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E. BUSINESS QUALITY: DEFINITION AND DIFFERENCE BETWEEN VALUE AND QUALITY

Gintarė Gulevičiūtė

Mykolas Romeris University, Lithuania
gintare.guleviciute@mruni.eu

Abstract

Purpose – to analyze definitions of e. business value and e. business quality, distinguish the main differences.

Design/methodology/approach – there had been used scientific literature deduction (drawing conclusions from the available information), analysis (obtained data analyzed separately), analogy (comparison of data with each other), generalization (the main features complex generalization), induction (from individual elements went to a general conclusion), comparison methods.

Findings – after analyzing the theoretical aspects of e. business value and e. business quality, there were introduced the main difference between them and suggested definition of e. business quality.

Research limitations/implications – quality is one of the most important factors in e. business, but there are no definition of e. business quality. After analyzing theoretical aspects of e. business value and e. business quality, there were introduced the definitions.

Practical implications – Companies are interested in developing e. business, because it helps to get more innovative, it means to get more profit. Most important, e. business can increase sales and reduce selling products and services price. These success criteria are easily measurable, but it is important to assess the immeasurable success criteria, such as user satisfaction or quality. The definition of e. business quality introduced in this article reflects the practical implications. This information could be used in order to develop e. business in more effective way.

Originality/Value – e. business is becoming an integral part of a traditional business. For the development of e. businesses, companies can reach potential customers worldwide. In order to create a long-term competitive advantage, e. business must focus on quality, but there are no definition of e. business quality. Also, there are no clear difference between e. business value and e. business quality. In this article there will be discussed a little-analyzed question of e. business quality.

Keywords: e. business, e. business quality, e. business value.

Research type: literature review.
**Introduction**

Companies are interested in developing e. business, because it helps to get more innovative, it means to get more profit. E. business is becoming an integral part of a traditional business. For the development of e. businesses, companies can reach potential customers worldwide.

Scientific issue. One of the main problems in the development and implementation of e. business - e. business quality definition uncertainty. Quality is a very important objective for all businesses and their customers. Quality is a form of corporate exclusivity, differentiation (Laundon, 2007). Without knowing the exact e. business definition of quality, it is difficult to develop the business itself, it is difficult to determine, what is needed to achieve and what criteria should be assessed by e. business. On this basis it is possible to isolate the main problem - the definition of e. business quality in academic sources and practice are not generally defined.

Object of the research. Definition of e. business quality.

Purpose – to analyze definitions of e. business value and e. business quality, distinguish the main differences.

There have been set the following objectives for the above mentioned purpose to be achieved to:

1. determine definition of e. business quality;
2. determine definition of e. business value;
3. distinguish the main difference between e. business value and quality.

Practical significance. For the development of e. businesses, companies can reach potential customers worldwide. It creates a competitive advantage (Luqman, Abdullah, 2011). In Europe in 2012 e. business grew by 19 %, reaching 311.6 billion profit (E-commerce Report, 2013) . In order to create a competitive advantage, e. business must focus on quality, but there are no definition of it. E. business quality can be analyzed on the basis of a global market. In this article there will be discussed a little-analyzed question of e. business quality.

**Definition of e. business quality**

E. business practice is defined clearly, but little is known about the e. business quality. In scientific literature, there is not worded definition of e. business quality. Meanwhile, e. business concepts can be found many. It is described as:

- Information, products and services purchasing and selling through computer networks (Kalkota, Whinston, 1996; Koronios, Xu, 2005);
- The business, which uses information technology infrastructure to increase business efficiency and provide a basis for new products and services (Kirvaitis, 2001);
- The business, which in order to benefit themselves and customers using information management and business infrastructure, develop, distribute or facilitate the
use of products and services, primarily through the electronic communication and other tools (Sodžiutė, Sūdžius, 2006, p. 14):

- Business transactions and enterprise business organization using information technology for data transmission network environments (Hedman, Kallinge, 2003; Lunevičiutė, 2009).

The current Lithuanian dictionary defines quality as “the feature, the value that is expected”. Combining the previously mentioned e. business and quality definitions, there could be stated, that quality of e. business is:

- Information, products and services purchasing and selling through computer networks feature, value that is expected;
- Feature, value that is expected of the business, which uses information technology infrastructure to increase business efficiency and provide a basis for new products and services;
- Feature, value that is expected of the business, which in order to benefit themselves and customers using information management and business infrastructure, develop, distribute or facilitate the use of products and services, primarily through the electronic communication and other tools;
- Feature, value that is expected of business transactions, and enterprise business organization using information technology for data transmission network environments.

These definitions can be used in order to define e. business quality, but it is hard to suggest, which definition can determine e. business quality in best way.

**Definition of e. business value**

The definition of value is analyzed and described in scientific articles and sources. E-business value is defined as the difference between the benefit received by the consumer and the cost needed to produce the product (Jelassi, Enders, 2005). Business model is a description of a business system for creating value that lies behind the actual processes (Balaraman, Kosalram, 2012).

In 1998 W. Ch. Kim and R. Mauborgne had already written of new business opportunities to raise the value. They introduced business value curve (see Figure 1), which is based on the answers to four questions (Kim, Mauborgne, 1998):

- What factors need to be reduced?
- What factors should be raised above the standard?
- What factors, which are considered to be granted, should be canceled?
- What should be created, that no one has not propose so far?

Although the value curve has been introduced and adapted to the traditional business, Chen (2001) propose to analyze it on the basis of the modern e. business. The main value delivered from using the internet is improved brand and/or product awareness (Zilber, Araujo, 2010). For example, Amazon can be identified as the creator of the new value curve, because when analyzing Amazon online shop, following four questions can be answered (Chen, 2001):
• What factors need to be reduced? Amazon reduced the price.
• What factors should be raised above the standard? Amazon has expanded the range of books. Amazon does not limit its strategic partnerships to suppliers and distributors, but also engages in alliances banks that offer Amazon a credit card which also adds value to customer relations, as part of the company's loyalty program (Donici et al, 2012).
• What factors, which are considered to be granted, should be canceled? Amazon abolished shopping needs.
• What should be created, that no one has not propose so far? Amazon has created an opportunity to search and order books online. Also, online retail sites with more helpful reviews offer greater potential value to customers (Mudambi, Schuff, 2010). A firm with a large number of customers and a way of getting the feedback rapidly, can help the firm to improve the quality, product and service faster than the competitors (Basha, Dhavachelvan, 2011).

**Figure 1. Value curve**

This example can be seen in the figure below (see Figure 2).
Source: Jelassi, Enders (2005) p. 127

**Figure 2. Amazon and traditional bookstores value curve**

Value curve can be used when analyzing e. business. It helps to understand, what main factors should be reduced, canceled, raised or created in developing e. business.

**Difference between e. business value and quality**

In terms of value, that e. business provides to the user, it can be expressed by the following formula, which arises definition of quality (Chen, 2001):

\[
\text{User value: } \frac{\text{(service)} \cdot \text{(quality)}}{\text{(price)} \cdot \text{(time)}}
\]

- Service - e. business provides the following options to the consumer: an interactive and personalized communication, speed and accuracy of a higher ability to track and measure the capacity, 24 hours communication, customer-centric business model, instantaneous communication with the user.
• Quality - e. business improves and adjusts the user experience by providing better information about the products and services, enabling users to form communities, that provide valuable feedback about the service, the quality of goods.
• Price - e. business can sometimes reduce the price.
• Time - e. business can reduce the execution time.

Jelassi, Enders (2005) extensively described the user's understanding of the value and introduced concepts such as “user benefits”, “value”, “value creation”. The relationship between these concepts can be seen at the Figure 3, but first it is important to clarify the meaning of these terms (Jelassi, Enders, 2005):

1. User benefits - it is the maximum amount of money, that the consumer is willing to spend to buy a product or receive a service. Let us suppose, that the user wants to buy a laser printer on eBay. After selecting the printer it can enter the maximum price he agree to pay for it (in this case - 200 USD). Starts the auction. When someone else nominated for the printer more than 200 USD, the user noticing. It is important to understand that the benefits to the user, which he expects from the printer is not compatible with a higher price than he is determined to pay. User benefit depends on:
   - Personal preferences: young people like sports cars, and those who have families – larger;
   - Location: it is possible to think about the heater in the Arctic and the Sahara;
   - Time: the benefits of electric light day and night;
   - Product quality: product functionality, reliability and easy installation. For example: Tesco.com online grocery store boasts of its fresh products and a comprehensive quality;
   - Product or service customization level: the more the product or service is adapted to the specific needs of the users, the more benefits they create;
   - Comfort: for example, Tesco.com aims to raise the comfort level of the users, especially focused on the busy people;
   - Quality of service in relation to the company website: it is the degree of personalization, ease of use, speed of responsiveness, quality of information;
     - Speed of delivery: fast delivery - the greater the value by the user;
     - Choice of products;
     - Brand: a strong brand can help create high quality standards of the companies image in the eyes of consumers;
     - Reputation: a good reputation for distinguished company produces less risk;
     - The primary functions: the minimum requirements that a company must meet. An example could be a company's website, with has active links or secure the payment mechanism for the goods;
     - Critical success factors are: the benefits, that are most important, when choosing to buy the product or not. For example: in Amazon case, these factors are a large choice of products, convenient and fast shopping.
2. Price - in this case include all costs, that are incurred in providing product to the consumer. It includes raw materials, production costs, advertising, production, sales and delivery.

3. Value - the difference between the user's benefit and price. The value must meet certain requirements:
   - It must be positive: the price must be lower than the benefits, received by the user. Often companies have not thought about this. A perfect example - in 1998 Motorola's first mobile phone from Iridium. It sought to deliver uninterrupted wireless connectivity anywhere in the world. However, this phone has been more difficult than the others, did not work in machines or buildings. Given the low level of user benefits, that this phone has brought and high prices, low consumer chose this phone and its sales were soon discontinued.
   - Must be higher than the value created by the competitors.
   - User surplus - in terms of the same model of the printer: if the user was willing to pay for it 200 USD, while 160 USD was paid, it means that there is user surplus - 40 USD.
   - Producer surplus - in conjunction with the same example, the user pays for the printer 160 USD, though in the real value is 80 USD. In this case, the producer surplus – 80 USD is the difference between the price, paid by the consumer and the real value of the goods.

Source: adapted by the Jelassi, Enders (2005) p. 97, 101

Figure 3. User value
After analyzing the definition of e. business value and its features, it can be concluded that e. business value is related to the e. business quality. Since e. business value is a very broad term, and the definition of e. business quality is not defined, it can be inferred that the e. business quality is a part of e. business value.

Conclusions

Combining different e. business and e. business quality definitions, there could be stated, that quality of e. business is feature, value that is expected from the business, which uses information technology infrastructure to increase business efficiency and provide a basis for new products and services. The definition of value is analyzed and described in scientific articles and sources. E-business value is defined as the difference between the benefit received by the consumer and the cost needed to produce the product (Jelassi, Enders, 2005). In 1998 W. Ch. Kim and R. Mauborgne introduced business value curve, which is based on the answers to four questions and helps to raise the value. After analyzing the definition of e. business value and e. business quality, it can be concluded that both these definitions are connected. Since e. business value is a very broad term, and the definition of e. business quality is not defined clearly, it can be inferred, that e. business quality is a part of e. business value.

References


SMALL AND MEDIUM-SIZED ENTERPRISES’ SATISFACTION WITH BANKS’ BUSINESS-ORIENTED SERVICES

Viktorija Skvarciany

Mykolas Romeris University, Lithuania
viktorija.skvarciany@gmail.com

Abstract

Purpose – the purpose of this paper is to investigate the impact of quality, variety, accessibility and price of banking services on small and medium-sized companies’ satisfaction with banks’ business-oriented services. This paper presents a regression equation of SMEs satisfaction with banks’ services, indicating the weight of each statistically significant factor in the overall SMEs satisfaction with the commercial banks’ services for business.

Design/methodology/approach – an empirical study, investigating the influence of quality, variety, accessibility and price of banking services on SMEs’ satisfaction with business-oriented services, was conducted. A sample of 405 small and medium-sized companies’ employees was used for the survey.

Findings – the results of the research show that price, accessibility and quality of banking services have a direct positive influence on the satisfaction of SMEs with commercial banks’ business-oriented services. However, the variety of banking services is not a statistically significant element and did not have an impact on the SMEs’ satisfaction with banks’ services for business. Moreover, it was found that the price and accessibility of banking services have a positive relationship with the quality of banking services.

Research limitations/implications – this research was conducted in small and medium-sized companies’ sector and the results of the survey cannot be used to interpret the satisfaction of other business sectors with banking services.

Practical implications – the findings suggest that banks can create SMEs’ satisfaction with business-oriented services through improving accessibility, quality and price of banking services in the way that best meets customers’ needs.

Originality/Value – satisfaction with the banking services concerning SMEs is an important factor influencing the success of commercial banking activities. The present study provides useful information on the factors influencing SMEs’ satisfaction with banking business-oriented services.

Keywords: banking services, satisfaction, commercial banks, small and medium-sized enterprises (SME), regression analysis.

