customs Code (2013). This means that the main standard rule applied for the customs valuation in the EU is that the customs value of imported goods should be considered as the transaction value, provided that provided that the sale or price is not subject to some condition or consideration for which a value cannot be determined with respect to the goods being valued (Terra, Wattel 2012, Lyons 2008). However, as it is noted by Lyons (2008) and Lux (2007), the WTO rules on customs valuation are transpositioned and incorporated literally or almost literally into Community legislation. Therefore, their direct effect in the system of EU law is usually denied, although a practical level, this raises a number of questions, which were explored by the CJEU.

Methodology

In order to examine practical problems of the implementation of the EU CCP (i.e. implementation of Common Customs Tariff and its traditional main elements (Barnard, 2010) – tariff classification of imported goods for customs purposes, determination of the customs origin of imported goods and their customs valuation) (the so-called three "C" system which is applied for the calculation of customs duties (classification, customs origin and customs value; see Baronaite, 2010)). This research examines the case law of the national courts of the Republic of Lithuania, in particular, practice of the Supreme Administrative Court of Lithuania, as the highest national judicial authority in disputes with customs authorities. It is important to mention, that according to the Law on Tax Administration of the Republic of Lithuania (2004) and the Law on the Proceedings of the Administrative Cases (1999) in Lithuania the disputes with the customs authorities which arise due to additionally calculated import taxes and related sums (such as interests and financial penalties) are considered as tax disputes. They are addressed by applying a multi-stage process that includes both pre-trial (customs authorities, Commission on Tax Disputes under the Government of the Republic of Lithuania) and judicial (Vilnius regional administrative court, the Supreme Administrative Court of Lithuania) level of the proceeding. In any case, the highest authority, which is responsible for the formation of final and mandatory practice (judicial precedents) which binds other persons and public authorities in all cases of such kind is the Supreme Administrative Court of Lithuania (the Law on the Proceedings of the Administrative Cases (1999), Article 13). Therefore the study focuses only on the cases which were examined in the Supreme Administrative Court of Lithuania and on the legal problems of the taxation of goods, which were imported from the third countries to Lithuania and were subject to additional customs duties (respectively, later challenged in the court). In order to evaluate the practical functioning of the CCP and to compare national practices on the application of the CCP rules with the practice of the CJEU in the same types of cases, all the national administrative cases as well as the judicial cases of the CJEU, which were analyzed in this article were divided into three main subcategories (tariff classification, customs origin and customs value).

A more detailed analysis of national case law was carried out using the LITEKO system (i.e. Information System of the Courts of Lithuania which is a public and official database accessible at the website

<http://liteko.teismai.lt/viesasprendimupaieska/detalipaieska.aspx?detali=2>.)The research was carried out according to the time limitations (yrs. 2010 – 2015), i.e. only the judicial cases, which were examined after the Treaty of Lisbon and its provisions on CCP has entered into force, were selected and studied. In order to systematize the research and to select the required cases which were examined during the described period of time, the relevant official case law classification categories ("Classificatory of the categories of judicial decisions in administrative cases") used by the Supreme Administrative Court of Lithuania were invoked (the study included particular cases related to customs activity, classification number 1.10.2 (Common Customs Tariff and tariff classification of goods), 1.10.3 (Customs valuation) and 1.10.4 (Customs origin).

During the reporting period, 23 cases related to the tariff classification of goods, 7 cases related to the determination of customs origin and 17 cases related to the determination of customs value were detected. From this sample, certain cases, which includes examples of case law on problematic issues of the CCP and Common Customs Tariff (identified in the chapter "Literature Review", such as application of the HSENs, distribution of the burden of proof for the determination of customs origin of goods and application of WTO rules on the customs valuation), were selected and compared with interpretations of the same EU rules, which were formulated in the practice of the CJEU. The exact results of the study (including references to the specific cases) are provided in the chapter "Results".

Results

Tariff Classification of Goods (Common Customs Tariff). Based on the analysis of literature, one of the main problems encountered in the process of uniform application of the Common Customs Tariff throughout the EU is the relationship between HSENs and EU law (Combined Nomenclature of the EU or CN). From a practical point of view, it can be seen that often tariff classification descriptions of imported goods, which are the basis of the amount of payable customs duty, varies and are differently described in the Combined Nomenclature of the EU, as well as in the HSENs explanations, provided by the WCO. Accordingly, in practice such situations were examined by the CJEU and the analysis of the relevant judicial practice leads to the conclusion that the CJEU has formulated a set of basic rules, which deals with the collisions between the Combined Nomenclature and the HSENs. These general rules allow determining the proper tariff classification description, which should be followed in each particular case.

The general relationship between the Combined Nomenclature of the EU, introduced by Regulation No 2658/87, and the legal acts adopted by the WCO was described by the CJEU in the number of cases (see for example joined cases ***Dinter*** GmbH v Hauptzollamt Düsseldorf and Europol Frost-Food v Hauptzollamt Krefeld, C-522/07 and C-65/08, para. 32). Here the Court has stressed that the Council of the European Union has conferred upon the Commission, acting in cooperation with the customs experts of the Member States, broad discretion to define the subject-matter of tariff headings falling to be considered for the classification of particular goods. However, the Commission's power to adopt the measures mentioned in Article 9(1)(a) of Regulation No 2658/87, like the classification of the goods, does not authorize it to alter the subject-matter of the tariff headings which have been defined on the basis of the HS established by the HS convention whose scope the European Union has undertaken, under Article 3 thereof, not to modify (see, to that effect, judgment in case Raytek GmbH and Fluke Europe BV v Commissioners for Her Majesty's Revenue and Customs, 2015). This position of the Court was essentially based on the fact that under the Article 3(1) of the HS Convention, each Contracting Party undertakes to ensure that its customs tariff and statistical nomenclatures will be in conformity with the HS, to use all the headings and subheadings of the HS without addition or modification, together with their related codes, and to follow the numerical sequence of that system. The same provision states that each Contracting Party must also undertake to apply the general rules for the interpretation of the HS (that is HSENs) and all the section, chapter and subheading notes of the HS, and not to modify their scope.

Therefore the CJEU has also ruled that the Commission, as an EU institution which is responsible for amending and updating the Combined Nomenclature is not auhorized to amend customs duty rates by

modifying the descriptions of goods in the Combined Nomenclature entirely to its own discretion (Hewlett-Packard Europe BV v Inspecteur van de Belastingdienst/Douane West, kantoor Hoofddorp, 2013, para. 40). Accordingly, the Combined Nomenclature of the EU must be kept in line with the general provisions of the HSENs (Joined Cases C-288/09 British Sky Broadcasting Group plc v The Commissioners for Her Majesty's Revenue & Customs and C-289/09 Pace plc v The Commissioners for Her Majesty's Revenue & Customs, 2011 E.C.R. I-02851, para. 64) as, for example, the CJEU has stated that the EU's Explanatory Notes of the Combined Nomenclature were not intended to replace the WCO HSENs but only to supplement them (Case 11/79, J. Cleton en Co BV v Inspecteur des droits d'entrée et accises a Rotterdam, 1979, para. 12-13).

Nevertheless, the presence of two formally different (but at least theoretically compatible) sources of law, which are used for the tariff classification of goods creates a practical question – which source should be considered as primary and legal binding in a case of collisions or uncertainties on classification? As it is pointed out by Lyons (2008), the EC material does not emanate from an authority entrusted with ensuring uniformity in the harmonized system by the contracting parties to it. Therefore, it may be thought it is, to that extent, less authoritative than the material issued by the WCO. The long-standing and traditional answer of the CJEU to this problem is such, that as regards the HSENs (that is the source of law adopted by the WCO) , they do not have legally binding force but at the same time are considered as an important means of ensuring the uniform application of the Common Customs Tariff and, as such, may be regarded as useful aids to its interpretation, i.e. for interpreting the scope of the various tariff headings in the Combined Nomenclature of the EU (see, inter alia, judgment in TNT Freight Management (Amsterdam) v Staatssecretaris van Financiën, 2012, para. 32; Data I/O v Hauptzollamt München, 2014, paragraph 33). This interpretatory effect of the HSENs was further explained in the already settled and numerous case law of the CJEU. Firstly, the CJEU has explained the conditions when the HSENs may be set aside and not applied. It may happen in situations when the content of explanatory notes from the WCO is formally not in accordance with the provisions of the Combined Nomenclature and when it alters the meaning of its provisions. Consequently, in cases C-38/75 (Douneagent der NV Nederlandse Sooprwegen v Inspecteur der Invoerrechten en Accijinzen, 1975) and C-233/88 (Gijs van de Kolk-Douane Expediteur BV v Inspecteur der Invoerrechten en Accijinzen, 1990), the Court has said, that the provisions of the HSENs can be set aside if they appear to be incompatible with the wording of the heading of the Combined Nomenclature or goes manifestly beyond the discretion conferred on the WCO. A similar position was held in the more recent practice (case JVC France v Administration des douanes - Direction nationale du renseignement et des enquêtes douanières, 2008, para. 34). Here the CJEU has ruled that where it is apparent that the explanatory notes are contrary to the wording of the headings of the Combined Nomenclature and the section or chapter notes, the explanatory notes must be disregarded . Therefore, in order to apply the HSENs, the wording of these explanatory notes must be consistent with the provisions of the Combined Nomenclature and cannot alter their scope or their content (see, *inter alia*, judgment in cases Sunshine Deutschland Handelsgesellschaft v Hauptzollamt Kiel, 2007, para. 27, Duval v Hauptzollamt Frankfurt am Main, 2015. para. 24, Vario Tek v Hauptzollamt Düsseldorf, 2015, para. 22). In such situations the HSENs could be used as a general interpretation guidelines for tariff classification of goods by the CJEU and by the national courts even if the status of the HSENs currently is not directly regulated by the Community Customs Code (currently, since 1 May 2016 - by the Union Customs Code) (see case C-472/12 (Panasonic Italia SpA, Panasonic Marketing Europe GmbH, Scerni Logistics Srl v Agenzia delle Dogane di Milano, 2014, para. 46)).

However, what regards the direct effect of HSENs in the system of EU law (direct invokability of the HSENs provisions in cases related to tariff classification of goods), the CJEU has numerously pointed out that interpretations provided by the HSENs must be taken into account in case when there are no Community rules, which could be applied in order to resolve questions concerning the tariff classification (Medion AG v Hauptzollamt Duisburg and Canon Deutschland GmbH v Hauptzollamt Krefeld, 2006; Commissioners of Customs & Excise v SmithKline Beecham plc, 2005; DFDS BV v Inspecteur der Belastingdienst — Douanedistrict Rotterdam, 2004; Fábrica de Queijo Eru Portuguesa Ldª v Tribunal

Técnico Aduaneiro de Segunda Instância, 2000). Therefore the HSENs is applied as an authoritative source of interpretation on tariff classification of goods where no relevant explanatory notes have been issued by the EU which could provide the necessary descriptions og goods. This trend of the judicial practice of the CJEU was already noticeable in a number of quite early cases, such as Deutche Bakels GmbH v Oberfinanzdirektion Munchen, 1970, para. 9-10; Gervais-Danone AG v Hauptzollamt Munchen-Schwanthalerstrasse, 1971, para. 5 and etc.). Hence, the HSENs provided by the WCO are an authoritative guide where there is no explanatory material from the EU.