Research type: research paper.
Introduction

Customers' satisfaction with banking institutions has been recognized as the important factor, which has an impact on increasing business profit (Gupta and Dev, 2012). According to Amin's et al. (2013) research, satisfaction has a significant connection to the bank's image. What is more, there are scientists claiming that customers' satisfaction is one of the key elements that affects customers' loyalty (Kitapci et al., 2013; Kantsperger and Kunz, 2010; Vegholm and Slver, 2008, etc.) and trust (Loureiro et al., 2014; Yap et al., 2012; Žvirelienė and Bičiūnienė, 2008, etc.).

One of the most important commercial banks ‘customers' groups is small and medium-sized enterprises, as it is considered to be one of the most promising sectors of Lithuanian economy (Adamoniene and Trifonova, 2007). Madill et al. (2002) confirm that the more satisfied SME customers are, the less likely the SME will change the bank. Hence, small and medium-sized enterprises’ satisfaction with banks’ business-oriented services is examined in this paper. Consequently, the object of the research is assessing small and medium-scaled enterprises' satisfaction with banks’ business-oriented services. Therefore, the aim of the research is to create a model measuring satisfaction of small and medium-sized enterprises with banks’ business-oriented services. The following objectives are settled: to analyse statistical data of satisfaction of small and medium-sized enterprises with banks’ business-oriented services; to carry out a correlation analysis of the data to determine the strength and direction of the relationship; to create a model to measure satisfaction of small and medium-sized enterprises with banks’ business-oriented services.

Conceptual background and hypothesis development

There are many different factors influencing satisfaction of small and medium-sized enterprises with banks’ business-oriented services. The following elements are selected for present research (Mačerinskienė and Skvarciany, 2012):

- quality of banking service;
- variety of banking services;
- accessibility of banking services;
- price of banking services.

Satisfaction with the price of banking services

A lot of surveys investigating price satisfaction and overall customer satisfaction relationship were conducted within the last years. Actually, researchers have found that satisfaction with service's price has a positive impact on overall customer satisfaction and loyalty (Matzler et al., 2005; Parahoo, 2010). Yanamandram and White (2010) distinguish unfair price as the main reason of customers’ dissatisfaction with financial services. What is more, Lymperopoulou et al. (2012) claim that „bank customer intentions to switch banks are affected by the level of their price satisfaction”. According to Matzler et al. (2007)
price satisfaction is a multidimensional construct having a strong and significant impact on overall price satisfaction. Consequently, the results of previous studies led to the following hypothesis:

\( H_1 \): Satisfaction with the price of banking services has a positive relationship with an overall small and medium-sized enterprises’ satisfaction with banks’ business-oriented services.

**Satisfaction with the accessibility of banking services**

Nowadays rhythm of work of small and medium-sized companies’ employees is becoming faster. Therefore convenient location of bank branches gives customers’ comfort. Gupta and Dev (2012) say that the access of banking institution is distinguished as one of the possible reasons of customers’ bank switching. Scholars differentiate four items included in the accessibility factor, which are as follows: the location of the branches of the bank is convenient; sufficient parking space is available; convenient working hours of the bank and the location of ATMs is fitting. For instance, Singh (2011) claims, that if banks provide the proper functioning of ATMs, customer satisfaction will be significantly higher. Therefore, the following hypothesis has been developed:

\( H_2 \): Satisfaction with the accessibility of banking services has a positive relationship with an overall small and medium-sized enterprises’ satisfaction with banks’ business-oriented services.

**Satisfaction with the quality of banking services**

Many scientists claim that customers’ satisfaction with the service quality is one of the most important determinants that influence an overall customers’ satisfaction (Aga and Safakli, 2007; Lenka et al., 2009; Chigamba and Fatoki, 2011; Chen et al., 2012). According to Fatima and Razzaque (2014) customers are more likely to have good relations with employees, who provide good quality of services to make customers more satisfied. Actually, scholars indicate different factors influencing customers’ satisfaction with banking service quality. It can be said, that nowadays one of the most important banking service quality dimensions is an online banking service. For example, according to Rod et al. (2008) overall internet banking service quality, which includes online customer service quality, banking service’s product quality, has a positive effect on customer satisfaction. On the basis of survey made by Bahia and Nautel’s (2000), accessibility and the price of banking services are the factors having an impact on banking service quality. Bizri (2014) maintains that accessibility and convenient location are an essential factor influencing customer patronage. Hence, the results of these studies led to the development of the following hypotheses:

\( H_{3a} \): Satisfaction with the price of banking services has a positive relationship with the quality of banking service.
**H₃b**: Satisfaction with the accessibility of banking services has a positive relationship with the quality of banking service.

**H₄**: Satisfaction with the quality of banking services has a positive relationship with an overall small and medium-sized enterprises’ satisfaction with banks’ business-oriented services.

**Satisfaction with the variety of banking services**

There are scientists claiming that the variety of banking services is one of the factors which influence the customers’ decision of commercial bank choice. For instance, Kaynak and Whiteley (1999) claim that the variety of services offered by bank is one of the key factors influencing the patronage tendencies and the behavioural patterns of bank customers. Moreover, according to the survey conducted by Jasienė and Staroselskaja’s (2010), 33% of respondents noted that the variety of banking services has an impact on their decision making. The research was made in Lithuania and therefore, it can be said that assortment of services provided by banks is important for the clients in the country. Hence, the following hypothesis was developed:

**H₅**: Satisfaction with the variety of banking services has a positive relationship with an overall small and medium-sized enterprises’ satisfaction with banks’ business-oriented services.

**Methodology**

The survey was conducted in Lithuania. The method of questionnaire was used for the research. All the respondents were small and medium-sized companies’ managers, such choice was made in order to gain insight of SMEs’ opinion on researched questions. Data was collected using electronic survey system. In order to provide the representativeness of the results, 400¹ employees of small and medium-sized companies had to be interviewed. In fact, 405 of the distributed questionnaires were returned. All of the data was included in the analysis.

¹ The number of respondents was calculated using the formula:

\[
n = \frac{1}{\Delta^2 + \frac{1}{N}}
\]

where:

- \(n\) – sample size;
- \(N\) – number of employees of small and medium-sized companies in Lithuania;
- \(\Delta\) – margin of error (\(\Delta = 0.05\)).

Applying the formula:

\[
n = \frac{1}{0.05^2 + \frac{1}{636000}} \approx 400.
\]

According to statistics (2013), the number of employees of small and medium-sized enterprises in Lithuania was 636000.
Empirical Findings

Firstly, it is necessary to establish the strength of the relationship between satisfaction with banks’ business-oriented services and factors influencing it. Correlations between variables are presented in Table 1. Really, all the correlation coefficients are quite strong and it is an evident that all the variables are related to overall satisfaction of small and medium-sized enterprises with banks’ business-oriented services. Actually, it means that all the variables are directly proportional to the satisfaction with banks’ business-oriented services.

Table 1. Correlation coefficients of the factors influencing satisfaction of small and medium-sized enterprises with banks’ business-oriented services

<table>
<thead>
<tr>
<th>Banks’ business-oriented services</th>
<th>Overall satisfaction with bank’s business-oriented services (Pearson r)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quality of banking services</td>
<td>0,600</td>
</tr>
<tr>
<td>Variety of banking services</td>
<td>0,475</td>
</tr>
<tr>
<td>Accessibility of banking services</td>
<td>0,570</td>
</tr>
<tr>
<td>Price of banking services</td>
<td>0,467</td>
</tr>
</tbody>
</table>

Secondly, the support of the hypotheses should be tested. The information provided in Table 2 shows that SMEs’ employees satisfied with the price of banking services tend to feel an overall satisfaction with banking services towards small and medium-sized companies. This supports the hypothesis $H_1$ ($p < 0,005$). Actually, according to the regression analysis, satisfaction with the price of banking services has the least influence on overall satisfaction. The accessibility has a positive relationship with an overall satisfaction with banks’ business-oriented services and this supports the hypothesis $H_2$ ($p < 0,005$). What is more, satisfaction with the price of banking services has a positive impact on satisfaction with the quality of banking services provided to SMEs. This supports the hypothesis $H_{3a}$ ($p < 0,005$). Satisfaction with the accessibility of banking services also has a positive effect on satisfaction with the quality of banking services and, consequently, this supports the hypothesis $H_{3b}$ ($p < 0,005$). Satisfaction with the quality of banks’ provided services for business has a positive impact on overall satisfaction which supports the hypothesis $H_4$ ($p < 0,005$). What is more, according to the regression analysis, banking service quality is identified as the factor having the greatest impact on overall satisfaction with services provided for SMEs. The satisfaction with variety of banking services, however, appears to be non-significant and does not support the hypothesis $H_5$ ($p > 0,005$).
Table 2. Results of the hypotheses testing

<table>
<thead>
<tr>
<th>Hypotheses</th>
<th>( p )-value*</th>
<th>Results</th>
</tr>
</thead>
<tbody>
<tr>
<td>( H_1 ): Satisfaction with the price of banking services has a positive relationship with an overall small and medium-sized enterprises’ satisfaction with banks’ business-oriented services.</td>
<td>0,000</td>
<td>Supported</td>
</tr>
<tr>
<td>( H_2 ): Satisfaction with the accessibility of banking services has a positive relationship with an overall small and medium-sized enterprises’ satisfaction with banks’ business-oriented services.</td>
<td>0,000</td>
<td>Supported</td>
</tr>
<tr>
<td>( H_{3a} ): Satisfaction with the price of banking services has a positive relationship with the quality of banking service.</td>
<td>0,000</td>
<td>Supported</td>
</tr>
<tr>
<td>( H_{3b} ): Satisfaction with the accessibility of banking services has a positive relationship with the quality of banking service.</td>
<td>0,000</td>
<td>Supported</td>
</tr>
<tr>
<td>( H_4 ): Satisfaction with the quality of banking services has a positive relationship with an overall small and medium-sized enterprises’ satisfaction with banks’ business-oriented services.</td>
<td>0,000</td>
<td>Supported</td>
</tr>
<tr>
<td>( H_5 ): Satisfaction with the variety of banking services has a positive relationship with an overall small and medium-sized enterprises’ satisfaction with banks’ business-oriented services.</td>
<td>0,087</td>
<td>Not supported</td>
</tr>
</tbody>
</table>

*Results supported at the significance level of \( p < 0,005 \).

According to the results of the analysis the model of an overall small and medium-sized enterprises’ satisfaction with banks’ business-oriented services was created (see Figure 1).

![Figure 1. The model of the formation of small and medium-sized enterprises’ satisfaction with banks’ business-oriented services](image-url)
The model shows the relations between the price, the service's quality, the accessibility of banking services and overall satisfaction with banking services.

Moreover, the result of the analysis is a linear regression specified by the equation (1) assigning weights of various variables according to their importance in defining the relationship between the overall satisfaction (dependent variable) and the price, the accessibility, the quality (independent variables).

\[
\text{Overall customers' satisfaction} = 0,265 + 0,373 \text{ quality} + 0,276 \text{ accessibility} + 0,168 \text{ price}
\]  

Conclusions

Analysing scientific literature regarding satisfaction of small and medium-sized enterprises' satisfaction with banks' business-oriented services, it has been found that satisfaction is one of the vital elements in relationships' of bank and SMEs formation. Three factors influencing the satisfaction of small and medium-sized enterprises with banks' business-oriented services were investigated and the regression equation was created. It was found that all the variables in the regression equation are statistically significant. What is more, it can be said that the quality of banking services is a factor having a major impact on the satisfaction of small and medium-sized enterprises with banks’ business-oriented services. In addition, it was also found that the variety of banking services is statistically insignificant element that has almost no influence on satisfaction of small and medium-sized companies with banks' business-oriented services. Actually, the regression analysis showed that overall satisfaction of small and medium-sized enterprises with banks’ business-oriented services is a compilation of the quality, the accessibility and the price of banking services towards SMEs. Besides, during the study it was noted that the price and accessibility of banking services have a positive effect on the quality of banking services.

According to the research results it could be said that to enhance an overall SMEs satisfaction with banks’ business-oriented services, commercial banks should pay more attention to the quality of e-banking web sites. In fact, the e-banking system has to be simple and convenient to use. The information provided on the web site should be easy to understand, easy to find and ought to provide particular steps for using e-banking system. Apart from that, the quality of services provided by banks’ employees is important as well. In reality, bank stuff members should always raise their qualification by attending workshops and courses to follow the latest updates of the field they work at as it helps to give the newest and the most important information to the clients. Furthermore, it might help to avoid the information asymmetry. Moreover, to increase customers’ satisfaction it is important to offer a competitive price. Actually, the price has to reflect the quality of the product and include the provision of all necessary information about the product and after-sales service as it can ensure long-term relationship building with the consumers. What is more, to improve an overall SMEs satisfaction with commercial banks, accessibility of the banks’ services ought to be ensured. In fact, banks’
branches have to be easily reachable for customers as quick services provision may cause SMEs to be more competitive and, hence, more successful.

To sum up, it becomes clear that commercial banks should make efforts to improve all the variables that have an impact on satisfaction of small and medium-sized enterprises with banks’ business-oriented services, as business-oriented services are considered to be a very important determinant that influences an overall customers’ satisfaction with the bank and the financial results of the bank itself.

References


GOOD FAITH AND FAIR DEALING
IN THE COMMERCIAL CONTRACT LAW

Viktorija Budreckienė

Mykolas Romeris University, Lithuania
viktorija.budreckiene@gmail.com

Abstract

Purpose – to analyze the commercial concept of good faith and fair dealing applicable in the UNIDROIT Principles of International Commercial Contracts, Draft Common Frame of Reference and Lithuanian commercial contract law.

Methodology – theoretical methods (analytic and systematic) had been applied in the research.

Findings – the author of the article concludes that the substantive content of good faith and fair dealing notion applied in Lithuanian commercial contract law should be specified taking into regard the peculiarities of business relations. What is more, the question, whether a businessman acted in good faith, should be answered with respect to common business practice of particular trade.

The case law of Lithuania also recognizes the peculiarities of commercial good faith and fair dealing notion. What is more, when determining if a businessman acted in good faith, courts also mention common commercial practice. However, it is doubted that courts really take this criteria into account and it can be guessed that often the application of this standard is limited only to mentioning. Due to application of common business practice criteria the content of good faith and fair dealing principle is even harder to unfold, especially, as it can be very difficult to prove the existence of such practice. Yet this is the problem not only of the court, but also the parties of the civil dispute, as the presentation of reasonable arguments and proofs is their right and obligation.

Research limitations/implications – the research has been limited to the analysis of commercial good faith and fair dealing doctrine in Lithuanian contract law, UNIDROIT Principles of International Commercial Contracts and Draft Common Frame of Reference.

Practical implications – the findings of the research can be applied by judges invoking good faith and fair dealing doctrine in commercial disputes, as well, by businessman determining the limits of their contractual freedom.

Originality/Value – A. Norkūnas, R. Balčikonis, S. Drazdauskas, A. Jakaitė, S. Arlauskas, R. Jakūbauskas, S. Cirtautienė and some other authors have analyzed particular aspects of general good faith and fair dealing principle in Lithuanian private law. Although these publications are important to this research in some particular aspects, the peculiarities of this notion applied precisely in Lithuanian commercial contract law have not been discussed. Taking into consideration the absence of legal doctrine in Lithuanian Republic the research is new and original. What is more, considering the importance of the stability of commercial turnover and
predictability of outcomes of possible disputes the research may be in particular valuable not only for scholars, but also for practitioners and businessmen.

**Keywords:** good faith and fair dealing, common business practice, businessmen.

**Research type:** general review.

## Introduction

Good faith and fair dealing is a widely recognized value of private law\(^1\). Lithuanian legal system is not different: this principle is clearly established in Lithuanian Civil Code\(^2\) (hereinafter referred to as the CC)\(^3\) and often cited in the case law. However, the question has to be raised, whether the principle of good faith and fair dealing has the same meaning in general contract law and commercial contractual relations. Is a party to a contract – a businessman - acting in good faith\(^4\) seen the same as any other person contracting without business purposes? Maybe it should be admitted that the modern private law is based more on social values and shares one general concept of good faith and fair dealing? This could seem reasonable, if we admit that this principle is a moral value shared by every member of society. On the other hand, there is no doubt that commercial contractual relationships have their specifics and rules of general contract law may not always be applicable to it. Especially, when a certain rule is designed to protect the weaker party to the contract and its application in business relationship may not only be problematic, but also unreasonable.

The general concept of good faith and fair dealing has been analyzed by many scholars in Lithuania\(^5\). We should separately mention the article of A. Jakaitė\(^6\), as well,

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\(^1\) Of course, this recognition has exceptions.


\(^3\) For example, the Article 6.158 of CC „Good faith and fair dealing“ states:

1. Each party of a contract shall be obliged to act in accordance with good faith in their contractual relationships.
2. The parties may not change or exclude by their agreement the duty established in Paragraph 1 of this Article.

\(^4\) For the purposes of this article the term “good faith” shall have the same meaning as “good faith and fair dealing”, except in case it is clearly expressed otherwise and these two notions are compared or analyzed as separate criteria.


\(^6\) Although the research of A. Jakaitė is limited to the analysis of the general principle of good faith in pre-contractual relations with no particular emphasis on the specifics of commercial relations, examples of Lithuanian and foreign case law provided in the article are certainly relevant for this research. Jakaitė, A. 2011. Sąžiningumo imperatyvas išsukurtiniuose santykiuose: turinys ir taikymo problematika. TEISPÉ, (79), 76-91.
recent article of S. Arlauskas and R. Jakūbauskas\textsuperscript{1}. Although these publications are important to this research in some particular aspects, good faith and fair dealing is mostly discussed with no emphasis on the peculiarity of commercial contractual law - rights and obligations inherent to business relationships.

Taking into the account the limited scope of this article, the author shall analyze commercial concept of good faith adopted in UNIDROIT Principles of International Commercial Contracts (hereinafter referred to as the \textit{UNIDROIT Principles})\textsuperscript{2}, also Draft Common Frame of Reference (hereinafter referred to as the \textit{DCF}R)\textsuperscript{3}. At the end of the article the author shall try to discuss the content of good faith standard applied in Lithuanian commercial contract law.

**Good faith and fair dealing in UNIDROIT principles**

The Article 1.7 of UNIDROIT principles (Good faith and fair dealing) states: “(1) Each party must act in accordance with good faith and fair dealing in international trade. (2) The parties may not exclude or limit this duty”.

So the text of the article reveals that the content of this standard should be analyzed taking into regard the international trade. As the authors of the Official Commentary emphasize, good faith and fair dealing should not be interpreted and applied in terms of national legal systems, but rather in international context\textsuperscript{4}.

However, for the purposes of this research, the word “trade“ is of significant importance. The authors of Official Commentary clearly acknowledge the specifics of the standard applied in commercial contractual relationship: “A further implication of the formula used is that good faith and fair dealing must be construed in the light of the

\textsuperscript{1} Authors note, that the conclusion of the court that the behavior of a party is contrary not only to the principle of good faith, but also to fair dealing, causes the problem of separation of these two notions. However, this issue has not been developed in detail, and analysis focuses on the content of the general principle of good faith. Arlauskas S.; Jakūbauskas, R. Sąžiningumo principas prievoliniuose teisiniuose santykiuose. Jurispudience, 20 (4), 1368-1390.

\textsuperscript{2} UNIDROIT Principles have been analyzed as this soft law instrument is designed to regulate specifically commercial contracts. What is more, it is one of the essential documents, which have been used in drafting of CC (regarding contract law provisions).

\textsuperscript{3} DCFR is analyzed, first of all, because it is one of the newest instruments designed to be applied in contract law of the European region. What is more, this toolbox is of significant importance, as the drafting process has been initiated by EU institutions, also it is a result of cooperation of widely recognized legal experts of EU Member states, so it at least partly reflects the tendencies in the European Union (hereinafter referred to as the EU) policy and tendencies in the contract law sphere.

\textsuperscript{4} “The reference to “good faith and fair dealing in international trade” first makes it clear that in the context of the Principles the two concepts are not to be applied according to the standards ordinarily adopted within the different national legal systems. In other words, such domestic standards may be taken into account only to the extent that they are shown to be generally accepted among the various legal systems”. UNIDROIT Principles of International Commercial Contracts with Official Commentary, [interactive]. 1994. [accessed 2013-09-11], http://www.jus.uio.no/lm/unidroit.international.commercial.contracts.principles.1994.commented/toc.html
special conditions of international trade. Standards of business practice may indeed vary considerably from one trade sector to another, and even within a given trade sector they may be more or less stringent depending on the socio-economic environment in which the enterprises operate, their size and technical skill, etc.\(^1\).

Of course, it cannot be denied that good faith and fair dealing is a moral standard\(^2\). It is admitted that it “is clear from the language of Art. 1.7 (‘good’, ‘fair’) that the application of the provision requires a value judgment. It converts a moral or ethical precept into legal standard. \(<...>\) The function of good faith and fair dealing is “the mitigation of the rigor of the law in order to strike a balance between legal certainty and substantive justice and to achieve equitable solutions in exceptional cases”\(^3\).

However, the objectiveness of this standard is highlighted. It is often stressed out that that Article 1.7 of UNIDROIT Principles should not be applied in the purpose of protection of rights of parties having weaker bargaining position. What is more, this limit is also applied in cases of contract concluded between businessmen having unequal bargaining position. So it is obvious that the content of such standard should not be understood the same as in cases of national good faith and fair dealing rules, which are often designed to protect the rights of weaker parties\(^4\).

What is more, the objectiveness of the doctrine is explained also by its relation to the trade within it is applied. „This means that the content of such standard cannot be interpreted as applicable only in particular relationship to particular parties according particular circumstances. The objectiveness in this case means that the standard must have the same content to all participants of respective trade. Furthermore, decisions of judges and arbitrators if a party acted in good faith cannot be based only on their personal values and must correspond standards recognized in international trade. Of course, there is still a debate on the content of such international trade standard: how broad such recognition must be. But the fact that a distinguishing line must be drawn cannot be denied“\(^5\). This extract explains the importance of specifics of commercial relationship – the behavior of a businessmen should necessarily be evaluated in the light of the trade in which he operates.

So we have to admit that good faith and fair dealing employed in UNIDROIT Principles definitely may be one of the examples proving that the content of this standard varies according to the type of relationships for which it is designed and commercial doctrine of this standard has its peculiarities.

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1. Ibid.
2. This is one of the reasons, why it is sometimes criticised as being not reasonable solution for commercial transactions. Despite that, it is expressly employed in UNIDROIT Principles and even recognized as one of the fundamental standards of this soft law document.
5. Ibid.
Good faith and fair dealing in DCFR

Although general Article I. – I:103 of DCFR adopting good faith and fair dealing obligation and it's commentary do not define any differences between good faith and fair dealing in business and other relations, the analysis of other articles shows that the authors of this soft law instrument intended to separate such concepts. An example – the unfairness test, defined in Article II.-9:405 (Meaning of “unfair” in contracts between businesses): „A term in a contract between businesses is unfair for the purposes of this Section only if it is a term forming part of standard terms supplied by one party and of such a nature that it use grossly deviates from good commercial practice, contrary to good faith and fair dealing”. The unfairness test defined in Article is definitely different from the ones which are defined in Articles II.-9:403 and II.-9:404. „While under these provisions a term is considered unfair if it „significantly disadvantages the other party, contrary to good faith and fair dealing“, the present Article requires the term to „grossly deviate from good commercial practice, contrary to good faith and fair dealing“. The reference to „good faith and fair dealing“, which is the common element of three unfairness tests, indicates that in all three cases „content control“ is a derivative of the general principle of good faith. Nevertheless, the standard applied under the present Article is considerably different from the one in the two preceding ones. In effect under the present Article a term is considered unfair only „if it deviates from good commercial practice“.

Another example of separation is also seen in regard to the scope of information duties: in determining, what information should be reasonably expected to be provided from one businessmen to another, it must be taken into account that in a commercial relationship the scope of the duty is quite different. This limits reasonable expectations of the businessman acquiring information to the extent which would not differ from good commercial practice. What is more, it is even suggested that the introduction of „good commercial practice“ criteria could be a solution to the problem of contradictions of Acquis communautaire (which in some sense includes DCFR) and commercial law.

However, it has to be noted that such distinction has been criticized. For example, M. W. Hesselink emphasized that the test under Article II.-9:405 of DCFR does not take into consideration the fact that business parties to the transaction may have very

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1 DCFR I. – I:103 (Good faith and fair dealing): (1) The expression “good faith and fair dealing“ refers to the standard of conduct characterized by honesty, openness and consideration for the interests of the other party to the transaction in question. (2) It is, in particular, contrary to good faith and fair dealing for a party to act inconsistently with that party’s prior statements or conduct when the other party has reasonably relied on them to that other party’s detriment.
2 II.-9:405 (Meaning of “unfair” in contracts between a business and a consumer).
3 II.-9:405 (Meaning of “unfair” in contracts between non-business parties).
different bargaining power, for example, a contract concluded between large international company and one-man company. He offered to take inspiration from Germany, where the same test is applied in commercial and consumer relations. M. W. Hesselink also raised the question regarding the concept on which such distinction has been based. Despite that, the Commentary of this Article expressly states that “the “content control” is not justified by general assumption of unequal negotiation power between the parties, but a general assumption that the use of standard terms drafted in advance by one party enabled the party supplying these terms to restrict the other party’s contractual freedom”.

So it is clear that under DCFR there is a line, separating the application of good faith and fair dealing in business and other relations. What is more, good commercial practice standard can probably be considered as the essential element of such separation.

Good faith and fair dealing in Lithuania

The Supreme Court of Lithuania defines good faith as a measure of human behavior which is determined by the objective and subjective criteria. “Objectively, good faith is understood as human behavior, corresponding to the requirements of reasonableness and justice, i.e., careful and considerate behavior. Subjectively, good faith describes the mental state of a person in a particular situation, depending on the person’s age, education, experience and facts. In order to determine whether a person acted in good faith, it is necessary to apply both of these criteria”.

The Article 6.158 of CC has been drafted under Article 1.7 of UNIDROIT Principles. As this Article of CC is applicable in all sorts of contractual relationships, the part “in international trade“ has been omitted and such solution is undoubtedly reasonable. However, some part of contracts regulated by CC and contractual disputes solved by Lithuanian courts are definitely commercial. For this reason, in cases when the contractual relationship is commercial, the common trade standards should be taken

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3 The Supreme Court of Lithuania, Civil Division, 19 June 2013 ruling of the board of judges in the civil case D. J. v. J. B (case No. 3K-3-336/2013).