Summarizing the arguments above, it can be stated that, according to the judicial practice of the CJEU, the EU's Combined Nomenclature must be aligned with the rules and provisions of the HSENs. However, in general terms, the practice of the CJEU doesn‘t treat the HSENs itself as belonging to the category of directly applicable sources of international law, which must be followed by the CJEU and the national courts of the EU Member States resolving the disputes concerning the tariff classification of goods and granting them priority over the EU law, i.e. Community Customs Code and the Combined Nomenclature of the EU (see case C-196/10 (Paderborner Brauerei Haus Cramer KG v Hauptzollamt Bielefeld, 2011, para. 32)). As the CJEU has stated in case C-267/13 (Nutricia NV v Staatssecretaris van Financiën, 2014, para. 27), the main legal nature of the HSENs currently is and remains explanatory: the HSENs can be invoked and directly applied only when there are no established EU rules.

In this context, attention must be drawn to the fact that the issues of application of the rules, enshrined in the HSENs has been resolved in the national courts of the Republic of Lithuania (the Supreme Administrative Court of Lithuania), but the case law has not yet formulated a clear conclusion on the legal significance and status of the HSENs. The analysis of the case law in the relevant period (yrs. 2010-2015) shows, that the Supreme Administrative Court of Lithuania usually indirectly lists the HSENs (as it was mentioned, they are prepared by the WCO on the basis of the International Harmonised Commodity Description and Coding System Convention) among other sources of law, which are applicable to the tariff classification of goods: “goods are classified according to the International Harmonised Commodity Description and Coding System Convention and the European Community customs legislation” (the Supreme Administrative Court of Lithuania, 31 January 2013 ruling of the panel of judges in the administrative case No. A^{143}-71/2013, 2013; the Supreme Administrative Court of Lithuania 1 February 2011 ruling of the panel of judges in the administrative case No. A^{143}-218/2011, 2011). However, a more detail comparative analysis confirms that on the practical level the application of the HSENs doesn’t correspond to the practice of the CJEU.

First of all, it should be noted that there are examples when some of the national institutions (such as the Commission on Tax Disputes under the Government of the Republic of Lithuania) apply the HSENs in order to classify goods directly. For example, in the administrative case No. A-442-176/2010 the Commission on Tax Disputes under the Government of the Republic of Lithuania invoked the provisions of the HSENs in order to classify imported goods (food products from Atlantic salmon (*Salmo Salar*)) and to explain the certain position (0303, 0304 and 0511 of the Harmonized System) where the product has to be classified (the Supreme Administrative Court of Lithuania 28 January 2010 ruling of the panel of judges in the administrative case No. A^{442}-176/2010, 2010). However, while checking the correctness of the decisions of such institutions in the relevant tax disputes, the Supreme Administrative Court of Lithuania usually refrains from applying the provisions of the HSENs and is justifying its final rulings (decisions) only on EU customs legislation, that is the Combined Nomenclature of the EU as the one and only main source governing the tariff classification of imported goods. Thus, even in cases where the applicant states that the descriptions of goods, used for their tariff classification, which are provided in the Combined Nomenclature of the EU is different from the descriptions and interpretations of the HSENs, the Court usually applies the rules of the Combined Nomenclature and doesn’t provide any explanations on the facts of the discrepancies between the two documents (see for example administrative case UAB "Bottcher Balticum" v Customs Department under the Ministry of Finance of Lithuanian Republic, the Supreme Administrative Court of Lithuania, 9 December 2010 ruling in the administrative case No. A^{261} –

1706/2010, 2010).

The situation is further complicated by the fact that there are cases in which the Supreme Administrative Court of Lithuania has ruled that in general in the cases on the tariff classification of goods the Court is not entitled to evaluate the provisions of the HSENs in detail. This judicial precedent was at first formulated in 2012, that is in the administrative case UAB "Imlitex" v Customs Department under the Ministry of Finance of Lithuanian Republic (the Supreme Administrative Court of Lithuania, 13 February 2012 ruling in the administrative case No. A^{261} – 218/2012, 2012) and later repeated in other cases, such as UAB "Plungės kooperatinė prekyba" v Customs Department under the Ministry of Finance of Lithuanian Republic, 2013 (the Supreme Administrative Court of Lithuania, 23 May 2013 ruling of the panel of judges in the administrative case No. A^{261}-718/2013). Thus in the administrative cases which are mentioned above the Supreme Administrative Court of Lithuania based its decisions solely on the provisions of the Combined Nomenclature of the EU which were considered as relevant for the legal relations concerning these particular disputes.

Therefore, although the national courts in principle agrees with the fact that the tariff classification of goods should be based on the provisions of HSENs, but in the specific dispute situations this source of law is not invoked even as an additional, interpretive source for the interpretation of the Combined Nomenclature of EU (as it is done in the practice of the CJEU). This is obviously creating the conditions to distort the EU's Common Commercial Policy and the uniform implementation of the EU's Common Customs Tariff. For example, while refusing to refusing to apply the HSENs the national courts doesn't analyze or even mention the existence of factors, which, according to the already mentioned practice of the CJEU are essential in order to make the decision to refer to the HSENs or not, such as the absence (or non-absence) of the relevant EU legislation on the tariff classification of goods, the existence (or non-existence) of the discretion of WCO to provide the explanations on the classification of specific goods, and, finally, the consistency of the HSENs (with the provisions of the Combined Nomenclature and its headings as well as the chapter or section notes. Although the final decision as to what rules should be applied in the particular dispute on the classification of goods should be taken after an examination of all these aspects, under the Lithuanian judicial practice such examination (investigation) usually is not carried out, even if the applicants raises the related questions in their complaints.

According to the individual Lithuanian authors (Gurevičienė, Sarapinienė 2014) which has examined some aspects of these issues, the problems related to the proper application of the HSENs and other legal sources governing the tariff classification of goods can be explained by the poor accessibility to the legal documents, especially taking into account position of private entities (international trade operators/taxpayers). For example, the relevant version of the HSENs has not been officially translated and published in Lithuania, therefore the information provided in them could be downloaded from the WCO website in foreign languages (this creates additional financial costs as it is not freely available) or accessed by the private persons on the *ad hoc* basis by making individual requests to the Tariff division of the Customs Department under the Ministry of Finance of Lithuanian Republic, although it is also a lengthy procedure which is unsuitable for business operations (Gurevičienė, Sarapinienė 2014). It is clear that the similar problems are encountered by the state authorities which are examining tax disputes and the courts. Currently, they have the ability to rely only on the documents provided in the specific case and have no practical possibility to analyze the text of the HSENs independently. Accordingly, in order to ensure the proper application of the HSENs in the Republic of Lithuania and to ensure the uniformity of tariff classification of goods throughout the EU (which is required by the practice and case-law of the CJEU), it is necessary to solve the above-mentioned problems. This requires both the legislative changes, as well as other solutions. First of all, as in the national jurisprudence the HSENs is not always seen as a source of law which must be taken into account in the process of interpretation of the EU customs law, it is necessary to adjust the Article 35 of the Law on Customs of the Republic of Lithuania by implicitly stating that the interpretation of the EU's Combined Nomenclature during the classification process must be based on the provisions of the HSENs. Secondly, the HSENs itself, as a source of law, should be

translated into the Lithuanian language and published as a separate publication, since otherwise there remains a risk that the international commitments of Lithuania, as the EU Member State, to implement the Harmonized System Convention will not be secured properly.

Rules of Origin. Based on the review of the literature, one of the main problems in this area is the allocation of the burden of proof on customs origin of imported goods. Therefore, a key question on the regulation of such issues in Lithuania is how the Lithuanian courts and other competent authorities interpret general legal criteria of customs origin (goods, which are "wholly obtained" in one country, and goods, which underwent substantial transformation in a certain country) in order to define both non-preferential and the preferential status of the goods. According to the Union Customs Code (2013) (Chapter II "Origin of Goods"), goods wholly obtained in a single country are originating in that country and goods whose production involved more than one country are deemed to originate in the country where they underwent their last, substantial transformation. Goods originating in a country are those wholly obtained or produced in that country. When production in more than one country is involved (and that is normally the case), goods are deemed to originate where they underwent their last substantial economically justified processing or working (see case C-373/08 (Hoesch Metals and Alloys GmbH v Hauptzollamt Aachen, 2010)). So, in this respect, the question arises how the burden of proof in determining the origin of goods should be distributed between the importer and the customs authorities? Does the determination of the customs origin, which is completed by the national customs authorities, must always be based on the certificates, provided by country from which the goods were imported and in what cases it has a right to question the legitimacy of the evidence submitted by the importers and its validity and to take into account additional evidence in its sole discretion (*ex officio*)? These types of disputes have been settled in cases on the taxation of goods imported from the third countries to the EU (Lithuanian) customs territory in administrative cases of the Lithuanian Supreme Administrative Court UAB "Baltical" v Customs Department under the Ministry of Finance of Lithuanian Republic, 2014 (the Supreme Administrative Court of Lithuania, 30 April 2014 ruling of the panel of judges in the administrative case A^{261}-146/2014, 2014) and UAB "Žalvaris" v Customs Department under the Ministry of Finance of Lithuanian Republic, 2014 (The Supreme Administrative Court of Lithuania, 30 April 2014 ruling of the panel of judges in the administrative case No. A^{261}-144/2014, 2014). There the courts tried to answer the question whether, according to the general rules of origin, these countries could be considered as the countries of customs origin for the imported goods.

In general, addressing these issues in the practice of the CJEU (see cases Pascoal & Filhos Ld. v Fazenda Pública, 1997; CAS SpA v Commission, 2008) is based on the assumption that the basic element of the relationship between importing and exporting states in relation to the verification of origin is the system where the origin is being established by the authorities of the exporting country. This is justified by the fact that the authorities of the exporting country are in the position to verify directly the facts, which determine the origin. However, as it was noted by the CJEU, the authorities concerned on both sides must monitor the system jointly and the mechanism of it can function only if the customs authorities of the importing country accept the determinations legally made by the authorities of the exporting country (case C-442/08 (Commission v Germany, 2010, para. 72-73); case C-386/08 (Brita v Hauptzollamt Hamburg-Hafen, 2010, para. 62).

On the other hand, this rule is not absolute, and the practice of the CJEU, as well as the legal doctrine (Lyons 2008, p. 238) confirms that if the customs office has reasonable doubts on the certainty of the certificates of customs origin, it can carry out an additional investigation (post-clearance checks) (case Les Rapides Savoyards v Directeur General des Douanes et Droits Indirects, 1983). A subsequent verification must be carried out not only when the importing Member State so requests, but also, in general, when, there are indications which point to an irregularity in regard to the origin of the imported goods (case C-409/10 (Afasia Knits Deutschland GmbH v Hauptzollamt Hamburg-Hafen, 2011, para. 32), joined cases C-23/04 to C-25/04 (Sfakianakis v Elliniko Dimosio, 2006, para. 30 and 31) and case C-442/08 (Commission v Germany, 2010, para. 82)). When verification shows that a certificate of origin is

inaccurate, the importer will be likely, subsequently be faced with a claim for post-clearance recovery of customs duty (see joined cases CT Control (Rotterdam) BV and JCT Benelux BV v Commission, 1993 and case Criminal Proceedings Against Edmond Huygen and others, 1993). The CJEU has also pointed out that in such case, a prudent trader aware of the rules must be able to assess the risks inherent in the market, which he is considering, and accept them as normal trade risks (case Amministrazione delle Finanze v Enterprise Ciro Acampora, 1980). However, the practice of the CJEU falls short of defining exact conditions for such verification procedures and the guarantees applicable to importers, although it is noted, that the risks which the traders must take in such cases are not "unlimited" (Kaufring and Others v Commission, 2001).

This gap between legal regulation and practice is essentially filled by the Lithuanian case law in particular type of cases, that is cases where an anti-dumping customs duties were imposed on the goods imported by the economic operator and the imposition of such duties was justified by the fact that the customs origin of these goods matches the particular country to which such duties were applied by the decision of the EU's competent authorities. There the national case law has established the additional guarantees to the importers and obliged the customs authorities to carry out additional investigations of the documents (evidence) and even the nature of economic operations with goods in order to determine their true customs origin. For example, in cases concerning imports of silicon products, which were processed in Taiwan, the Supreme Administrative Court of Lithuania has repeatedly ruled that Lithuanian customs wrongly considered China as the country of their customs origin and had no legal reason to apply anti-dumping customs duties, which were applicable by the EU for such goods, imported from China (the Supreme Administrative Court of Lithuania, 30 April 2014 ruling of the panel of judges in the administrative case A^{261}-146/2014, 2014; the Supreme Administrative Court of Lithuania, 30 April 2014 ruling of the panel of judges in the administrative case No. A^{261}-144/2014, 2014). Thus, the Supreme Administrative Court of Lithuania acknowledged that the duty to prove the customs origin of goods, which are subject to anti-dumping customs duties, must be transferred to the national customs authorities (such conclusion was based on the general rule that the validity of an anti-dumping duty must be proved by the customs). However the national court didn't specify in detail the legal origin or background of this rule merely stating that the duty to prove the customs origin of goods which are subject to an anti-dumping duties should be interpreted as an obligation to prove the connection between the origin of the imported goods and their processing in another country (the customs authorities are obliged to use all means of evidence which are possibly available to them in order to determine the country of origin, which is subject to anti-dumping duties). In order to justify this conclusion in the rulings commented above the Court made only the reference to the Community Customs Code (Council Regulation (EEC) No 2913/92 of 12 October 1992 establishing the Community Customs Code 1992), Article 25. However, the Article 25 of the Community Customs Code only provides a general rule which lays down the operations which do not provide a customs origin and doesn't set any special rules for the application of anti-dumping customs duties.

Besides, as it was additionally noted by the Court, the determination of customs origin itself may not be considered as the tax relief (exemption), the taxpayer is only sufficient to prove the mere existence of business operations, which were useful to him and which has influenced the change of the customs origin. However, as it was also stressed by the Court in the cases cited above, such situation may not be interpreted as a transposition of the burden of proof to the taxpayer as only the obligation to prove the conditions of tax exemption or relief applies to the person seeking such relief or exemption (according to the opinion of the Court, the rules of customs origin according to their nature should not be interpreted as the form of tax relief or exemption). This recent practice of the Supreme Administrative Court of Lithuania raises the importance of two aspects of the process of the determination of customs origin. Firstly, it stresses the fact, that the decisions of the national customs authorities on the determination of customs origin should be based not only on the formal sources of evidence but on the ascertaining of the real content of business transactions (such the processes of production and subsequent further processing of goods). Secondly, it substantially restricts the conditions for the application of anti-dumping customs

duties in Lithuania on goods imported from the third countries to which such duties are applied by the EU and in general is more focused on the protection of the rights and interests of taxpayers (importers of goods) than on the protection of the fiscal interests of the EU and the Member State. This raises the subsequent question whether such practice, in general, is consistent with the position of the CJEU, especially as the national court haven't provided any arguments for the legal origin of the principle that the validity or legality of an anti-dumping customs duty must proved by the customs authorities themselves.

It should be emphasized that, as was pointed out before, there is an absence of the consistent practice of the CJEU on this particular matter (on the distribution of the burden of proof on the origin of goods, to which an anti-dumping customs duties are applied). On the other hand, the latest practice of the General Court of EU, which has recently started to be formed in case T-412/13 (Chin Haur Indonesia, PT v Council, 2015, para. 118), leads to the conclusion that the primary obligation to provide an evidence on the origin of imported goods should be switched to the importer: the information submitted by the applicant (importer) should be sufficient to determine whether the applicant hadn't participated in circumvention of the anti-dumping duties. Hence, in this regard, Lithuanian national judicial practice and the position of the EU judicial authorities do not match, therefore, such situation raises the question about the necessity to review certain provisions of national law on the rules of origin of imported goods (Law on Customs of the Republic of Lithuania, 2004). In particular, it may seem relevant to add certain provisions on the distribution of the burden of proof between the taxpayer (importer) and customs authorities (currently such regulations are completely absent in text of the national law), imperatively emphasizing that the primary responsibility for proving the customs origin of goods belongs to the importer (Articles 37-38 of the Law on Customs of the Republic of Lithuania).

Customs Valuation. In deciding the question whether the WTO rules on customs valuation may be applied directly to the system of the EU law, CJEU has repeatedly pointed out that individual rules of the WTO Agreements do not have characteristics, which are necessary to consider them to be directly applied (self-executing) (case C-361/11 (Rechtbank Haarlem v Inspecteur van de Belastingdienst/Douane West, kantoor Hoofddorp, 2013, para. 57); case C-306/13 (LVP NV v Belgische Staat, 2014)). Therefore, an importer or exporter shall be entitled to rely on the WTO rules only when the EU institution intended to implement a particular obligation assumed under the GATT Agreement by means of the EU legislation or when the EU legislation provides a clear reference to the legal provisions of the WTO (GATT) agreements. In the practice of the CJEU, such examples are applied in the field of anti-dumping customs duties, but not in the determination of customs valuation.

However the national courts in Lithuania applies WTO rules on customs valuation not only in the specific cases (for example when there are no clear EU rules on customs valuation), but also in defining the general duties of persons, participating in international trade operations, despite the fact that procedures of valuation of goods for customs procedures are regulated in detail by the Community Customs Code (Article 29). Such practice was followed by the Supreme Administrative Court of Lithuania in the administrative case UAB „Matroksas“ v Customs Department under the Ministry of Finance of Lithuanian Republic (The Supreme Administrative Court of Lithuania, 5 May 2010 ruling of the panel of judges in the administrative case No. A^{442}-715/2010, 2010) and in the administrative case "Editos Šakytės įmonė" v Customs Department under the Ministry of Finance of Lithuanian Republic (The Supreme Administrative Court of Lithuania, 2 November 2010 ruling of the panel of judges in the administrative case No. A^{143}-1243/2010, 2010). Here, the court has pointed out that has pointed out that under the WTO rules in cases where the customs authorities have a reasonable doubt on the declared value of the goods and accuracy of the customs value, the burden of proof is shifted to the importer. Consequently, the interpretation of rules, applied to the customs valuation, differs both at the level of the CJEU practice and at the level of the national practice. As a possible solution to this problem, we may indicate the necessity to review the provisions of the EU law itself that is Article 2, para. 1 of the Community Customs Code, which should include clarifications on the relationship between EU customs law and international agreements, distinguishing the agreements that can't be applied directly.

Conclusions

From the perspective of certain EU Member States (i.e. Lithuania), the uniform implementation of Common Commercial Policy and the Common Customs Tariff, as its main element, is not fully ensured on the practical level. The research highlights that significant differences between national practices and practices for the application of relevant EU customs law, which is formed by the CJEU, were detected.

Although the national courts in Lithuania in principle agrees with the fact that the tariff classification of goods should be based on the provisions of HSENs, but in the specific dispute situations this source of law is not invoked even as an additional, interpretive source for the interpretation of the Combined Nomenclature of EU (as it is done in the practice of the CJEU). According to the CJEUit, the scope and the purpose of the application of the HSENs is to explain the existing sources of the EU law, such as the Combined Nomenclature and the HSENs itself could be treated as directly applicable in some exceptional cases (when there are no relevant EU law which regulates tariff classification of specific goods). Although the final decision as to what rules should be applied in the particular dispute on the classification of goods should be taken after an examination of all these aspects, under the Lithuanian judicial practice such examination (investigation) usually is not carried out, even if the applicants raises the related questions in their complaints. This signal the need for the legislative review of the rules, entrenched in the Law on Customs of the Republic of Lithuania (2004), in particular, the Article 35, para. 1, that should implicitly define the application of the HSENs and to provide legal guarantees for the proper accessibility to this source of law in Lithuania.

Lithuanian national judicial practice and the position of the EU judicial authorities do not match in cases on the determination of customs origin of imported goods, in particular in cases when the burden of proof of customs origin is transferred to the customs authorities, and not to the importer. Therefore, such situation raises the question about the necessity to review certain provisions of national law on the rules of origin of imported goods, imperatively emphasizing that the primary responsibility for proving the customs origin of goods belongs to the importer (Articles 37-38 of the Law on Customs of the Republic of Lithuania). Consequently, the interpretation of rules, applied to the customs valuation, differs both at the level of the CJEU practice and at the level of the national practice, which allows direct application of the WTO Agreements in the national legal system (what is not recognized by the practice of the CJEU). As a possible solution to this problem, we may indicate the necessity to review the provisions of the EU law itself that is Article 1, para. 1 of the Union Customs Code, which should include clarifications on the relationship between EU customs law and international agreements, distinguishing the agreements that can't be applied directly.