4 The Supreme Court of Lithuania, Civil Division, 21 September 2009 ruling of the board of judges in the civil case BUAB „Vikata ir Ko“ v. UAB „Daisruna ir Ko“ (case No. 3K-3-361/2009); The Supreme Court of Lithuania, Civil Division, 30 November 2010 ruling of the board of judges in the civil case AB „Alytaus tekstilė“ v. AB „Rytų skirstomieji tinklai“ (case No. K-3-485/2010) and others.

5 For the purpose of this article terms “good commercial practice”, “common business practice”, “common commercial practice”, “common trade standards” are used as synonyms, presuming that they define predominant business standards applied in particular trade sector.
into account, as it is done in Article 1.7 of UNIDROIT Principles. This notion is affirmed in one of the case law examples where the Supreme Court of Lithuania recognizes two separate concepts defined in the Article 6.158 of CC: “good faith” and “fair dealing”, and explains that the second one signifies the good faith in business, which means both: acting in accordance with general standards of the behavior applied to any person and specific standards of behavior existing in particular business sector\(^1\).

Good faith and fair dealing provision is almost never applied alone – an article regulating precise aspect is mostly applied in conjunction. For this reason, good faith and fair dealing (without the application of other legal norms) rarely is the criteria having decisive role in the judgment – most often the infringement of good faith and fair dealing norm is also an infringement of other (more precise) legal provision. However, this is different in Actio Pauliana cases, where one of mandatory conditions for the satisfaction of the claim is bad faith of the defendant and third person. It should be noticed that common business practice is often mentioned in the decisions of the courts solving Actio Pauliana disputes between businessmen. Despite that, this criterion is almost never regarded as a decisive factor in determining whether a party acted in good faith. Courts often mention, that the conclusion of the transaction corresponded common business practice, but decide to satisfy Actio Pauliana claim, because they determine that a party knew or should have known that the transaction infringed the rights of the creditor. Yet this practice has exceptions. We should mention a decision of Supreme Court of Lithuania (2010) where the court ruled differently. Although, the claim was dismissed not only due to the fact that the conclusion of transaction corresponded business practice\(^2\), this time the court minimally commented on its content: „Actio Pauliana cannot be explained in a way creating preconditions to contest transactions which at the time of conclusion were not forbidden and corresponded common commercial practice, despite the fact that at that moment the debtor also had obligations towards other creditors and later bankruptcy proceedings were started. Such interpretation and application of law raises legal uncertainty, distrust in the debtor who has financial problems and unreasonably limits the ability to operate and pursue settlement with all creditors avoiding bankruptcy <…>. Such decisions are often dictated by business logic and sometimes it is the only possibility to avoid the bankruptcy”\(^3\).

In the opinion of the author of this article, common business practice is almost unanalyzed in case law of Lithuania and she doubts that courts really take this criterion into account\(^4\). Most often the application is limited only to mentioning. On the other hand, it is obvious that the analysis of common commercial practice is a very complicated process, which is highly dependent not only on the qualification and experience in

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1 The Supreme Court of Lithuania, Civil Division 16 December 2008 ruling of the board of judges in the civil case AB “VST“ v. UAB „Olympic Casino Group Baltija“ (case No. 3K-3-572/2008).
2 It has to be noted that common business practice is discussed in determining if the transaction infringed the rights of the creditor (other condition of Actio Pauliana case), but cannot be doubted that these conditions are very related and overlap.
3 The Supreme Court of Lithuania, Civil Division, 30 November 2010 ruling of the board of judges in the civil case AB „Alytus tekstilė“ v. AB „Rytų skirstomieji tinklai“ (case No. K-3-485/2010).
4 Except infrequent cases.
business relations of the judge, the time, which can be spared for the analysis, bus also – on qualification of the parties who must prove the existence of such practice.

Conclusions

The distinction between general notion of good faith and its commercial equivalent is clearly expressed not only in UNIDROIT Principles, which are designed to be applied in international trade, but also in DCFR, which is drafted to be applied in consumer, non-business and commercial relationships. The analysis of these soft law instruments makes it clear that separation of general and commercial concepts of the principle has been recognized. What is more, common business practice of particular trade should be regarded as very significant for the application of good faith and fair dealing standard in commercial relationships – it should be applied in conjunction with the criteria of common business practice, inherent to particular business sector.

The Supreme Court of Lithuania also recognizes peculiarities and differences of good faith notion applied in commercial relations. What is more, when determining if a businessman acted in good faith, court mentions commercial practice as one of the criteria, important for such evaluation of the behavior. However, it is doubted that most courts really take it into account and it can be guessed that often the application of this standard is limited only to mentioning. But this is also the problem of parties of the dispute, as the presentation of reasonable arguments and proofs to the judge is their right and obligation.

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The Supreme Court of Lithuania, Civil Division, 21 September 2009 ruling of the board of judges in the civil case BUAB „Vikata ir Ko“ v. UAB „Daisrune ir Ko“ (case No. 3K-3-361/2009).
The Supreme Court of Lithuania, Civil Division, 30 November 2010 ruling of the board of judges in the civil case AB „Alytaus tekstilė“ v. AB „Rytų skirstomieji tinklai“ (case No. K-3-485/2010).

The Supreme Court of Lithuania, Civil Division, 19 June 2013 ruling of the board of judges in the civil case D. J. v. J. B (case No. 3K-3-336/2013).


CLINICAL PSYCHOLOGICAL ASSESSMENT IN LITHUANIAN HEALTH CARE INSTITUTIONS: OPINION ANALYSIS OF PROFESSIONALS

Augustinas Rotomskis

VU Special Psychology Laboratory, Lithuania
rotomskis.augustinas@gmail.com

Abstract

Purpose – to investigate the state of clinical psychological assessment in the Lithuanian health care system: 1) what kind of tests are used in clinical practice and what are clinicians' opinions about them; 2) what kind of psychological functions are assessed in clinical practice and what is the opinion of clinicians about the assessment of these psychological functions; 3) what kind of issues are the most pressing in clinical assessment.

Design/methodology/approach – 101 clinical psychologists, who work in Lithuanian health care institutions, completed a questionnaire about their opinion on clinical psychological assessment.

Findings – Attention, memory, executive functions, intelligence and emotions are the most important and frequently assessed psychological functions in clinical practice. Neuropsychological assessment of attention, memory, executive functions, are viewed as the most problematic fields of assessment. The adaptation, standartization and revision of the various neuropsychological tests is suggested. The most pressing issues in clinical practice are: 1) the assessment of specific psychological functions (neuropsychological and psychosocial functioning); 2) the assessment of specific disorders (schizophrenia spectrum disorders and autism spectrum disorders); 3) the assessment of specific stages of development (children and teenagers).

Research limitations/implications – 32 percent of health care institutions (30 out of 95 identified institutions), which provide mental health care, did not participate in the study. The majority of these institutions are from the provinces.

Practical implications – psychological assessment plays a key role in the practice of a clinical psychologist. This study investigated and pinpointed the most pressing issues and needs of psychologists in clinical practice. According to the study results, recommendations ascertaining to the adaptation and revision of tests and preparation of clinical psychologists for their practice can be made.

Originality/Value – this is the biggest and most thorough investigation of the state of clinical psychological assessment in the Lithuanian health care system.

Keywords: clinical psychology; assessment, specialists’ opinion.

Research type: research paper.
Introduction

Psychological assessment plays a key role in the practice of a clinical psychologist. The field of psychological assessment has seen some drastic changes in the recent decade. New tests have been adapted and standardized in the Lithuanian-speaking population. The culture of clinical has greatly improved (ethical requirements for test use have risen, specialists training has incorporated more assessment courses, quality of assessment practice has been attended more thoroughly by universities) (Gudaitė, 2007). In order to provide psychologists services that ascertained to European standards there is a need for reliable, valid, legal and suitable for use tests in Lithuania. The availability of proper tests enables the acquisition of quality psychic health care services (Hunsley and Mash, 2008).

Despite the developments in the recent decade one biggest issues in clinical practice is the shortage of proper tests (Dapšienė ir Kalpokienė, 2011). In the biggest survey on clinical assessment among psychologists in the Lithuanian Health Cares system to date 49 % of respondents the shortage of suitable tests for clinical practice as the most important issue in clinical assessment (Grigutytė, 2011). The majority of tests used in the current practice of clinical psychologists in the Lithuanian health care institutions do not meet the standards for proper tests (Dapšienė ir Kalpokienė, 2011). Although is a shortage of tests for various psychological functions, there is a lack of knowledge of the most prevalent needs and issues, which clinical psychologists face in clinical practice. The state of clinical psychological assessment in the Lithuanian health care system from the practitioners perspective is poorly researched.

Study aim

To investigate the state of clinical psychological assessment in the Lithuanian health care system from the psychologists' practitioners perspective: 1) what kind of tests are used in clinical practice and what are clinicians opinions about them; 2) what kind of psychological functions are assessed in clinical practice and what is the opinion of clinicians about the assessment of these psychological functions; 3) what kind of issues are the most pressing in clinical assessment.

Methodology

101 clinical psychologists from 65 Lithuanian health care institutions completed a questionnaire about their opinion on clinical psychological assessment. Firstly, the participants were asked what tests are used during clinical assessment. The identified test was rated on a 6-point scale, how often the test is used in clinical practice, how they perceive the efficacy of the test, how they view the necessity of the test for clinical practice. Secondly, the participants of the study were asked what kind of psychological
functions are assessed during clinical assessment. The identified psychological functions was rated on a 6-point scale, how often the psychological functions is evaluated, how the assessment of a particular psychological function is important to clinical practice, how they perceive day-to-day effectiveness of the clinical assessment of a particular psychological function. Lastly, 3 open questions were asked: “For which psychological functions is the greatest need of new tests?”; “What kind problems and mistakes are most often encountered in clinical practice?”; “What kind of tests first of all should be standardized or adapted?”.

Results

The 15 most frequently used tests are presented in Table 1. The most frequently used tests measure intelligence, emotions and neuropsychological functions. The minority of the used tests are viewed as good instruments for clinical assessment. 43 of 61 tests were rated more often as ineffective then as effective instruments in clinical practice. The 15 tests perceived as the most effective are presented in Table 2. The majority of tests that are the most important for clinical practice measure neuropsychological processes, intelligence and emotions. The 15 tests perceived as the most important are presented in Table 3.

Table 1. The 15 most frequently used tests in clinical practice

<table>
<thead>
<tr>
<th>Test</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>WAIS-III</td>
<td>93</td>
</tr>
<tr>
<td>WISC-III</td>
<td>93</td>
</tr>
<tr>
<td>MMPI</td>
<td>90</td>
</tr>
<tr>
<td>“4-1”</td>
<td>90</td>
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<tr>
<td>HTP</td>
<td>90</td>
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<tr>
<td>Raven’s progressive matrices</td>
<td>89</td>
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<tr>
<td>HAD</td>
<td>89</td>
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<tr>
<td>BDI</td>
<td>89</td>
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<tr>
<td>Rorschach test</td>
<td>89</td>
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<tr>
<td>Luria’s 10 word test</td>
<td>89</td>
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<tr>
<td>Pictograms</td>
<td>89</td>
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<tr>
<td>Schultz tables</td>
<td>89</td>
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<tr>
<td>DISC</td>
<td>87</td>
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<tr>
<td>MMSE</td>
<td>87</td>
</tr>
<tr>
<td>Bender Gestalt test</td>
<td>85</td>
</tr>
</tbody>
</table>

Note: Percentage: Percentage of clinicians who use the test.
### Table 2. The 15 tests perceived as the most effective

<table>
<thead>
<tr>
<th>Test</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>WAIS-III</td>
<td>49</td>
</tr>
<tr>
<td>WISC-III</td>
<td>45</td>
</tr>
<tr>
<td>“4-1”</td>
<td>38</td>
</tr>
<tr>
<td>Pictograms</td>
<td>24</td>
</tr>
<tr>
<td>Schultz tables</td>
<td>23</td>
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<tr>
<td>Luria’s 10 word test</td>
<td>23</td>
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<td>Rorschach test</td>
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<tr>
<td>Raven’s progressive matrices</td>
<td>22</td>
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<tr>
<td>HAD</td>
<td>22</td>
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<tr>
<td>BDI</td>
<td>22</td>
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<tr>
<td>HTP</td>
<td>22</td>
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<tr>
<td>Spielberg State-Trait Anxiety Inventory</td>
<td>21</td>
</tr>
<tr>
<td>MMPI</td>
<td>21</td>
</tr>
<tr>
<td>DISC</td>
<td>18</td>
</tr>
<tr>
<td>Bender Gestalt test</td>
<td>18</td>
</tr>
</tbody>
</table>

*Note: Percentage: Percentage of clinicians who view the test as very effective.*

### Table 3. The 15 most important tests for clinical practice

<table>
<thead>
<tr>
<th>Test</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>WAIS-III</td>
<td>63</td>
</tr>
<tr>
<td>MMSE</td>
<td>62</td>
</tr>
<tr>
<td>WISC-III</td>
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<tr>
<td>MMPI</td>
<td>62</td>
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<tr>
<td>BDI</td>
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<td>HAD</td>
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<td>Rorschach test</td>
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<td>HTP</td>
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<td>WASI</td>
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</tr>
<tr>
<td>“4-1”</td>
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</tr>
<tr>
<td>Burdon tables</td>
<td>46</td>
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<tr>
<td>Schultz tables</td>
<td>44</td>
</tr>
<tr>
<td>Spielberg State-Trait Anxiety Inventory</td>
<td>44</td>
</tr>
<tr>
<td>Zung depression scale</td>
<td>40</td>
</tr>
<tr>
<td>Luria’s 10 word test</td>
<td>39</td>
</tr>
</tbody>
</table>

*Note: Percentage: Percentage of clinicians who view the test as very important for clinical practice.*
21 different psychological functions are assessed in clinical practice. There is variation among different clinical psychologists and health care institutions, but every participant of the study assesses emotions, intelligence, attention, orientation, memory and executive functions in their clinical practice. Also, these psychological functions are most frequently assessed in clinical practice. Other psychological functions, which are assessed in clinical practice, include behavior (97 %), personality (97 %), motivation (91 %), verbal skills (85 %), development (84 %), sensation (79 %), perception (79 %), attitudes (71 %), self-appraisal (69 %), creativity (55 %), willpower (55 %), consciousness states (41 %), psychomotor (38 %), learning (8 %). Emotions, intelligence, orientation, memory, executive functions and attention are the most important evaluated psychological functions in clinical practice. The perceived importance of the assessment of the identified psychological functions is presented in Table 4.

Table 4. The perceived importance of the assessment of psychological functions in clinical practice

<table>
<thead>
<tr>
<th>Function</th>
<th>Very important</th>
<th>Important</th>
<th>More important than not important</th>
<th>More unimportant than important</th>
<th>Unimportant</th>
<th>Very unimportant</th>
</tr>
</thead>
<tbody>
<tr>
<td>Emotions</td>
<td>72 %</td>
<td>25 %</td>
<td>3 %</td>
<td>0 %</td>
<td>0 %</td>
<td>0 %</td>
</tr>
<tr>
<td>Intelligence</td>
<td>67 %</td>
<td>31 %</td>
<td>0 %</td>
<td>1 %</td>
<td>1 %</td>
<td>1 %</td>
</tr>
<tr>
<td>Memory</td>
<td>69 %</td>
<td>27 %</td>
<td>2 %</td>
<td>2 %</td>
<td>0 %</td>
<td>0 %</td>
</tr>
<tr>
<td>Executive functions</td>
<td>72 %</td>
<td>21 %</td>
<td>5 %</td>
<td>0 %</td>
<td>1 %</td>
<td>1 %</td>
</tr>
<tr>
<td>Attention</td>
<td>67 %</td>
<td>19 %</td>
<td>7 %</td>
<td>2 %</td>
<td>3 %</td>
<td>2 %</td>
</tr>
<tr>
<td>Orientation</td>
<td>64 %</td>
<td>19 %</td>
<td>4 %</td>
<td>7 %</td>
<td>5 %</td>
<td>1 %</td>
</tr>
<tr>
<td>Personality</td>
<td>51 %</td>
<td>23 %</td>
<td>24 %</td>
<td>1 %</td>
<td>1 %</td>
<td>0 %</td>
</tr>
<tr>
<td>Motivation</td>
<td>49 %</td>
<td>28 %</td>
<td>21 %</td>
<td>1 %</td>
<td>1 %</td>
<td>0 %</td>
</tr>
<tr>
<td>Development</td>
<td>49 %</td>
<td>26 %</td>
<td>11 %</td>
<td>3 %</td>
<td>7 %</td>
<td>4 %</td>
</tr>
<tr>
<td>Willpower</td>
<td>47 %</td>
<td>26 %</td>
<td>11 %</td>
<td>5 %</td>
<td>7 %</td>
<td>4 %</td>
</tr>
<tr>
<td>Behavior</td>
<td>47 %</td>
<td>21 %</td>
<td>13 %</td>
<td>9 %</td>
<td>6 %</td>
<td>4 %</td>
</tr>
<tr>
<td>Verbal skills</td>
<td>42 %</td>
<td>19 %</td>
<td>16 %</td>
<td>13 %</td>
<td>6 %</td>
<td>4 %</td>
</tr>
<tr>
<td>Self-appraisal</td>
<td>41 %</td>
<td>31 %</td>
<td>11 %</td>
<td>7 %</td>
<td>6 %</td>
<td>4 %</td>
</tr>
<tr>
<td>Attitudes</td>
<td>41 %</td>
<td>17 %</td>
<td>14 %</td>
<td>14 %</td>
<td>11 %</td>
<td>3 %</td>
</tr>
<tr>
<td>Sensation</td>
<td>21 %</td>
<td>31 %</td>
<td>14 %</td>
<td>9 %</td>
<td>15 %</td>
<td>10 %</td>
</tr>
<tr>
<td>Perception</td>
<td>21 %</td>
<td>31 %</td>
<td>14 %</td>
<td>9 %</td>
<td>15 %</td>
<td>10 %</td>
</tr>
<tr>
<td>Creativity</td>
<td>15 %</td>
<td>11 %</td>
<td>14 %</td>
<td>21 %</td>
<td>22 %</td>
<td>17 %</td>
</tr>
<tr>
<td>Consciousness states</td>
<td>8 %</td>
<td>9 %</td>
<td>32 %</td>
<td>31 %</td>
<td>9 %</td>
<td>11 %</td>
</tr>
<tr>
<td>Psychomotor</td>
<td>7 %</td>
<td>2 %</td>
<td>32 %</td>
<td>31 %</td>
<td>12 %</td>
<td>16 %</td>
</tr>
<tr>
<td>Learning</td>
<td>4 %</td>
<td>7 %</td>
<td>8 %</td>
<td>47 %</td>
<td>14 %</td>
<td>20 %</td>
</tr>
</tbody>
</table>

The perceived effectiveness of the psychological functions assessment is presented in Table 5. Intelligence, behavior, emotions, orientation, states of consciousness and
attention are perceived as the most effectively assessed. The majority of the clinicians consider the assessment of these functions either as very effective or as effective. Meanwhile, memory, executive functions, creativity, sensation and perception are considered as the least effectively assessed. The minority of the clinicians consider the assessment of these functions either as very effective or as effective.

Table 5. The perceived effectiveness of the psychological functions assessment is presented

<table>
<thead>
<tr>
<th>Function</th>
<th>Very effective</th>
<th>Effective</th>
<th>More effective than ineffective</th>
<th>More ineffective than effective</th>
<th>Ineffective</th>
<th>Very ineffective</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intelligence</td>
<td>73 %</td>
<td>24 %</td>
<td>3 %</td>
<td>0 %</td>
<td>0 %</td>
<td>0 %</td>
</tr>
<tr>
<td>Behavior</td>
<td>72 %</td>
<td>23 %</td>
<td>3 %</td>
<td>2 %</td>
<td>0 %</td>
<td>0 %</td>
</tr>
<tr>
<td>Emotions</td>
<td>72 %</td>
<td>28 %</td>
<td>0 %</td>
<td>0 %</td>
<td>0 %</td>
<td>0 %</td>
</tr>
<tr>
<td>Orientation</td>
<td>71 %</td>
<td>24 %</td>
<td>5 %</td>
<td>0 %</td>
<td>0 %</td>
<td>0 %</td>
</tr>
<tr>
<td>States of consciousness</td>
<td>71 %</td>
<td>22 %</td>
<td>5 %</td>
<td>2 %</td>
<td>0 %</td>
<td>0 %</td>
</tr>
<tr>
<td>Attention</td>
<td>68 %</td>
<td>27 %</td>
<td>5 %</td>
<td>0 %</td>
<td>0 %</td>
<td>0 %</td>
</tr>
<tr>
<td>Willpower</td>
<td>51 %</td>
<td>23 %</td>
<td>7 %</td>
<td>20 %</td>
<td>0 %</td>
<td>0 %</td>
</tr>
<tr>
<td>Personality</td>
<td>53 %</td>
<td>24 %</td>
<td>10 %</td>
<td>13 %</td>
<td>0 %</td>
<td>0 %</td>
</tr>
<tr>
<td>Motivation</td>
<td>47 %</td>
<td>23 %</td>
<td>11 %</td>
<td>19 %</td>
<td>0 %</td>
<td>0 %</td>
</tr>
<tr>
<td>Self-appraisal</td>
<td>44 %</td>
<td>16 %</td>
<td>19 %</td>
<td>21 %</td>
<td>0 %</td>
<td>0 %</td>
</tr>
<tr>
<td>Attitudes</td>
<td>44 %</td>
<td>14 %</td>
<td>19 %</td>
<td>23 %</td>
<td>0 %</td>
<td>0 %</td>
</tr>
<tr>
<td>Psychomotor</td>
<td>37 %</td>
<td>38 %</td>
<td>10 %</td>
<td>15 %</td>
<td>0 %</td>
<td>0 %</td>
</tr>
<tr>
<td>Learning</td>
<td>37 %</td>
<td>31 %</td>
<td>13 %</td>
<td>19 %</td>
<td>0 %</td>
<td>0 %</td>
</tr>
<tr>
<td>Motivation</td>
<td>32 %</td>
<td>13 %</td>
<td>46 %</td>
<td>9 %</td>
<td>0 %</td>
<td>0 %</td>
</tr>
<tr>
<td>Development</td>
<td>31 %</td>
<td>23 %</td>
<td>30 %</td>
<td>16 %</td>
<td>0 %</td>
<td>0 %</td>
</tr>
<tr>
<td>Memory</td>
<td>13 %</td>
<td>13 %</td>
<td>51 %</td>
<td>23 %</td>
<td>0 %</td>
<td>0 %</td>
</tr>
<tr>
<td>Executive functions</td>
<td>12 %</td>
<td>14 %</td>
<td>47 %</td>
<td>27 %</td>
<td>0 %</td>
<td>0 %</td>
</tr>
<tr>
<td>Creativity</td>
<td>11 %</td>
<td>13 %</td>
<td>43 %</td>
<td>33 %</td>
<td>0 %</td>
<td>0 %</td>
</tr>
<tr>
<td>Sensation</td>
<td>9 %</td>
<td>14 %</td>
<td>41 %</td>
<td>36 %</td>
<td>0 %</td>
<td>0 %</td>
</tr>
<tr>
<td>Perception</td>
<td>9 %</td>
<td>12 %</td>
<td>41 %</td>
<td>38 %</td>
<td>0 %</td>
<td>0 %</td>
</tr>
</tbody>
</table>

Thematic analysis was used to interpret the results from the open question “What kind problems and mistakes are most often encountered in clinical practice?”. A thematic map of the practical problems can be seen in Figure 1. Three predominant themes have been identified: 1) the assessment of specific psychological functions (neuropsychological and psychosocial functioning); 2) the assessment of specific disorders (schizophrenia spectrum disorders and autism spectrum disorders); 3) the assessment of specific stages of development (children and teenagers). The majority of participants answered that there is greatest for tests that measure neuropsychological processes (attention, memory,
executive functions, etc.). A pie chart of participants answers is presented in Figure 2. 61% percent of participants answered there is the greatest need for tests that measure neuropsychological processes, 15% - emotions, 11% - personality, 5% - development, 5% - motivation. In Table 6 top 10 tests which first of all should be adapted or standartized are presented.

Figure 1. Initial thematic map of three main themes of the practical problems in clinical practice

Figure 2. Psychological functions that require new tests
Table 6. The 10 most needed tests in clinical practice

<table>
<thead>
<tr>
<th>Test</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>MMPI II</td>
<td>27</td>
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<tr>
<td>“4-1”</td>
<td>21</td>
</tr>
<tr>
<td>BDI</td>
<td>19</td>
</tr>
<tr>
<td>Kraepelin tables</td>
<td>18</td>
</tr>
<tr>
<td>Schultz tables</td>
<td>17</td>
</tr>
<tr>
<td>Raven’s progressive matrices</td>
<td>17</td>
</tr>
<tr>
<td>Bender Gestalt test</td>
<td>15</td>
</tr>
<tr>
<td>Zung depression scale</td>
<td>15</td>
</tr>
<tr>
<td>Burdon test</td>
<td>12</td>
</tr>
<tr>
<td>DISC</td>
<td>7</td>
</tr>
</tbody>
</table>

Note: Percentage: Percentage of clinicians who think this test first of all should be adapted or standartized in the Lithuanian speaking population.

Attention, memory, executive functions, intelligence and emotions are the most important and frequently assessed psychological functions in clinical practice. Neuropsychogical assessment of attention, memory, executive functions, are viewed as the most problematic fields of assessment. The adaptation, standartization and revision of the various neuropsychological tests was suggested. The most pressing issues in clinical practice are: 1) the assessment of specific psychological functions (neuropsychological and psychosocial functioning); 2) the assessment of specific disorders (schizophrenia spectrum disorders and autism spectrum disorders); 3) the assessment of specific stages of development (children and teenagers).

Conclusions

Intelligence, neuropsychological processes and emotions are the most frequently and important assessed psychological functions in clinical practice. Despite this fact, the assessment of neuropsychological processes (attention, memory, executive functions) is viewed as problematic and ineffective. Currently in clinical practice the greatest need is of neuropsychological tests. The adaptation, standartization and revision of the various neuropsychological tests is heavily supported by the majority of clinicians.