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ECONOMICS AND CULTURE 13(2), 2016

DOI: 10.1515/jec-2016-0021

PROBLEMS RELATED TO THE ABOLITION OF DIVIDED REAL ESTATE OWNERSHIP

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Abstract. Legal relationship between apartment owners in residential buildings and the land owners, that is, divided real estate ownership, was created in the Republic of Latvia in 1990, within the framework of the Land Reform, restoring property rights of the former owners or their heirs or privatising apartments in multi-apartment residential buildings. The existence of such legal relationship created different lease problems and restrictions on the property rights to the owners of both the building and the land. To abolish the legal relationship related to divided real estate ownership, the Ministry of Justice of the Republic of Latvia has developed a draft law *Regarding the Abolition of Mandatory Divided Real Estate Ownership in Multi-Apartment Buildings* (hereinafter referred to as Draft Law). Unfortunately, in the opinion of authors of this article, there are serious shortcomings to the Draft Law which must be corrected. The aim of the research is to identify the problematic issues by selecting and analysing the legislation on the abolition of the divided real estate ownership, which is related to the calculation of redemption price, payment method and consequences of non-payment, which are not regulated by the new Draft Law. The article reflects research on the determination and calculation of redemption price reglamented by the Draft Law and also analyses the Law of December 8, 1938, *On the Abolition of Divided Real Estate Ownership and its practical implementation,* which may significantly influence the redemption price and the method of its calculation; however, the mentioned law has been disregarded in developing the Draft Law. Thus the research has both theoretical and practical significance. For the research purposes general research methods, such as historical, analytical, inductive, deductive, logical-constructive and descriptive methods, are used. For the interpretation of legislation norms, grammatical, systemic, teleological and historical methods are used.

Keywords: divided real estate ownership; apartment owners; land reform

Type of the paper: Theoretical paper

JEL Classification: P37, K11

Introduction

During the Land Reform, which was started in 1990, legal form of divided real estate was established amongst the apartment owners in multi-apartment residential buildings and the former owners of the land and their heirs, which caused discomfort of ethical and legal character. Because of that, Ministry of Justice of the Republic of Latvia created regulations for the abolition of divided real estate ownership. Ministry of Justice of the Republic of Latvia has elaborated the government draft law *Regarding the Abolition of Mandatory Divided Real Estate Ownership in Multi-Apartment Buildings* (hereinafter referred to as Draft Law). However, the Draft Law has been repeatedly criticised, and several essential issues have not been duly reglamented in it.

The goal of the research is to select and analyse the legislation, case law and opinion of the field experts on the abolition of the divided real estate ownership with an intention to identify topical issues that are not regulated by the Draft Law and offer possible solutions related to the calculation of redemption price, payment method and consequences of non-payment.

The questions for the research are the following: (1) what legal and practical problems are not addressed in the new Draft Law for the remediation of the divided real estate ownership issue? (2) how to elaborate the Draft Law, to ensure optimal solution for the problem of divided real estate ownership in Latvia?

Research hypothesis: in order to ensure the equality and fairness amongst all former owners or their heirs after the restoration of land ownership under multi-apartment residential buildings, in calculating the redemption price, it is necessary to take into account the enforcement of the law of December 8, 1938, *On the Abolition of Divided Real Estate Ownership* in relation to the fulfilment or non-fulfilment of the one-off redemption payment.

The research shows that the issue of apartment owner solvency has not been taken into account in developing the Draft Law and the method of redemption price calculation as well as the term and consequences of procedure defined by the Draft Law have not been properly assessed and justified. Also the law of December 8, 1938, *On the Abolition of Divided Real Estate Ownership* has been neglected. The mentioned law provided that upon the abolition of divided real estate ownership, the users who are given full ownership rights as a result of the given law shall pay one-off redemption payment to the general owner. However, a part of the citizens ignored the given law and did not pay the redemption price.

In the beginning of the Land Reform, the former legal owners and their heirs had the right to restore their previous status even though the redemption price had not been paid. In the authors' view, this is a violation of the principles of equality and justice, as in equal real circumstances, one category of citizens was in a more advantageous position than the other. As a result of it, there is an absurd situation – those former owners or their heirs who did not pay one-off redemption price restored their ownership and actually received the parcel as a gift. Today, in addition, these citizens can receive lease payment and the redemption payment – it is a threefold benefit that cannot be justified. Therefore, the authors of the research will address the issue of redemption price calculation, payment procedure and consequences of non-payment, taking into account the historical aspects, although there are several other drawbacks to this Draft Law. It must be added that the problem of divided real estate ownership existed in other European countries. However, assessing the existing research results and the adoption and historical aspects of legislation in Latvia, the authors decided that detailed analysis of experience in other states will not contribute to this research, as it has been decided that it would be reasonable to make the necessary corrections in the developed Draft Law, which stem from the historical aspects of Latvian legislation and the present social and political situation in Latvia.

Literature Review

There has been wide discussion amongst the experts of civil justice field in relation to the research on the issue of the abolition of the divided real estate ownership in both Latvia and other states of Europe, where this problem has been important. It must be added that these discussions basically are available on the Internet. There are few scientific publications that would address this issue.

In authors' opinion, a thorough research on the request of the Ministry of Justice has been performed by business law firm *Sorainen* – 'On the Legal Framework of Real Estate Ownership After the Completion of the Land Reform – the Problem of Full Implementation of Civil Law Concept of Land and Building Indivisibility' (Ministry of Justice, 2008).

The study discusses in detail the issue of divided real estate, analyses the relevant legislation, examines the experience of other countries and offers possible solutions. It points out that it would be advisable to enclose the issues related to this new legislation in a separate law (the so-called 'umbrella law'). This law could consolidate the legislation regulating the completion of the Land Reform, and it would determine the main principles. In relation to the plausible redemption price, it indicates that the price should be economically justifiable (market price). In this context, it would be advisable to consider the assessment of the whole real estate (land parcel and buildings) and then the value of the land parcel separately, assuming that there is no building on it owned by another person (Ministry of Justice, 2008).

Analytical research has been carried out several times by the State Land Service. For example, in the study 'Divided real estate and forced lease in Riga multi-apartment residential buildings', it has been concluded that '[…] in present circumstances the land under multi-apartment residential buildings is attractive to

investment' (State Land Service, 2012).

In the study on the necessity to modernise the Civil Law part of Property Law (fourth, fifth, sixth and seventh subchapters), it is pointed out: '[…] it is necessary to introduce new institutions that could substitute the effective system of the divided real estate ownership. Such institutes exist in the legislation of other post-Soviet countries. To this end, it would be advisable to supplement the part on other property rights with a subsection on the ownership of a building (superficies) and emphyteusis, as well as trust rights, taking as an example the legislation of property rights in Estonia and Lithuania. If the conceptual approach is clear, it would relatively easy to develop and incorporate these norms, taking into account that in Estonia and Lithuania these institutions are developed fairly detailed' (Rozenfelds, 2008).

From the moment the Draft Law was published, the attitude of the civil law experts and the society towards its content, in the opinion of the authors, has been rather sceptical than optimistic. In assessing the public opinion of civil law experts, the authors agree that the development of the Draft Law has objective grounds but it also has significant drawbacks.

Klementijs Rancāns, the board member of the association of apartment owners and tenants 'Ausma' and a lawyer, pointed out in several publications that the Draft Law is legally incorrect, it does not conform to the Constitution and human rights in general, the real value of the land parcel is not determined; and that the problem was created by the state and municipalities, so they must redeem the land, the price of the land under living buildings is abominable, the area of the land parcel attached to the building is determined by default and illegally (Rancāns, 2015).

The solution would be to start with the review of the cadastral value of the land that are under multi-apartment residential buildings. The restrictions to the rights of land owners are determined by the Constitution, Article 116. No doubt that the price of the land under multi-apartment residential buildings that are not profitable in Riga or any other place in Latvia must be the same. The price of the land under multi-apartment residential buildings in Vecrīga must be lower than that in city suburbs (Avotiņš, 2016).

Aivars Gontarevs, the Chairman of the Board in a real estate company 'Latio namsaimnieks', discussing the cadastral value comments it: 'Therefore the issue of value must be addressed first, and after that we can deal with the legal aspects of the issue'" (Kļaviņš, 2016).

Many experts of civil law find the requirement to settle the redemption price in 10 years alarming. Šļahota said that banks will be interested in the financing of the land purchase only to those inhabitants who have the real estate mortgage. It is so because then these properties are united and their value increases. But if there is a forced mortgage, the owner is insolvent and has no financial means to settle the redemption price and if during these 10 years the person does not manage to set the money aside or borrow, there is a possibility that the inhabitant of the apartment may lose the apartment, and this is the biggest risk of this project (Dārziņa, 2016).

Trying to find a fair solution, the law of December 8, 1938, *On the Abolition of Divided Real Estate Ownership*, which describes quite a simple process of divided real estate property abolition, as well as the *Instruction on the Abolition of Divided Real Estate Ownership,* which in the opinion of the authors are of great importance in developing the Draft Law, have been analysed. These two documents are the basis for the assessment of the historical order that was applied denoting one-off redemption price and whether it has some influence nowadays.

To obtain a clear vision of how the redemptions rights were put into practice, the authors of the research examined and assessed materials from the State Archives of Latvia, fund No 824 (State Archives of Latvia, 2013), on the redemption procedure in Riga, Kr.Valdemāra iela and Šarlotes iela (group 24, No 8). Having examined the materials, the authors could ascertain that the former owners and their heirs, according to the order defined by the law, received documents with the calculation of the redemption price and purchase agreements with the terms of payment (State Archives of Latvia, 2012a). The documents show that irrespective of whether the redemption price was paid or not, the land became the property of

these citizens. The one-off payments of the redemption price were examined in the materials of the State Archives of Latvia (2011, 2012a, 2012b, 2001, 2009). But the fact that the redemption price has not been paid was shown by another archive reference (State Archives of Latvia, 2013) and the added documents in which it was stated that 'there is no information in the archive funds about the purchase agreements with Riga City Council till December 15, 1939, and from December 16,1939, till July 21, 1940'.

Despite the fact that authors of the research managed to analyse archive materials only for a small fraction of properties, there is enough material to conclude that there is a multitude of real estate that have not been redeemed according to the law of December 8, 1938, *On the Abolition of Divided Real Estate Ownership.* Unfortunately, the authors did not manage to find publications that would analyse in detail the issue of the realisation of the above-mentioned norms in Latvia.

Valid conclusions can be found in the judgements of the Supreme Court and the Constitution Court in which the necessity to restore justice and equality and the achievement of legitimate targets, as well as the necessity to ensure conformity of this legislation to the Constitution, solving arguments that have arisen after the Land Reform is stated.

Methodology

For the study purposes general scientific research methods and specific methods for the interpretation of laws have been used.

General scientific research methods:

Historical analysis – studying the creation and historical development of the divided real estate ownership;

Analytical method – studying laws, case laws, theoretical literature and opinions of different authors, to understand the content of the divided real estate ownership;

Inductive method – studying the problems connected with the laws regulating the divided real estate ownership un coming to general findings of the research;

Deductive method – studying the grounds for the calculation of the redemption price, which can be inferred from the Draft Law and the law of December 8, 1938, *On the Abolition of Divided Real Estate Ownership*;

Logical construction – for the formulation of findings and suggestions;

Descriptive analysis – analysing in detail the peculiarities of the divided real estate ownership and the method of redemption price calculation, summarising the information and on the basis of acquired findings, providing explanation as well as determining the related problems.

Methods for the interpretation of laws:

Grammatical analysis – to determine precise notion and content of the divided real estate ownership from the linguistic point of view;

Systemic method – interpreting the legal norms related to the termination of the divided real estate ownership and calculating the redemption price, in relation to the Civil Law and other laws;

Teleological method – interpreting the substance of the aim of the divided real estate ownership and methods for redemption price calculation and the laws regulating it;

Historical analysis – explaining the circumstances that served for the development of divided real estate ownership and that created necessity to solve the situation.

History of divided real estate ownership development

On 4 May, 1990, the Republic of Latvia restored its independence. Later, on 13 June, 1990, the Supreme Council adopted the decision *On Agrarian Reform in the Republic of Latvia*, which served as a milestone marking the beginning of the Land Reform, which granted rights of owners in regard to land and buildings (construction), according to the situation on 21 July, 1940, or their heirs. At the same time, any Latvian citizen could acquire land and buildings formerly owned by the state.

At the end of 1989, a group of experts emerged for the preparation of the Agrarian Reform in Latvia, which at its own initiation stated to develop the principles for the reform and defined its objectives. The drafting of the law on the Land Reform and its implementation afterwards was a tough and complicated process, as it had to be carried out in the circumstances of political and ideological instability; there was heated controversy on which political and economic system would be most acceptable for Latvia and about the role of the state and its tasks. Already, in developing the draft of the Land Reform, it appeared that the society lacked common and comprehensive understanding about a fair framework for the reform and its aims and objectives. On the contrary, different, and often conflicting, aims were proposed. The peculiarity of the Land Reform in Latvia is that it was not regulated by a single law or a set of mutually related laws, instead several laws were chaotically developed, and some articles in these laws during the long period until the adoption of the law by the Supreme Council (later in the Saeima) were amended several times, which resulted in contradictions amongst and within these laws (Boruks, 266–268; 2001).

As the researchers of the Land Reform admit, legislation governing the Land Reform was passed hastily, under the influence of different social and political factors; therefore, for several times, it was necessary to make amendments in these laws. The consequences of it can be felt even nowadays.

One of the regulations in which these negative consequences can be observed is the development of divided real estate ownership. Possibly due to haste and ill-considered solutions as well as due to innumerable amendments made during the Land Reform, the principle of physical unity of the property was violated. The Section 968 of the Civil Law stipulates the following: 'A building erected on land and firmly attached to it shall be recognised as a part thereof.' Dealing with cases regarding the restoration of ownership rights to the former owners or their heirs, land ownership rights were restored within the historical boundaries also to the land parcels on which buildings (constructions) owned by other persons were situated. Passing the law *On the Time and Procedures for Coming into Force of the Introduction, Inheritance and Property Law Part of the Renewed Civil Law of the Republic of Latvia of 1937*, it was defined that 'taking into account the conditions defined in the first part of the Section 14, paragraph 1–4, Sections 968 and 973 cannot be applied, and until the uniting into a single real estate the buildings (constructions) or orchards (trees) shall be considered as independent ownership objects' (Law *On the Time and Procedures for Coming into Force of the Introduction, Inheritance and Property Law Part of the Renewed Civil Law of the Republic of Latvia of 1937,* 1992).

As written in the annotation of the Draft Law: 'Requiring the restoration of land ownership rights to a definite land parcel within its historical boundaries, the former owner or its heir from the beginning has to take into account that, in case before the restoration of the independence of the Republic of Latvia a building (construction) has been erected on this land parcel that belongs to another person the owner will be obliged to lease the land to the building owners' (Ministry of Justice, 2015). Unfortunately, a more elaborate explanation on the far-reaching consequences and the possible problems was not available. This, however, did not discourage the former owners or their heirs from restoring their ownership rights to such land parcel within their historical borders, even though there were other alternative solutions in the laws of the Land Reform – to require to provide property rights or usage rights to an equivalent land parcel or to require compensation according to the order defined by the law. The authors conclude that under such circumstances, the former owners or their heirs were given a choice but the apartment owners in multi-apartment residential buildings were not offered such a choice and they had to face the facts. This, to some extent, contradicts the Section 1 of the Civil Law, that is, the principle of good faith, according to which '[…] a person may be deprived of exercising one's subjective rights or the fulfilment of subjective duties if it is found that the conflicting interests of the other party according to the aim of the law and the

circumstances of the case are deemed to be more important' (Senate for the Supreme Court of the Republic, 2005). However, the former owners or their heirs cannot be reproached for ignoring the principle of the good faith, as they exercised their rights provided by the law and possibly did not consider the seriousness of the consequences. Such reproaches can be addressed towards the authors of these Land Reform laws who had ignored the Section 1 of the Civil Law.

Of course, it was possible to solve the restoration of the ownership rights differently, observing the interests of apartment owners in multi-apartment buildings, not restoring the ownership rights to the former owners or their heirs to the land parcels or their parts within the historical boundaries where multi-apartment residential buildings and buildings (constructions) owned by other persons are situated. In Estonia, for example, the former land owners could not restore the property right to a land parcel on which there was situated a building belonging to a third person. Instead, the land owners received a land parcel on which there are no buildings belonging to other persons. But the state maintained the ownership of illegally alienated (nationalised) land on which there were situated buildings belonging to other persons (Ministry of Justice, 2008).

Following the same principle, the ownership was restored to the former owners in Lithuania (with some exceptions). However, no proper attention was paid to it in Latvia; therefore (according to the information of the Ministry of Justice of the Republic of Latvia), '[…] In Latvia, as a result 3677 multi-apartment residential buildings (11 0907 apartments in total), which are situated on 7354 land parcels owned by other persons, have mandatory tenant relationships with the owners of the land parcel' (Ministry of Justice, 2015). Now, in the opinion of authors, there is no point in criticising these decisions, which had and still have negative long-term consequences, but now it is important to adopt effective legal framework that would eliminate the errors of the past and would provide a possibly fair mechanism for the abolition of divided real estate ownership in Latvia.

Redemption price and its calculation, abolishing divided real estate ownership

As mentioned earlier, there are several deficiencies in the Draft Law. Some of them have been widely discussed amongst the experts of the respective field in press, television, radio and so on. Therefore, the authors will discuss the redemption price and its calculation, as well as the consequences of non-payment of the redemption price.

According to the Section 1, Paragraph 4 of the Draft Law, the land which is the subject of redemption is 'a land parcel defined according to the legislation regulating the privatisation of residential buildings which is functionally necessary land parcel which coincides with the parcel which is the subject of mandatory divided real estate property ownership' (Ministry of Justice, 2015). The price of the land parcel which is the subject to redemption and the order of its calculation are regulated in Section 5 of the Draft Law and it is quite simple. The price is calculated by multiplying the sum of the cadastral value of the land parcel or its part by the redemption price correction coefficient 1.18. In the opinion of the authors, the annotation of the Draft Law does not justify why such coefficient has been set and why in such amount. Calculating the redemption price, the cadastral value of the land parcel or land unit valid in respect of the day, when a notice about the exercising the option of redemption is dispatched, is applied (Ministry of Justice, 2015). The makers of the Draft Law find this method of calculation legitimate, reasonable and fair. In the annotation of the Draft Law, it is indicated that the cadastral value comprises 85% of the real estate's market value. By multiplying the cadastral value with the coefficient 1.18, we obtain a figure that can be comparable to the market value of the real estate (Ministry of Justice, 2015). At the same time, the annotation contains a very important reference to the comments of the European Court of Human Rights, that is, to ensure the social justice, the remuneration for the expropriation of the real estate may be smaller than the market value. However, we may conclude that the lawmakers have disregarded this advice in developing the Draft Law. In Germany, for example, the remuneration is set below the market value. The owners of the buildings purchasing the land under the building must pay only half of the market value; the price may be decreased even further if the owner of the building duly informs the land owner about the desire to purchase the land parcel (Ministry of Justice, 2015).

Taking into account the comments of the European Court of Human Rights and the fact that the cadastral value of the real estate is set close to the market value, in calculating the redemption price, only cadastral value or even half of the cadastral value should be taken into account. However, it should be noted that the assessment has been made by taking the existing cadastral value of the real estate into account, as we do not know what may the value be at the moment of the final reading of the Draft Law in Saeima. The authors do not preclude that in case of increase in the cadastral value of the real estate, the number of those apartment owners who will have a desire and an ability to redeem the land may rapidly fall. Therefore, the issue of the method for calculating the cadastral value and the decrease in the cadastral value should be addressed first, because, in the opinion of the authors, cadastral values in some parts of Riga are too high.

It should be stressed that there are land parcels in Latvia that are repurchased from the former owners or their heirs. In such a situation, in calculating the redemption price, the cadastral value or the purchase value should be taken as a basis. The redemption price must be calculated proportionally to the respective redeemable undivided share. If the price of the land purchase is higher than the cadastral value, it must be provided that the redemption price may not be higher than the cadastral value. It must be added that such a requirement is determined by the fact that at the present moment, the cadastral value has almost reached the value of the real estate. Even more, the real estate where there is situated a building belonging to other person is encumbered and its value is lower. Rozenfelds also concluded that '[…] the value of the real estate that is encumbered by forced lease is several times lower than the value of the parcel that has no encumbrance' (Constitutional Court, 2011). In the Court's judgment in Case No 2002-12-01 as of 25 March, 2003, it is said: 'Since the consequences of the occupation is a burden that lies on the whole society and it is impossible to remedy these effects completely, the principle of fairness requires that not only the interests of the former land owners or their heirs are taken into account during the Land Reform but also the separate interests of other citizens and the society in general' (Constitutional Court, 2003).

The authors of the study have concluded that unfortunately, in developing the redemption price and the legislation regulating its calculation methods, the historical situation has been taken into account. Until 8 December, 1938, there existed divided real estate ownership between the state or the municipality as with the 'general owner' and natural and legal persons as with 'entitled users with ownership rights'. From the day the law of 8 December, 1938, *On the Abolition of Divided Real Estate Ownership* came into force, on the basis of Section 1 and 2 of the mentioned law, divided real estate ownership rights defined in agreements or which arise from the laws were revoked and the 'entitled users with ownership rights' were given full ownership rights to the real estate.

However, according to Section 5 of the law of 8 December, 1938, *On the Abolition of Divided Real Estate Ownership*, entitled users with ownership rights, who were given full ownership rights with this law, had to pay one-off redemption price that was calculated in the order and the amount defined by the law. The norms included in the Sections 3, 5, 6, 7, 8, 10 and 25 determined the term, amount and the order of the payment. Section 25 of the law established that an entitled user with ownership rights can pay the redemption price to the general owner in equal yearly payments during 5 years counting from the day when redemption price has been set. On the basis of Section 35 of the law, the *Instruction on the Abolition of Divided Real Estate Ownership,* which defined a more detailed regulation of redemption price issues, was issued.