The most pressing issues in clinical practice are: 1) the assessment of specific psychological functions (neuropsychological and psychosocial functioning); 2) the assessment of specific disorders (schizophrenia spectrum disorders and autism spectrum disorders); 3) the assessment of specific stages of development (children and teenagers).
References


ITC guidelines on test use. *International Test Commission, 2000*.

MODELING A VALUE CHAIN IN PUBLIC SECTOR

Daiva Rapcevičienė

Mykolas Romeris University, Lithuania
daiva54@yahoo.com

Abstract

Purpose – Over the past three decades comprehensive insights were made in order to design and manage the value chain. A lot of scholars discuss differences between private sector value chain – creation profit for the business and public sector value chain, the approach that public sector creates value through the services that it provides. However, there is a lack of a common understanding of what public sector value chain is in general. This paper reviews the literature on how the private value chain was transformed into public value chain and reviews a determination and architecture of a value chain in public sector which gives a structural approach to greater picture of how all structure works. It reviews an approach that the value chain for the public sector shows how the public sector organizes itself to ensure it is of value to the citizens.

Design/methodology/approach – descriptive method, analysis of scientific literature.

Findings – The public sector value chain is an adaptation of the private sector value chain. The difference between the two is that the customer is the focus of the public sector context, versus the profit focus in the private sector context. There are significant similarities between the two chain models. Each of the chain models are founded on a series of core components. For the public sector context, the core components are people, service and trust.

Research limitations/implications – this paper based on presenting value chain for both private and public sectors and giving deeper knowledge for public sector value chain model.

Practical implications – comprehension of general value chain model concept and public sector value chain model helps to see multiple connections throughout the entire process: from the beginning to the end. The paper presents the theoretical framework for further study of the value chain model for waste management creation.

Originality/Value – The paper reveals the systematic conceptual overview on comprehension of value chain model for both private and public sectors.

Keywords: value chain, public sector, value model.

Research type: scientific literature review.

Introduction

Value Chain Management is a broad topic and has been examined and expanded by researchers from different angles over the last thirty years. One prominent research field
is sustainability in value chain management. Public services can be regarded as a critical factor for the competitive development and the growth of ‘country systems’ (national economic, social and industrial systems). According to this approach, the organizations or any public body, or even concession operator operating in the public sector play a key role as providers of services of general interest, which unquestionably have a strong impact on both the life quality of citizens and the productivity of enterprises. The performances of these organizations should be characterized by high quality and cost effectiveness as the aim is to bring Public Administration as much closer as possible to citizens and enterprises by creating 'public value' through the production of services increasingly more tailored to the needs of users.

**Evolution of Value chain concept**

The value chain itself describes the full range of activities which are required to bring a product or service from conception, through the different phases of production (involving a combination of physical transformation and the input of various producer services), delivery to final consumers, and final disposal after use (Kaplinsky and Morris, 2000).

The concept of value chain came from business management and was first described and mostly popularized by Michael Porter in his 1985 best-seller “Competitive Advantage: Creating and Sustaining Superior Performance”. Porter termed the larger interconnected system of value chains the "value system". All firms’ activities were divided into two value streams: primary and supportive activities. Primary activities relate directly to the physical creation, sale, maintenance and support of a product or service, while support activities support the primary functions. This value system includes the value chains of a firm's supplier (and their suppliers all the way back), the firm itself, the firm distribution channels, and the firm's buyers.

![Figure 1. Porter's value chain](image-url)
Porter’s main idea of value chain is that value chain is a high-level model of how businesses receive raw materials as input, add value through various processes, and sell finished products to customers. The value chain categorizes the generic value-adding activities of an organization (Brown, 2009).

All basic value streams were introduced in Michael Porter’s book but were explained more clearly by James Martin in his 1995 book called “The Great Transition”, where were pulled together many issues, models, and methods for transforming the traditional old-world organization into a value-creating enterprise. Martin uses value stream, rather than process, to define the end-to-end stream of activities that deliver particular results for a given customer (external or internal).

Ralph Whittle and Conrad Myrick in the book, Enterprise Business Architecture (2004), provides a common reference model by defining the business strategy, governance, organization, and business functions, and establishes a baseline that links strategy and results by defining which organizations perform those functions. This book provides a consistent classification of all the tasks, activities, functions, and processes into value streams. A value chain is the disaggregating of a firm into its strategically relevant activities for the purpose of understanding the behavior of costs as well as the existing and potential sources of differentiation. The concept has been extended beyond individual organizations. The industry wide synchronized interactions of those local value chains create an extended value chain, sometimes global in extent. Capturing the value generated along the chain is the new approach taken by many management strategists. By exploiting the upstream and downstream information flowing along the value chain, the firms may try to bypass the intermediaries creating new business models (Brown, 2009).

The promotion of value chains is a complex challenge within the realm of private sector development and beyond. Actors in a value chain may range from microenterprises to multinational corporations, and it is thus beyond doubt that developing a holistic approach to deal with such diverse actors is challenging (Stamm and Drachenfels, 2011). Moreover, these actors – the different links of the value chain – can be embedded in quite different environments. Domestic value chains may e.g. link rural producers with urban marketers; in global value chains producers from developing countries might for example be linked to firms in industrialized countries. The specific location of firms implies differing regulatory frameworks and differing access to input factors and information.

Public value chain

Any public sector organization that provides services to the citizens plays a key role in value creation for the country. Providing a quality service and creating public goods, competitive development and the growth of the county are ensured. So the main issue for the public sector organizations is to create better value through public services and to meet needs provided by citizens, private organizations and other public bodies.
In the last three to four decades, government and business have been part of a far-reaching economic transformation, made possible by remarkable advances in information, communication and transport technologies. Both theory and practice in the private sector have already identified a link between employee satisfaction and customer satisfaction, on the one hand, and between customer satisfaction and the bottom line, on the other. The combination of these two relationships yields a causal chain in which an improvement in employee attitudes and behaviours leads to an improvement in customer attitudes and behaviours, which leads in turn to an increase in growth and profit.

The main idea of the public value chain architecture is creation of the two basic value flows:

1. Primary activities, such as service concept design, physical resources procurement, human resources selection and management, service creation and delivery and etc.;
2. Support activities, such as strategic planning, financial management, brand management and etc.

It is important to note that the Public Sector Service Value Chain Model builds on previous knowledge. In the present context, the Public Sector Service Value Chain model is an adaptation of the Private Sector Service Profit Chain Model (Heintzman and Marson, 2003; Marson and Heintzman, 2009).

![Figure 2. Public value chain](source: Heintzman and Marson, 2003)

Primary activities are the basic flow of services provided by public institution and support services helps to increase value to different groups of society. Value chain can be analysed from the different dimension of the interest groups. The main analysis explores the ways in which the organization creates value for its stakeholders and distribute this value between them. For private sector companies, this normally refers to the set of
benefits which are required by the firm’s stakeholders (although now there also pressures for corporate social responsibility’ even in the private sector). Public sector has to meet more expectations. Typically, in the public sector we can find these dimensions:

1. User value;
2. Value for wider groups;
3. Political value;
4. Social value;
5. Environmental value.

These five dimensions have to meet to meet demand expectations taking into consideration three macro segmentations:

- Demand from people
- Demand from any kind of enterprise;
- Demand from institutions, including Public administration bodies and non-profit organizations (Alberto, 2013).

The Public Sector Service Value Chain consists of three core components: People, Service and Trust (Hietzman, 2010; Heintzman and Marson, 2003; Kaplinsky, 2002; Kaplinsky and Morris, 2000) and this approach of public value chain is analyzed in three dimensions:

1. Employee satisfaction and commitment;
2. Citizen/client service satisfaction;
3. Citizen trust and confidence in public institutions.

The model has three key building blocks, similar to the private sector models. This three-part model can help to widen not just the academic discussion on trust and confidence, but, even more important, the perspective and priorities of public managers. It serves to link two of the key priorities for public sector reform – service improvement and human resource modernization – priorities that are usually addressed in isolation, despite the fact that success in one depends on success in the other (Heintzman and Marson, 2003).

This model highlights three sets of “drivers,” one for each of the building blocks. All three elements have “drivers” and could be understood as an independent variable that can be shown to be an important predictor of performance outcome. If we are to make progress on any of these public sector building blocks, or, more properly, on all three together, further research and reflection will be needed to identify the precise “drivers” for each of them, especially the first and third building blocks – a key issue for managers and practitioners, to which we will return. As noted, it is in the consideration of the drivers and their relative priority, and of the relations and interactions between them, that the complexity of this model, as of other such models, emerges.

The fourth feature of the model to note is that it involves two sets of linkages: one between the satisfaction and commitment of public employees and the satisfaction of citizen clients (or client citizens) with the quality of government service delivery; and the other between citizen satisfaction and citizen trust and confidence in public institutions. Obviously a key issue is the empirical evidence for these linkages (Heintzman and Marson, 2003).
Figure 3. Public sector service value chain

According to the Figure 3 links between dimensions are not symmetrical. The first is a two-way linkage and the second is a one-way relationship. This is a key point, because it helps to advance understanding of these relationships in the public sector. There is a reciprocal or mutually reinforcing relationship between employee and citizen/client satisfaction, but not between satisfaction and trust. In other words, a priori trust appears to play less of a role, either in service satisfaction or in the a posteriori trust generated by service satisfaction, than might be assumed.

Figure 4. Strong services internally and externally contribute to confidence in the public service
According to Heintzman and Marson (2010), the success of the Public Sector Service Value Chain to empower employees to respond effectively to customer concerns and enhance the delivery of public services has been attributed to the scope of the components and their linkages. Marson and Heintzman first proposed the model in order address a concern that the public sector would be unable to meet its service objectives without an internal focus on the employees delivering the service. This is particularly relevant for management staff and corporate structures since management is recognizably at a distance from the delivery of public services and the employees delivering those services. Successful integration of the Public Sector Service Value Chain value has resulted in amendments to management structures to ensure employees remain satisfied with their jobs and feel well equipped to respond to client needs. The importance of a satisfied and motivated labour force is evident from Figure 4 and the role of employee satisfaction as one of the model’s core components (DPRA, 2012).

Conclusions

Value chain is examined over thirty years. During that time value chain model was established for both, public and private sector. The findings suggest that there were similarities between the public sector value chain and the private sector value chain. Public sector value chain is analysed from the point of service to citizens. The public sector value chain is an adaptation of the private sector value chain. The difference between the two is that the customer is the focus of the public sector context, versus the profit focus in the private sector context. There are significant similarities between the two chain models. Each of the chain models are founded on a series of core components. For the public sector context, the core components are people, service and trust. Under different titles, the importance of people and trust are found in the private sector model context. The core components of the private sector service profit chain are customer loyalty, profitability and growth (DPRA, 2012).

References

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INTERORGANIZATIONAL NETWORKING IMPACT TO INNOVATION

Evelina Šakalytė

Mykolas Romeris University, Lithuania
evelina.sakalyte@yahoo.com

Ilona Bartuševičienė

Mykolas Romeris University, Lithuania
ilonabartuviciene@mruni.eu

Abstract

Purpose – to distinguish main inter-organizational networking characteristics and emphasize impact to innovation within the company and between related actors. Network formation is one of the essential factors to effective business performance and fostering competitiveness. The emergency of growing competition and influence of globalization leads companies to effectively use inner-sources and capabilities in order to be ahead of competitors.

Design/methodology/approach – scientific literature analysis.

Findings – the paper emphasizes the role and the value of networking that leads to innovation in order to succeed in a fast changing environment.

Research limitations/implications – the research on networking and innovation impact to service sector has not been thoroughly implemented yet.

Practical implications – the inter-organizational networking is a strategy of management and a powerful tool for development, solving of problems and acceptance or exchange of innovations. Innovation is a crucial element in the development of companies as well as their competition with rivals. Innovation enables companies to continuous adaptation to the global economy.

Originality/Value – the paper stresses the importance of innovation that is seen as a highly significant factor and an impetus to modernization in the rapidly changing and increasingly more competitive business environment. The paper focuses on the significance of inter-organizational networks and its impact on innovation development.

Keywords: networking, innovation, network capital, social capital, knowledge flow.

Research type: scientific literature review.
Introduction

In the fast changing and complex environment it becomes harder and harder to compete alone in the market. Knowledge is seen as one of the most significant element and resource of organization which leads to successful performance and competitiveness as well as fostering of innovation within an organization. Inter-organizational networking is the best tool for spreading knowledge within an organization and between other network’s organizations. Inter-organizational networking allows cooperation within a network and share of information and different approaches. Therefore this spread and circulation of knowledge and ideas can lead to innovation inside an organization. No less important, networking between external partners enables company to gain new knowledge and take over innovation or imitate improvements and boost efficiency.

Inter-organizational Networking Characteristics and Impact to Innovation

Resource based researchers state that organizations are dependent on tangible and intangible resources from outside factors. According to that organizations change their structure and strategy in order to succeed. Networking researchers claim that network organizations operates according to the network system which becomes a important part of organization’s existence and makes an influence to organization’s decisions (Mizruchi and Galaskiewicz, 1994, op. cit.). Network background can be analyzed by how network and its extent: a) provides opportunities for its participants to have active relationship in order to use network (resource dependence); and b) indicates attitudes and behaviour within a network. The more members are centralized in the network, the more similar companies behave in the market, because they share like information (Doerfel, 1999).