On studying the materials of the National Archives of Latvia (mentioned in the *Literature Review*), the authors found that many users with ownership rights, who with the law coming into force became the only owners, had paid redemption price, but some had not paid the redemption price. In such circumstances, a situation in which some of the former owners or their heirs are in a more privileged situation in comparison with the other owners who have made the payment has developed. Therefore, in defining the redemption price in the Draft Law, in the opinion of the authors, it is necessary to take these historical facts into account.

The authors believe that before calculating the redemption price, each owner must be required to submit a

certificate from the National Archives of Latvia attesting the fulfilment of the norms of the law of 8 December, 1938, *On the Abolition of Divided Real Estate Ownership* and the one-off payment for the respective land parcel. In case the payment had not been made, the payable amount must be subtracted from the calculated redemption price. Of course, it would be necessary to decide how to convert the redemption price into the present currency – euro.

In determining the redemption price, it would be necessary to calculate the contributions made, which increased the value of the real estate, and the redemption price must be respectively reduced. It should be pointed out that in many cases, contributions have been made, which considerably increased the value of the land parcels where the ownership rights have been restored to the former owners or their heirs. It can be concluded by examining the documents in the National Archives of Latvia. It may create additional difficulties, but it would ensure justice and equity and would also reduce the burden for the owners of apartments related to the redeeming of the land parcel.

Issues related to the calculation of the cadastral value, conversion of the redemption price, comparing to the amount in euro and the assessment of the contributions can be subject to separate discussion and will not be included in the scope of this research.

One more aspect undermining the completeness of the Draft Law is related to the decision on the order and consequences of redemption rights and redemption price payment.

In the second part of the Section 11 of the Draft Law, it is said: 'Decision on the exercising of redemption option is taken if the co-owners of apartments owning more than a half of apartments in the forced divided real estate have voted in favour of the redemption of the land parcel' (Ministry of Justice, 2015). However, in the third part of Section 11 of the Draft Law, it is said: 'Decision taken in a general meeting of the apartment owners on the exercising of redemption option is binding to all owners of apartments in the building'. Although the Ministry of Justice of the Republic of Latvia in the annotation of the Draft Law has explained the necessity of such regulation, the authors believe that a part of owners, because of insufficient financial means, will not be able to influence the decision, as at the present moment, there is no requirement to obtain a 100% support of all inhabitants. These apartment owners will then forcefully become the hostage to the situation and as a result may become homeless.

In the first part of the Section 16, it is said: 'If redemption opportunity is used (second part of Section 15) in respect to the apartment real estate, where the owner or the owners have not paid their part of the redemption price according to the order defined in this law, a sworn bailiff registers a mortgage in favour of the land parcel owner in the divided real estate as a security for claim in the amount of the respective redemption price' (Ministry of Justice, 2015). Here it must be noted that the 3-month term denoted by the Section 15 of the Draft Law, part 1, is too short. In determining this term, the ability of the apartment owners to make savings in 3 months and also the amount of the minimal wage – EUR 370 – and the average pension must be taken into account. The average pension, for example, in October, 2015, was EUR 292. However, during the past year, the number of people who have received pension under EUR 20 has increased. There is also a growing number of those whose pension is between 20 and 100 Euros (Paparde, 2016). The authors consider that the term must be prolonged from 3 to 6 months and also that the one-year term defined by the Draft Law, Article 7, must be proportionally prolonged.

But in the seventh part of the above-mentioned section, it is said: 'Owner of the mandatory divided real estate land parcel, in whose favour the mortgage is registered, shall not have the right to claim the payment of the unsettled redemption price in 10 years since the registration of the moment of mortgage' (Ministry of Justice, 2015).

This means that after 10 years, the owner of the land parcel will be able to bring claim against the owner of the apartment for the recovery of the debt. It must be pointed out that in developing the Draft Law, the income of the apartment owners, whether there are existing credit agreements and whether all of them will be able to build up savings to settle the redemption payment and at the same time pay default interest, determined by the fifth part of the Section 16, have not been assessed. Only general calculations have been

made taking as a basis the average wage or pension. However, in the opinion of the authors, it is neither acceptable nor permissible. Therefore, in solving the issue of legal consequences for those apartment owners who will not have settled the redemption payment in due time, a different solution must be sought.

The authors agree with an opinion expressed on the Internet: 'The reform should provide that the land under multi-apartment residential buildings becomes the property of apartment owners or is available to the municipality, from which apartment owners could lease the land under the building for a reasonable price. If an apartment owner is not ready to redeem the land, it should become the property of the state or the municipality and apartment owners could continue to lease the land for a reasonable price' (Association *Progresīvie* Board, 2014). This would be a good solution in situations when the apartment owner is unable to settle the redemption payment even in 10 years. Such apartment owners there will definitely be, because the cadastre value of land parcels in Latvia can considerably vary starting from 1000 EUR to 500 000 EUR. The author assumes that those owners of land parcels who will redeem their land with an aim to gain profit from the lease of the land parcel will use their opportunity to alienate the real estate of apartment owner by means of judicial settlement. Unlike in the Land Reform laws of Latvia, in developing the legal framework for the abolition of divided real estate ownership, Estonian lawmakers chose a different solution for situations when illegally alienated land was returned to its former owner or its heirs – to them, land in another place was provided where buildings (constructions) belonging to other persons are not situated. Nationalised land on which buildings (constructions) belonging to other persons were situated remained the state property, thus providing the owners of the buildings (constructions) an opportunity to use it and redeem it (Rancāns, 2016). This principle should also be followed in Latvia in abolishing the divided real estate ownership. The state and municipalities are responsible for the incomplete regulations of the Land Reform. Thus they should assume some part of the responsibility and redeem the land parcels on which multi-apartment residential buildings are situated and then they must offer to redeem the land to the apartment owners. Or it must offer long-term lease of the parcel to ensure the rights to property defined by the Section 105 of the Constitution (Constitution of the Republic of Latvia, 1993) also to those persons who would not be able to settle the redemption payment within the statutory deadline. Of course, that would require considerable financial contribution. State Land Service has calculated that the cadastral value of 7,354 land units could be EUR 130,000,000, or even EUR 180,000,000 (Ministry of Justice, 2015). But it must be taken into account that this amount may gradually decrease as the state will receive payment for lease and redemption. Unfortunately, such alternative is not provided by the state, to assume the responsibility and to redeem the land from the owners. Therefore, the authors will offer other solutions in the conclusion of the paper.

Results

The authors consider that the situation of divided real estate ownership in Latvia has evolved as a result of ill-advised and poorly developed legislation regulating the Land Reform.

The issue of divided real estate ownership has been subject to numerous studies, and in many countries, the legislation regulating divided real estate ownership has already been created. Therefore, several experts have expressed an opinion that it would be necessary to adopt the experience of other countries (e.g. Estonia and Germany). The authors are of the opinion that despite the similarity of the problems, there are several historical, sociological and political factors that are typical only to Latvia. Therefore, it would be quite difficult to adopt the legislation of other countries.

It is important to develop the Draft Law, but there are significant drawbacks in it and its adoption in the present version will not improve the situation and will create even bigger problems, especially to the apartment owners. Therefore, the authors of the Draft Law should consider openly expressed criticism and suggestions for improvement expressed openly in public, and also additional research must be carried out (e.g. about the solvency of apartment owners), and then they must appropriately improve the present version of the Draft Law.

Conclusions

In restoring the property rights to the former owners or their heirs, the principles of equality and fairness were not followed as on the same grounds the property rights were restored both to those who according to law of December 8, 1938, *On the Abolition of Divided Real Estate Ownership* had paid the redemption price and to those who had not done it. In developing the Draft Law, these historical circumstances, which are very important in calculating the redemption price, have not been taken into account.

It is necessary to determine precisely in the Draft Law the issue of redemption price calculation taking into account whether the requirements of the law of December 8, 1938, *On the Abolition of Divided Real Estate Ownership* have been met.

The Draft Law should seek an opportunity to reduce the redemption price if the state or municipality has made material contributions in the real estate in order to improve the state of it and to develop it, for example, in the building of land drainage systems, access ways and so on, which has substantially improved the value of the real estate. Therefore, the authors of the Draft Law have to carry out additional research to find out: (1) whether there is real estate in which the state or the municipality has made some contribution since the moment of nationalisation; (2) if there have been such contributions into the real estate, they must be identified; and (3) their amount must be calculated. On the basis of results obtained in such research (providing that the quantity of such real estate where there has been contributions is large), the Regulations of the Cabinet of Ministers that would define the order in which the presence of contributions is denoted and their amount calculated must be developed. Not only lawyers but also the representatives of the respective fields (from the State Land Service, representatives from the Land Register, surveyors, certified real estate agents, experts in construction, etc.) must be invited to participate in the development of these regulations of the Cabinet of Ministers.

The Draft Law should seek an opportunity to reduce the redemption price if the owner of the real estate has received lease payment. The amount paid for lease must be deducted from the calculated redemption price.

In the Annotation of the Draft, in Section 2.3.1., explanation about the calculation of the redemption price by applying the correction coefficient 1.18 is provided; therefore, redemption price reaches the market value of the real estate. However, the Annotation of the Draft Law does not provide valid explanation why exactly this coefficient has been chosen and why the redemption price is adjusted to the market value. Thus the Section 2.3.1. of the Annotation requires a more detailed explanation.

On the basis of the above, the following amendments should be made in the Draft Law

Change Section 5, part 1, in the following wording:

‘(1) The owners of apartments redeem the land paying the redemption price that consists of the sum of the cadastral value of land units or their parts which are included in the land parcel, from this amount a deduction is made in the amount that the owner of the land has received from the apartment owners for the land lease till the day of notification dispatch, mentioned in the Article 6 thereof, plus the sum of contributions made by the state or the municipality in the real estate from the moment of its nationalization till the restoration of the property. The order of calculation of the contribution and the amount is defined by the Cabinet of Ministers.’

Supplement Section 5 and change it to the following wording:

‘(5) If land units or their parts included in the land parcel are purchased from the former owners or their heirs on the basis of a purchase agreement, the redemption price shall be set in the amount of the purchase sum registered in the Land Register.’

In the Draft Law, Section 15, part 1, a 3-month term is set for the payment of the redemption price. It is too short and not all apartment owners will be able to observe it. Therefore, the term must be prolonged

till at least 6 months. The one-year term set in the Subsection 7 of the Draft Law should also be respectively prolonged. Thus the following amendments should be done in the Draft Law:

(a) Section 5, Part 1:

replace the word ‘three’ in the Section 15, Part 1, with ‘six’.

(b) Section 7:

replace the word ‘year’ in the Section 7 with words ‘within one year and three months’.

Registering a mortgage in favour of the land owner if the apartment owner has not paid the redemption price creates risk to the apartment owner to lose rights of owner to the apartment after 10 years. Such consequences of the divided real estate abolition cannot be justified. Forcing a person to purchase a property not providing a different option after 10 years to ensure the maintaining of the property contradicts the norms of the Constitution, Section 105 and even any moral norms. The authors offer an alternative solution: in cases when the apartment owner is unable to pay the redemption price within 10 years, the respective undivided share in the shared property is taken over by the state, but the apartment owner has the right to long-term lease of the land under the building or until the moment of purchase. The order in which the state takes over the land that has not been redeemed is defined by the Cabinet of Ministers. It must be added that this suggestion is just a concept at the present moment, as the authors see that the state is not interested in the acquisition of the land under multi-apartment residential buildings; therefore, it is too early to offer precise wording to articles of the law.

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DE GRUYTER OPEN

ECONOMICS AND CULTURE 13(2), 2016

DOI: 10.1515/jec-2016-0006

ETHICAL LEADERSHIP: MEANING AND MEASUREMENT. LATVIAN RETAIL TRADERS' PERSPECTIVE

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Abstract. In the contemporary situation of ever-growing market internationalisation, local and global competition different company leadership aspects, especially ethical leadership, gain a special importance. It is possible to say that in theoretical literature, there is more or less consensual agreement upon the meaning of ethical leadership still regarding the evaluation models there are many models. Therefore, the main challenge is to determine the case sensitive model(s) for the industry or the type of business organisation. The goal of the article is to delineate theoretically and to test empirically amongst Latvian retail traders one of the models of evaluation (the one of the Executive Servant Leadership Scale, ESLS). The research questions are (1) What is the ranking of the ESLS first-order factors? and (2) What are the possible problem areas in the ethical leadership as seen by the Latvian retail traders? The authors of the present paper aspire to identify the problem areas out the future lines of investigation. The current research uses the following research methods: the monographic (the literature study related to the concept of ethical leadership and its evaluations models); expert interviews to narrow down the items to be tested; and the survey with the following factor analysis.

Keywords: ethical leadership; levels of ethical leadership; authentic leadership; transformational leadership; frameworks for analysis of ethical leadership

Type of the paper: Theoretical paper, Empirical study

JEL Classification: M14, L81

Introduction

In the contemporary situation of ever-growing market internationalisation, local and global competition different company leadership aspects gain a special importance. One of these aspects is ethical leadership. Implicit in the ongoing conversation regarding ethical leadership is the notion that leaders hold tremendous power and that those leaders who perceive organisations and people beyond 'competency inputs' and 'performance outputs' are increasingly important in a profoundly interdependent society (Reed et al. 2011). It is possible to say that in theoretical literature, there is more or less consensual agreement upon the meaning of ethical leadership still regarding the evaluation models there are many approaches. Therefore, the main challenge is to determine the case sensitive model(s) for the industry or the type of business organisation. The goal of the article is to delineate theoretically and to test empirically amongst Latvian retail traders one of the models of evaluation (the one of the Executive Servant Leadership Scale, ESLS). The research questions are: (1) What is the ranking of the ESLS first-order factors? and (2) What are the possible problem areas in the ethical leadership as seen by the Latvian retail traders? The authors of the present paper aspire to identify the problem areas out the future lines of investigation. The current research uses the following research methods: the monographic (the literature study related to the concept of ethical leadership and its measuring possibilities); expert interviews to narrow down the items to be tested; and the survey with the following factor analysis. During the past decade, the concept of ethical leadership gains more attention in management literature, both as a theoretical and a practical issue related to the sustainable development of the organisation. In the first part of the article, we perform a critical review of the literature regarding the conceptions of ethical leadership, as well as evaluation models. The second part is devoted to the empirical testing of one particular model – the ESLS – amongst the Latvian retail traders.

Literature Review

In order to distinguish between various approaches to the concept and practice of ethical leadership, we propose to apply the three-level leadership model: ethics of the leader, the means of ethical leadership and the heart of leadership (Palmer 2009). Let us dwell briefly on each of the levels. First, there are theories concerning ethical behaviour of business leaders based on high personal moral standards and role modelling. It has been stressed that leaders who behave morally are probably less prone to moral transgressions in their business practices (Bowie 2005; Zaccaro et al. 2008). At the same time, we have to admit that this kind of approach can lead to holding leaders personally accountable to higher standards of morality that they are not being able to live up (Palmer 2009). Catherine Marsh (Marsh 2013) describes qualities such as mindfulness, engagement, authenticity and sustainment. The value perspective of mindfulness is composed of the valued approaches of ethical leadership: observation, time for reflection, systems thinking, rational process and dialogue and questioning. The value perspective of engagement embraces diversity, cultivates relationships, terminates relationships and encourages risk taking. Authenticity represents personal integrity and self-knowledge; sustainability is composed of the valued approaches of ethical leadership. The second group (level) of theories concerns the means of ethical leadership. This means to look for from the viewpoint of specific actions that are taken in performing leadership functions. Another way would be to view the means of leadership in terms of styles or models of leadership. The latter approach allows better understanding of the diverse actions within the particular leadership model. But the problem consists in the fact that none of the leadership styles is inherently moral or immoral, although some of them tend to discern ethical dimensions – everything goes when the job has to be done. The way how leaders' ethical/unethical behaviour affects their subordinates is being analysed in various research papers, the attention of investigators mostly is paid to aspects of leadership such as unethical behaviour of followers, multifocal social exchange perspective, trickle-down effect of ethical influence, phenomenon of social distance, relationship conflict and leadership of ethics. Given their positions in organisations, supervisors are often deemed legitimate models for normative behaviour (Mayer et al. 2012; Ghahroodri et al. 2013). The above-mention factors make it possible to develop the concept/model of the leadership of ethics (ELI, ethical leadership inventory) consisting of three phases (Spangenberg & Theron 2005). The ELI interprets leadership as a complex, continuous process expressing itself in an extensive array of inter-dependent behavioural actions. The third level of ethical leadership presupposes existence of a common mission and vision. However, if leader's vision is inherently in conflict with the mission of the business or when the vision is centred upon the mission that is inherently unsupportable, the ethical leadership fails (Bowie 2005; Kaptein 1998; Sarwar 2013). As a rule, the transformational and charismatic leaders are thought to be ethical leaders who model ethical conduct (Brown & Mitchell 2010), the same regards the authentic leaders (Walumbwa et al. 2008; Yukl 2008; George 2003). The contrast of the transformational as authentic leadership and transactional as inauthentic leadership is analysed by Groves and LaRocca (2011) and Turunc, Celik and Mert (2013), as well as by Brown, Trevino and Harrison (2005). The transformational leadership is defined as a process in which leaders and followers engage in a mutual process of raising one another to higher levels of morality and motivation (Turunc et al. 2013). It comprises five leadership dimensions: idealised attributes, idealised behaviours, inspirational motivation, intellectual stimulation and individualised consideration. Such leaders earn credit and respect from their followers by considering their needs above their personal needs and taking into account moral consequences of their key decisions (Groves & LaRocca 2011). They influence others by developing collective vision and inspiring them to look for a common good, rather than their self-interest. A social learning perspective of ethical leadership proposes that leaders influence others via modelling (observational learning, imitation and identification). In our opinion, this construct of ethical leadership is the most fruitful as it allows (a) to develop a model of ethical leadership starting from the bottom up, that is, taking into account the particular business situation and ethical organisational culture, and (b) to work out specific criteria for management. Brown and others propose that leaders become attractive, credible and legitimate ethical role models by engaging in ongoing behaviours that are evaluated by the followers as normatively appropriate (Brown et al. 2005). Table 1 summarises

characteristics of the main models of ethical leadership.

Table 1. Summary of ethical leadership comparisons (Source: Reed et al. 2011)

Model	Similarities	Differences
Transformational leadership	Concern for others – altruism Ethical decision-making Integrity Role modelling	Ethical leaders emphasise ethical standards and moral management (more transactional) Transformational leaders emphasise vision, values and intellectual stimulation
Authentic leadership	Concern for others – altruism Ethical decision-making Integrity Role modelling	Ethical leaders emphasise moral management (more transactional) and 'other' awareness Authentic leaders emphasise authenticity and self-awareness (dark side – can have unrealistic expectations of an unattainable level of self-knowledge)
Spiritual leadership	Concern for others – altruism Integrity Role modelling	Ethical leaders emphasise moral management Spiritual leaders emphasise visioning, hope/faith, work as vocation
Servant leadership	Concern for others – altruism Integrity Role modelling Moral manager Transactional/transformational	Ethical leaders emphasise the aspect of serving others, putting their interests before the self-interest

Apart from defining parameters of the ethical leadership, it is important, both theoretically and practically, to formulate the appropriate models of evaluation. A few questionnaires have been developed in recent years to measure the aspects of ethical leadership, but they differ in important ways and they all have limitations. The question of how to define and measure ethical leadership has not been resolved, and there is substantial conceptual confusion about this construct (Yukl et al. 2013). Brown and others have worked out 10-item instrument to measure perceptions of ethical leadership – the Ethical Leadership Scale (ELS), which includes aspects such as (1) listening to what employees have to say; (2) disciplining employees who violate ethical standards; (3) conducting his/her personal life in an ethical manner; (4) having the best interests of employees in mind; (5) making fair and balanced decisions; (6) being trustworthy; (7) discussing business ethics or values with employees; (8) setting the behavioural example; (9) defining success not only by results but also by the way that they are obtained; and (10) always asking question 'what is the right thing to do?' (Brown, et al. 2005). In sum, the difference of this model from all others lies in the fact that evaluation is being performed by the employees. They define ethical leadership as the demonstration of normatively appropriate conduct through personal actions and interpersonal relationships and as the promotion of such conduct to followers through two-way communication, reinforcement and decision-making. Tanner and others criticise the ELS method for being rather abstract and not sufficiently specific regarding the ethical leadership. Moreover, they note that the ELS states that employees who evaluate leaders should be initially competent in the sphere of ethical behaviour. As a corrective, they developed a new measure – the Ethical Leadership Behaviour Scale (ELBS). The ELBS focuses on visible ethical behaviour across different situations. The variables of this measure are the following: ethical leader behaviour, job satisfaction, affective commitment, work engagement, emotional exhaustion, health complaints, absenteeism, employee tenure and interaction frequency (Tanner et al. 2010). Kalshoven and others on the basis of the research mentioned above worked out the Ethical Leadership at Work Questionnaire (ELWQ) – the multidimensional measure of ethical leadership. They state that a leader's ethical behaviour consists of different behaviours that create different outcomes. The ELWQ consists of seven scales: people orientation, fairness, power sharing, concern for sustainability, ethical guidance, role

clarification and integrity (Kalshoven et al. 2011). Amongst other measures of the ethical leadership measures/scales, we would like to mention also the TERA model – ethical questioning based on three aspects: knowledge, volition and action. The knowledge component aims, on one hand, to help individuals to identify their personal viewpoint and, on the other, to become aware of other ethical perspectives. The volitional component brings to light the axiological dimension, beliefs, standards and principle to which individuals subscribe in their daily professional activities. The action component, in its turn, presupposes the determination of considerations that would serve to defend the personal position (Langlois 2011). The normative model of ethical leadership evaluation consists of five subcomponents: society expectations, organisational values, norms and beliefs, outcomes, society evaluation and reconnection. This model is dynamic by its nature; it presupposes business ethics to be continuous and iterative process (Fryer 2011). Still, the most important for our current research is the ESLS elaborated by Reed, Vidaver-Cohen and Colwell (Reed et al. 2011). The scale in question consists of five first-order factors reflecting leadership attributes such as (1) interpersonal support, (2) building community, (3) altruism, (4) egalitarianism and (5) moral integrity. Whilst the Executive Servant Leadership is the second-order factor, it captures the idea that the above mentioned distinct but correlated factors, each measured by multiple items, can be explained by the higher-order construct, that is, by the ESL. Based on the factors and items put forward by Reed and others, a list of 55 statements was created. The current research on the ethical leadership perception amongst the Latvian retail trades makes use of adapted and shortened version of this questionnaire.