Kulmala et al. (2005) presents network characteristics based on value chains. Researchers claim that network organizations focus most on their major competencies and the main goals for networking is innovativeness, profitability and growth. The best practices within the network are accepted and shared faster if the level of openness between related actors is high. According to Ebers and Jarillo (1998) op. cit., formation of networks have these advantages: bilateral learning, strategy formation in specialization, effective information and resource flows, economy of scale, and organizing market structure with network members (Kulmala et al., 2005). Networks are creating opportunities for innovation, which are connected to knowledge and learning (Brass, 2004).

Jaskyte and Lee (2006) reveal four major components of inter-organizational relations which can contribute to innovativeness: resources, technological assistance, information flows and clients. Transfer of knowledge and resources, legitimacy, shared learning, leveraging of organizations resources foster innovation within the network and network actors. In the exchange of resources, organizations are able to interact and to spread and exchange innovative practices between them.
Organizations join or form networks in order to gain legitimacy, serve clients more effectively, gain more resources and solve complex situations. All network organizations are seeking to achieve a goal that they could not have achieved independently. Inter-organizational network benefits such as shared risk, advocacy, positive deviance, innovation, flexibility and responsiveness, suppose that the formation of inter-organizational networks can be a strategy for developing an organizational structure that is able to create a change. Innovation is an important function of networks because it is critical to addressing complex problems (Popp et al., 2013).

According to Chetty and Holm (2000) op. cit., networks collect interfirm resources. Resources which are collected in a synergy manner help network participants to gain knowledge, search new opportunities and markets, and learn from collaborative experience (Uddin, 2013). It is important to pay attention and work together in an inter-organizational network relationship where different partners deal collaboratively on the value creating process rather than focusing on individual level (Uddin, 2013).

Recently, there is a greater interaction and collaboration among companies because of the rapidly changing and dynamic environment and lower costs of information technology. Bovet et al. (2000) op. cit. state that the interaction among business network members helps to enhance corporate competitiveness (Hsueh, 2010). Network embeddedness arises from the social capital established by companies in mutual networks. Social capital includes human resources, corporate performance, regional performance and national performance. According to Yli-Renko et al. (2001) op. cit., network embeddedness produces relationship capital and makes knowledge flow among enterprises easy, gives opportunity to complementary capabilities, resource sharing. All these elements contribute to the creation and concentration of the companies' knowledge capital which enables companies to acquire supplemental assets, advantages in the market and technical information (Hsueh, 2010).

Network creation requires investments from the network actors. The development of strong and tight inter-organizational relations for innovation, the foundation and maintenance of customer–supplier relations, the attendance and partnership in networks demands time and resources (Kauffeld-Monz and Fritsch, 2013).

Interorganizational Network Formation: Social Capital and Network Capital Approaches

Participation in business network is an important element in innovation performance. Researchers of inter-organizational networks (op. cit. Meagher and Rogers, 2004; Lichtenhaller, 2005; Sammarra and Biggiero, 2008; Tomlinson, 2010; Bergenholtz and Waldstrom, 2011) point up that internal and external innovation is a complicated process and requires knowledge share and exchange between companies and other related actors (Huggins et al., 2012). The innovation performance of firms is extremely related to network capital investment. Therefore, companies avoid innovating alone and innovate with external actors and inter-organizational networks are seen as a significant element of innovation process (Huggins et al., 2012).
Huggins et al. (2012) introduce the concept of network capital to show the ties in the network between organizations and other actors from the network capital and social capital aspect and to show the distinction of them. Geographic space and physical proximity models are also involved. Fig. 1 demonstrates that inter-organizational network forms with knowledge flow are configured in accordance with the geographic space and network space. In addition, inter-organizational network within and across network and geographical space are connected with the innovation performance.

Figure 1. Innovation and inter-organizational networks

This model demonstrates that inter-organizational networks help to simplify the knowledge flows what enables companies to obtain knowledge to develop innovation. Huggins et al. (2012) distinguish two forms of inter-organizational knowledge network: alliance network, through which companies collaborate to innovate; and contact networks, through which companies source knowledge. Networking through alliances provides formalized collaboration and repeated relationship. Whereas contact networks are more informal interactions and relationships between related actors which are more active and continuously updating and changing their contacts. The main role of alliance networks and contact networks is to gain knowledge which leads to innovation. However, if networks are willing to keep themselves in the innovation process, knowledge networks need to embrace new members and do some alterations in order to keep the pace with changing environment. The network space is distinguished to two elements: social capital and network capital.

Putnam (1993) op. cit. defined social capital as social organizations features such as trust, norms, and networks that can improve the efficiency of society (Robison et al., 2002). Coleman (1990) op. cit. defined social capital as a variety of different entities.
having aspect of social structure and ability to facilitate certain actions of individuals who are within the structure. These entities include obligations, expectations, trust, and information flows (Robison et al., 2002).

The significance of networking focuses on the value of networking and collaboration in creating social capital. Social capital contains three main elements: resources embedded in a social context; that are accessed or mobilized; is purposive. The importance of networking in this perspective is seen as ability to employ resources held by other actors and increase the flow of information in a network. Furthermore, according to Lin (1999) op. cit., a network can exert more influence on its social and political surroundings than individual actors. Social capital can also help spread innovation, which is best done through bottom-up networks. In the most successful examples of networking, social capital is both an individual and a collective good (Muijs et al., 2010).

The second element of network space is network capital. Network capital relates to facilitation of knowledge flow within the network. Huggins et al. (2012) defines network capital concept as a response to the increased recognition and a mechanism based on the logic of business and professional expectations.

According to Huggins et al. (2012) research, inter-organizational knowledge networks are considered to be a crucial element underlying the economic success and competitiveness of regions. The existence of established spatially proximate knowledge networks is one of the key factors why a number of the most successful regions around the world have become or remained more competitive than those regions where networking method have not been established.

Regional context gives information about economic and innovation performance in geographical regions. From an inter-organizational network perspective, it might be expected that social capital investments in knowledge networks will be higher where a knowledge-based economic environment is more embedded, and where networks are likely to be more stable. In the emerging regions, firms may be more biased towards network capital investments, in order to strategically search and access knowledge from contacts and alliance partners (Huggins et al., 2012). Since suppliers and customers are significant resources for service innovation, clustering and networking can help widen and increase the efficiency of knowledge acquisition for innovation. Several countries encourage clustering and networking to enhance innovation across their economies, but some have implemented specific policy measures for ICT fields (OECD, 2005).

According to Popp et al. (2013), Thorgren et al. (2009) op. cit. studied the influence of network characteristics on the innovative performance of small and medium size enterprise networks. “Researchers found that a network can achieve greater innovative performance when there are many network members, when the network is formed on member initiative (i.e., a bottom-up formation process), and when there is a large administrative function (e.g., network board)” (Thorgren et al., 2009) op. cit. In addition, the research revealed that a larger network encourages innovation by providing more opportunities, resources and complex products. Authors stress bottom-up formation processes which are crucial to innovation processes because they bring strengthened member commitment, motivation and social capital and influence the speed of innovative performance development (Thorgren et al., 2009) op. cit.
Conclusions

Formation or accession to inter-organizational networks are considered as a crucial factor that help to exchange knowledge and share resources between related actors within the network. Knowledge is one of the most significant elements and a resource of organization which leads to successful performance and competitiveness, and is seen as a significant factor to success, development and growth in today’s fast changing business environment.

Inter-organizational networks contain positive characteristics, such as: 1) it contributes to innovativeness by providing resource flow, technological assistance, effective information flow and allow cooperation within a network and share of information and different approaches; 2) it enables company to gain new knowledge, take over innovation or imitate improvements and innovations as well as help network companies in the growth process and efficiency. Inter-organizational networks enable mutual learning, strategy formation, economy of scale, and organizing market structure with network members; 3) it helps to solve complex situations and achieve a goal that companies could not have achieved independently and benefit in shared risk, advocacy, positive deviance, innovation, flexibility and responsiveness.

Inter-organizational networking should be analyzed employing social capital and network capital approaches and effects of usage of social platforms in business performance and creation of inter-organizational networks. Networks are supposed to do influence on social and political surroundings. In addition, social capital should be a tool to spread innovation. Whereas, network capital helps with the knowledge flow within the network according to expectations and business strategies.

References


PRINCIPLE OF LEGAL CERTAINTY AND (IN)DIRECT EFFECT OF DIRECTIVES

Aistė Samuilytė-Mamontovė

Mykolas Romeris University, Lithuania

asamuilyte@yahoo.com

Abstract

Purpose – The research discloses problematic aspects of the case law of the European Court of Justice (ECJ) denying direct effect of the directives between private parties and real effect of (in)direct effect of the directives in the light of the principle of legal certainty.

Design/methodology/approach – Research employs logical, systemic, teleological and comparative analysis methods.

Findings – Though ECJ still explicitly refers to the ruling made in Marshall case prohibiting horizontal effect of directives, its practice in reality is quiet controversial, begging for discourse and suggestions capable to assist in assuring the respect to the principle of legal certainty.

Research limitations/implications – The focus of this article is not to analyse and disclose classical ECJ cases on (in)direct effect of the directives. Research is limited to analysis of exceptions to the rule that denies direct effect of directives and reveals their compatibility with the principle of legal certainty.

Practical implications – Key users of rules formed in the case law of the ECJ are national courts that shall assure application of the principle of legal certainty and abstain from acting contra legem. Such research is important in forecasting evolution of the case law of the ECJ in this area for courts and legal advisors that face with doctrine on effects of the directives in practice.

Originality/Value – Doctrines on the effect of the directives are of great interest to legal researchers. However, lately ECJ case law allows making more detailed generalizations, though it also leaves certain open questions on the importance of the principle of the legal certainty in relation to principles of effectiveness and supremacy of European Union law. Superior courts of Lithuania usually refer to these doctrines in pretty theoretical aspects, however it is very rarely applied in practice.

Keywords: legal certainty, direct effect, indirect effect, consistent interpretation, directives.

Research type: research paper.
Introduction

In the legal systems of both the European Union (hereinafter referred to as the EU) and Lithuania, the principle of legal certainty is one of the fundamental principles of law on which, first of all, the requirement for the law to be clear and precise so that the subjects of law may have a clear knowledge of their rights and duties and use them accordingly is based. Under the established case-law of the Court of Justice of the European Union (hereinafter referred to as the Court of Justice), “the general principle of legal certainty, which is a fundamental principle of Community law, requires, in particular, that rules should be clear and precise, so that individuals may ascertain unequivocally what their rights and obligations are and may take steps accordingly”1. The Constitutional Court of the Republic of Lithuania has repeatedly stated that “legal certainty and legal clearness are one of the fundamental elements of the principle of a state under the rule of law which is entrenched in the Constitution: legal regulation must be clear and harmonious, legal norms must be formulated precisely, they may not contain ambiguities”2.

Therefore, every subject has a legitimate expectation that legal norms in effect applied in his/her respect meet the abovementioned requirement and their legal status and content providing for the rights and duties of a person are understood universally unambiguously at the moment of the formation of a legal relation.

The issue of the vulnerability of the principle of legal certainty is especially relevant in analysing direct and indirect effect of EU directives. Pursuant to Article 288 of the Treaty on the Functioning of the European Union, a directive is an act of indirect effect the addressees of which are the Member States. National authorities enjoy the discretion to choose the form and methods of the implementation of a directive. Even though in the primary EU law an imperative obligation to implement the provisions of a directive properly and in time is formed, the implementation is usually late or improper. In pursuance of the effectiveness of EU law in the Member States, the Court of Justice has established the doctrines of direct and indirect effect of EU directives that should, seemingly, solve the problem of securing the principle of the effet utile of the EU law in the Member States. However, the ambiguity of the case-law of the Court of Justice related to the possible horizontal effect of the directives leads to a number of questions: whether the doctrine of indirect effect is compatible with the principle of legal certainty; whether the obligation to avoid the application of a legal norm in conflict with EU law does not mean its direct effect; whether in the present stage of the development of EU law one may speak about direct horizontal effect of the directives.


Compatibility between the doctrine of indirect effect and the principle of legal certainty

According to the classical model, an EU directive can have a direct effect if the conditions of direct effect are satisfied and the relation is vertical, i.e. between a private person and the state. Although the Court of Justice provides a rather wide definition of the notion “state”, this doctrine is not sufficient to reach the effectiveness and efficiency of EU law in the Member States. Despite experiencing “pressure” from Advocates-General as well as legal scholars regarding the possibility for the directives to have a direct horizontal effect, the Court of Justice upholds the position formed as early as in the Marshall case: “<...> a directive may not be relied upon against an individual, it must be emphasized that according to article 189 (now article 288) of the EEC treaty the binding nature of a directive, which constitutes the basis for the possibility of relying on the directive before a national court, exists only in relation to 'each Member State to which it is addressed'. It follows that a directive may not of itself impose obligations on an individual and that a provision of a directive may not be relied upon as such against such a person”¹.

Such a position of the Court of Justice is aimed at indirectly “punishing” Member States for failure to fulfil the duties arising from EU law, i.e. failure to implement the directives. Precisely against the state that is responsible for proper and timely implementation of a directive. Furthermore, the Court of Justice emphasises the specific nature of a directive that does not allow directly imposing obligations on private subjects, because this power of the EU is exercised through passing acts of direct effect – regulations. In this way, the Court of Justice seeks to avoid violations of the principle of legal certainty and legitimate expectations of individuals. However, further steps of the Court of Justice in establishing and developing the doctrine of the indirect effect of EU directives gives rise to new discussions.