Methodology

The research project consists of three subsequent stages. First, we conducted two expert interviews with a representative from Latvian Retail Traders' Association and a researcher specialising in human resource management. As a result, we identified 20 items to measure the most significant aspects of servant leadership. The items were divided according to first-order factors (interpersonal support, building community, altruism, egalitarianism and moral integrity), coded (IS, BC, A, E, MI) and presented in a mixed order. *Interpersonal support* is offered by the top executives in the development of employees' potential and organisational culture. The main items operationalising the interpersonal support are, amongst others, helping other to succeed, nurturing employees' leadership potential, treating others with dignity and so on. *Building community* involves cooperation with the external community. *Altruism* means serving others willingly without expecting any reward, placing the interests of others before self-interest. *Egalitarianism* lies on the assumption that leaders are not inherently superior to others. Thus, the items of the egalitarianism are constructive criticism and input from employees, debating over ideas. *Moral integrity,* as represented in the ESLS, means behaviour that inspires employee trust and promotes transparency and honesty throughout the organisation. Both experts reviewed the list of statements, after that we did the necessary adjustments. Then we created the five-point Likert-type questionnaire (strongly agree to strongly disagree). The instrument was administered to a non-probability sample of 76 retail traders' in Riga that are outside the shop chains and buying groups (the total number of traders of this category in Riga is 76). The questionnaire was introduced as follows: 'We are conducting a survey on leadership ethics and leadership ethic evaluation among Latvian retail traders. We ask to respond to the statements regarding the top executive at the working place one accidentally chosen employee from each organization.' Data was collected, anonymity and confidentiality was guaranteed. Thirty participants filled out the questionnaire for a 39.47% response rate. In data analysis, we proceeded in three stages: first, we calculated the mean value for items within first-order factors; then we calculated the mean value for each first-order factor; and finally, we looked into some correlations between different groups of statements. The research questions are

1. What is the ranking of the Executive Servant Leadership first-order factors?
2. What are the possible problem areas in the ethical leadership as seen by the Latvian retail traders?

Results

The respondents were asked to put a value on 20 statements. They were assured of the confidentiality. The results, that is, the mean values of each item (statement), are presented in Table 2.

Table 2. Mean values of the first-order factor items (Source: authors' compilation)

Ranking	Statement	Mean value
1.	(BC) Encourages a spirit of cooperation amongst employees	3.50
2.	(IS) Listens carefully to others	3.50
3.	(IS) Treats employees with dignity and respect	3.33
4.	(E) Welcomes ideas and input from employees at all levels of the organisation	3.30
5.	(MI) Inspire employee trust	3.17
6.	(E) Encourages debate on his/her ideas	3.13
7.	(E) Invites constructive criticism	3.07
8.	(MI) Promotes transparency and honesty throughout the organisation	3.07
9.	(BC) Considers the effects of organisational decisions on the community	3.00
10.	(BC) Values diversity and individual differences in organisation	2.97
11.	(A) Places the interests of others before self-interest	2.90
12.	(IS) Look for ways to make other successful	2.83
13.	(MI) Models the behaviour he/she expects from others in the organisation	2.83
14.	(BC) Believes our organisation has a duty to improve the community in which it operates	2.70
15.	(MI) Freely admits his/her mistakes	2.63
16.	(E) Displays interest in learning from employees, regardless of their level in the organisation	2.60
17.	(A) Serves others willingly with no expectation of reward	2.50
18.	(IS) Nurtures employee leadership potential	2.50
19.	(A) Prefers serving others to being served by others	2.37
20.	(A) Sacrifices personal benefit to meet employee needs	2.17

IS, interpersonal support; BC, building community; A, altruism; E, egalitarianism; ME, moral integrity

Table 1 presents the ranking of assigned mean values to different statements related to different aspects (items) of the Executive Leadership Scale.

The next step was to calculate the mean value for each group of statements. The results are presented in Table 2.

Table 2. Mean values of the first-order factors (Source: authors' compilation)

First-order factor	Mean value
Altruism	2.48
Moral integrity	2.93
Egalitarianism	3.03
Interpersonal support	3.04
Building community	3.04

Comparing the mean values, we can see that there are no significant differences between the factors, save

the one of the altruism. Owing to the limited number of respondents, we cannot say that the results are conclusive; still we witness a tendency – the statements concerning the factor of altruism have received the lowest scores (the mean value of 2.48). Especially low ranked are statements such as 'Prefers serving others to being served by others' and 'Sacrifices personal benefit to meet employee needs'. This means that employees view their top managers as self rather than service orientated; thus an important aspect of ethical leadership is missing. In order to explicate this phenomenon, we juxtaposed the lowest ranked factor – *altruism* – with two equally high ranked factors, namely, *building community* and *interpersonal support*. If the coefficient between two answers is positive, for example, up to +1, we can conclude that the answers are rather similar. If the coefficient is negative, it follows that the answers contradict each other. Our interest lies specifically with the negative coefficients, as they exhibit possible problem areas (see Table 3) worth for consideration.

Table 3. Comparative analysis of the first-order factor items (Source: author's compilation)

	Sacrifices personal benefit to meet employee needs (A)	**Serves others willingly with no expectations of reward (A)**	**Places the interests of others before self-interest (A)**	**Prefers serving others to being served by others (A)**
Considers the effects of organisational decisions on the community (BC)	0.10	0.76	0.99	0.5
Encourages a spirit of cooperation amongst employees (BC)	−0.62	0.08	0.77	−0.29
Believes our organisation has a duty to improve the community in which it operates (BC)	0.83	0.97	0.73	0.98
Vales diversity and individual differences in the organisation (BC)	−0.17	0.57	0.9	0.25
Look for ways to make others successful (IS)	0.35	0.88	0.98	0.69
Nurtures employee leadership potential (IS)	0.81	0.96	0.64	0.96
Treats all employees with dignity and respect (IS)	−041	0.32	0.84	−0.05
Listens carefully to others (IS)	−0.57	0.14	0.31	−0.24

IS, interpersonal support; BC, building community; A, altruism; E, egalitarianism; ME, moral integrity

At first, let us look into correlations between *altruism* and *building community,* paying attention to negative coefficients. Amongst all coefficients, three of them are the negative ones (ranking between −0.17 and −0.62. The latter one pertains the relation between two items 'Sacrifices personal benefit to meet employee needs' (*A*) and 'Encourages a spirit of cooperation amongst employees' (*BC*). As the answers are opposite (coefficient −0.62), we can detect the most significant problem related to the ethical leadership in the surveyed organisations, that is, the exclusion of the leader from the truly collaborative effort. In other words, although the leader encourages team spirit, he/she is not a part of that team, acting as a direction-giving outsider. Second, juxtapositions of the items of *altruism* and *interpersonal support* exhibit four negative coefficients, respectively, −0.05, −0.24, −0.41 and −0.57. Let us consider the last two coefficients. Coefficient −0.41 is a cross-point between the item of 'Treats all employees with dignity and respect' (*IS*) and 'Sacrifices personal benefit to meet employee needs' (*A*). The possible leadership ethics problem lies in the fact that the leader, though ready to treat employees respectfully, is not ready to give

up his/her personal interest even for a good cause, when it does not suit him/her. The coefficient −0.57 delineates another problem – leaders, according to employees, are not interested to take into account their opinion. This undermines the very principle of the Executive Servant Leadership, in which altruism is one of the key factors. Although our research does not yield the conclusive results because of the limited number of participants, we believe that the factor analysis demonstrates tendencies and allows determining the critical areas of ethical leadership in the surveyed organisations, namely, the employee believes that their leaders do not exhibit qualities associated with altruism, placing their self-interest first. There can be a number of reasons for this, for example, the disregard for long-term goals of organisation (sustainability) on the part of leaders, the miscommunication and the cognitive dissonance between expectations of both parties (employees and leaders). These aspects should be researched further – by quantitative survey amongst employees and by follow-up interviews paying a special attention to the items of altruism factor.

Conclusions

The current article is devoted to the study of the concept of ethical leadership and its various interpretations in the theoretical literature as well as to the description of various evaluation scales in order to determine the most suitable for the Latvian retail trade organisations. After reviewing a number of evaluation models, we propose that the most applicable one is the ESLS, as it takes into account various aspects of leadership and gives voice to employees. There are several conceptions of ethical leadership – the transformational leadership is aimed at vision, values and intellectual stimulation; the authentic leadership emphasises the moral management; the spiritual leadership sees the work as passion and vocation; the servant leadership is characterised by putting interests of others before the self-interest. Amongst various measures of ethical leadership, we can mention the ELS, the ELBS, the ELWQ, the TERA model and the ESLS. The ESLS differs from other models because it is related to practical business management strategy and ethical accountability through the principle of sustainability. The conceptual model of the ESLS consists of five first-order factors: Interpersonal Support, Building community. In the empirical part of the research, we put forward two research questions: (1) What is the ranking of the ESLS first-order factors? and (2) What are the possible problem areas in the ethical leadership as seen by the Latvian retail traders? The answers to them in details are given in the article, but, in sum, we can state that the ranking of the first-order factors is the following (from the highest to lowest position): Building Community and Interpersonal Support, Egalitarianism; Moral Integrity, Altruism. The lowest mean value was signed to the factor of Altruism; this means that employees believe that their leaders do not exhibit qualities associated with altruism, placing their self-interest first and this does not facilitate the social accountability and sustainability of business organisation. The comparative first-order factor item analysis illuminated specific aspects need to be research in future, mostly related to the items of Altruism.

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