In order to ensure a uniform functioning of the system of EU law in the Member States, the Court of Justice, in the judgement in the Von Colson and Kamann² case, established the doctrine of the indirect effect of directives, i.e. the obligation for national courts to interpret national law in the light of the wording and purpose of a directive. In the sense of the effectiveness of EU law, such a judgement of the Court of Justice is to be evaluated positively. However, having in mind that this doctrine is to be applied to relations between private subjects as well, a question whether in this way the principle of legal certainty is not violated arises.

In developing this doctrine, the Court of Justice also formulated certain “protectors” by claiming that a national court may apply methods of interpretation allowed under the national law³; however, the limitations to the obligation to interpret a

³ It is suggested that for the purposes of legal certainty national courts, when interpreting national law in compliance with EU directive, shall clearly indicate the methods of interpretation of law they employ.
domestic law in an appropriate manner are set by the general principles of law – firstly, the principle of legal certainty – and, in particular, in the sense that this obligation cannot serve as a basis for an interpretation contra legem of national law. The Court of Justice in its case-law most clearly stated certain limitations of the effect of this doctrine in criminal cases: when Member States rely on the directive against an individual in a criminal procedure, a directive cannot, of itself and independently of a national law adopted by a Member State for its implementation, determine or aggravate the liability in criminal law of persons who act in contravention of the provisions of that directive. Therefore, the obligation to interpret a harmonised national legal act can be fulfilled if it does not have the effect of determining or aggravating criminal liability of a private subject. Such an argumentation of the Court of Justice does not raise any additional questions, as it is compatible with national systems of criminal law.

Still, not without a reason a question whether on the whole the doctrine of indirect effect can function in civil relations between two private subjects arises. After all, the fact that a national court, on the basis of the principle of loyal cooperation, will interpret national law in conformity with an EU directive may grant a right to one of the subjects and impose an obligation on the other. Is that compatible with the principle of legal certainty?

In 2012, in its judgement in the Dominguez case, the Court of Justice as if tried to add clarity to the doctrines of the functioning of directives and interrelation between these doctrines. The Court of Justice in answering the questions of a national court step by step frames the scheme of the functioning of a national court. First of all, it formulates an obligation for the national court to interpret the whole national law, especially Article L.223-4 of the Code du travail, applying the methods of interpretation recognised by national law with a view to ensuring the effectiveness of Directive 2003/88 and passing a judgement that would be consistent with the pursued objective. Furthermore, the court must determine whether it can find an interpretation of that law that allows the absence of the worker due to an accident on the journey to work to be treated as being equivalent to one of the situations covered by that article of the Code du travail. Of course, the Court of Justice, even being aware of the provisions of national law, does not interfere with the jurisdiction of the national court and does not comment on whether it is possible to interpret national law in conformity with the provisions of the directive. However,
knowing that the legal dispute involves two private subjects, it does not claim that such an interpretation is impossible. Therefore, even despite the consistent denial of the possibility of direct horizontal effect of directives by the Court of Justice, the application of doctrines of indirect effect in a horizontal relation remains problematic, as in the case when a national legal norm takes the content of a directive it can have the same legal consequences as the direct effect of directives. Thus direct horizontal effect of directives is as if brought through the back door, as Craig insightfully noticed and called it the “indirect direct effect of directives”.¹

Noteworthy is the fact that for the courts of final instance of Lithuania the doctrine of indirect effect of directives is known; however, its actual application is rather exceptional. Usually, national courts limit themselves to quoting the definition of the doctrines of the effect of EU directives but lack determination in interpreting provisions of national law in conformity with an EU directive.² Moreover, a national court usually does not identify the methods of interpretation. Presumably, national courts, in interpreting national law in conformity with an EU directive, should, for the sake of legal certainty, clearly identify the methods of interpretation that are followed and, if the interpretation of law is not effective in achieving the set objectives, provide well-grounded reasoning.³

**Compatibility between the obligation to disregard national provisions that are in conflict with EU law and the principle of legal certainty: Mangold approach**

Under the case-law of the Court of Justice, “<...> it is the responsibility of the national court <...> to provide, in a case within its jurisdiction, the legal protection which individuals derive from the rules of Community law and to ensure that those rules are fully effective, setting aside any provision of national law which may conflict with that law”.⁴

When analysing the case-law of the Court of Justice, a reasoned question whether a national court must avoid the application of a national provision if it is in conflict with any source of EU law, arises. As an example one could take the Mangold case dealing with a dispute between an employee and an employer, practicing as a lawyer, regarding a fixed-term contract of employment concluded with the employee, then 56 years old, on the

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² For the purposes of this research analysis of case-law of the Supreme Court of Lithuania and Supreme Administrative Court of Lithuania from 2008 to 2013 was conducted. It is noteworthy that ruling of Supreme Court of Lithuania of 5 April 2011 in the civil case *UAB „Smulkus urmas“ v. Plungės rajono savivaldybės administracija*, No. 3K-3-155/2011, analysis the meaning and practical problems of application of indirect effect of the directives.


basis of national law providing for a possibility to conclude fixed-term contracts of employment with older workers. The European Commission suggested avoiding the application of the controversial national provision even if it is accepted as being in conflict with the directive before the expiry of the period for the transposition of the directive. If the initial formula of the judgement was that it is possible to refer to the directive before the expiry of the period for its transposition in cases between two private subjects, a question whether such a rule is compatible with the principles of legal certainty and legitimate expectations may arise. However, the Court of Justice in its first comment on the principle of non-discrimination on the grounds of age as a general principle of EU law established in a directive, chose a different formulation: “it is the responsibility of the national court to guarantee the full effectiveness of the general principle of non-discrimination in respect of age, setting aside any provision of national law which may conflict with Community law, even where the period prescribed for transposition of that directive has not yet expired”.

Even though precisely in the Mangold judgement the Court of Justice provided an impetus for discussions on the possible direct horizontal effect of a directive when a national legal act that is in conflict with the said directive is not applied (“negative”, “non-application” or exclusionary effect), the remaining doubts were dispelled by the judgement of the Court of Justice in the Küçükdeveci case. The Court of Justice cited the much criticised Mangold judgement; however, its comment was clearer and the obligation to disregard a conflicting national provision was related to the contradiction with the general principle of EU law rather than the directive itself. Still it is unclear whether this principle is as clear and unconditional as to have a direct effect in horizontal relations.

More clarity regarding the obligation to avoid the application of a conflicting national provision was brought in the Dominguez judgement, where the Court of Justice stated that it is for the national court to determine the legal nature of the respondent in the main proceedings. If it suits the definition of a “state”, “as Article 7 of Directive 2003/88 fulfils the conditions required to produce a direct effect, the consequence would be that the national court would have to disregard any conflicting national provision [italics added]. If that is not the case, it should be borne in mind that even a clear, precise and unconditional provision of a directive seeking to confer rights or impose obligations on individuals cannot of itself apply in proceedings exclusively between private parties.” In such a situation, the party injured as a result of domestic law not being in conformity

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1 See the Opinion of AG A. Tizzano in Case C-144/04 Mangold [2005] ECR I-9981, paragraphs 102-111.
3 Case C-144/04 Mangold [2005] ECR I-9981, paragraph 78.
5 Case C-282/10 Dominguez [2012] not reported yet, paragraphs 41-42.
with European Union law could nonetheless, relying on the doctrine of state liability, go to the national court and file a lawsuit against the state in order to obtain compensation for the loss sustained.

Such a line of the argumentation of the Court of Justice allows concluding that the obligation to disregard any conflicting national provision is not absolute. In order to carry out a revision of the conformity of national law with EU law, one should, first of all, determine the status of a legal norm of the EU law. To create the obligation to disregard any conflicting national provision, the norm under consideration must be clear, unconditional and of direct effect. On the basis of the fact that in this sphere the case-law of the Court of Justice is casuistic, a national court may easily follow the obligation to disregard any conflicting national provision when the status of the norm of EU law is clear. In case of a doubt, the national court should ask for a preliminary ruling.

However, it is possible to claim that the judgement in the Mangold case can be approached form the positive side, as the naming of the principle of non-discrimination on the grounds of age a general principle of law allows a private subject to defend its violated rights in respect of another private subject. Still one cannot deny that the legal certainty of the respondent was violated. The existence of such a principle could not a priori be known to and its content perceived by the respondent and, therefore, he could not have acted following the requirements of the principle instead of the national law in effect. Furthermore, even more doubts regarding the legitimate expectation of an individual to know the scope of his/her rights and obligations are raised by the judgement of the Court of Justice in the Römer case, where it was stated that an individual can refer to the right of non-discrimination on the grounds of sexual orientation only from the expiry of the period for the transposition of the directive which concerns the said principle. Such a position of the Court of Justice creates an ambiguous situation regarding the prospects of the development of the status of other principles of law.

A “different” horizontal effect of directives

Even though Advocates-General have put effort to expand the conditions for the direct effect of directives, the Court of Justice continued upholding the position that provisions of directives cannot be applied against private persons. Some confusion was caused by the judgements of the Court of Justice in the CIA Security and

1 The directive can have also preclusive effect: the directive precludes the application of a national provision contrary to it in horizontal relationship without imposing any obligations on individuals. See Case C-215/97 Bellone [1998] ECR I-2191; Case C-456/98 Centrosteele [2000] ECR I-6007.


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Unilever cases. These judgements, in legal literature and conclusions by Advocates-General, are usually presented as judgements in which the possibility to apply directives in proceedings between private parties in order to avoid the application of conflicting national law is recognised. However, this is not exactly the case. The Unilever case can serve as an example. A dispute between companies regarding oil supplied by Unilever for Central Food was heard at a national court. Central Food refused to pay for the goods claiming that the origin of the oil supplied to it was not labelled in accordance with the Italian legal acts. Then Unilever filed a lawsuit requiring Central Food to pay for the goods and claiming that national provisions must not be applied because the European Commission imposed an obligation to postpone their application (procedural aspect). This concerns the requirement for the Member States to immediately communicate to the European Commission any draft technical regulation (for example, related to requirements for product safety, dimensions, name, marking and labelling, etc.) before its adoption formulated in Directive 89/189. The Court of Justice, similarly to the CIA Security case, held that there was a procedural defect. The difference is that in the first case (CIA Security), the relation between the companies was non-contractual and the state breached the rule of the procedure for the provision of information, while in the second case (Unilever) the relation was contractual and the rule of the implementation of the procedure, i.e. the obligation to postpone the adoption of a draft technical regulation, was breached. The outcome of such a violation is the disregard of a national legal act (technical regulation) that obviously causes negative consequences for one of the parties to the proceedings due to the failure of the state to properly implement procedural requirements set by a directive.

A reasonable question arises: why the strict rule of the Marshall case that a directive can never impose obligations on private persons is not applied in this case? The Court of Justice, disregarding the critical positions of Member States and the Advocate-General, held that the rule of Marshall and Faccini Dori case-law does not apply when there is a substantial procedural defect [italics added] and thus draws a line between directives that create rights and obligations for private subjects and directives that set procedural requirements for Member States. Therefore, a procedural defect renders a technical regulation inapplicable. So Central Food which under national law had the right to refuse accepting the goods, following EU law is under an obligation to accept it. Even though this may not be called direct effect in the classical sense, but it is very close

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to that considering its impact on private subjects. A directive that is not implemented has an impact on a private subject; it alters the situation of Central Food\(^1\).

The application of such a rule formulated by the Court of Justice in proceedings between two private parties is hardly justifiable. In the CIA Security case, this rule was applied for the first time and private subjects had no possibilities to a priori foresee such interpretation of law. In the long-term perspective, there remains the possibility of the violation of the principle of legal certainty, as a complicated task falls on a private person: to realise whether particular legal act is a technical regulation falling within the scope of the regulation of the directive, whether the state had to notify the European Commission about draft regulation, whether the procedure for the notification was carried put properly, whether in a specific case the national provision must be disregarded, how the question regarding a breach of a contract entered into by two private parties should be resolved in the case of the absence of the guilt of one of the parties to the contract. In order to protect the legal certainty of private subjects to the greatest possible extent, Advocate-General Jacobs suggested setting as strict as possible limitations on the scope of exceptions to the Faccini Dori rule\(^2\).

The application of such a rule formulated by the Court of Justice may become a real challenge in the national legal systems. Case-law is where the problem aspects of this rule of the Court of Justice manifest themselves most clearly. Further on, an example of the legislation of the Republic of Lithuania constituting a procedural defect is presented.

On 23 December 2011 the Seimas of the Republic of Lithuania adopted the Law on Modifications of and Amendments to the Articles 2, 3, 18, 22, 34 of the Law on Alcohol Control\(^3\) (hereinafter referred to as the Law) which since 1 January 2013 prohibits the sale of beer, cider, beer blends with non-alcoholic beverages, alcoholic cocktails bottled in packaging of more than 1 litre in retail sales outlets as well as beverages of the above types the ethyl alcohol strength of which by volume exceeds 7.5 percent in the Republic of Lithuania. In this case such a regulation can be analysed as a restriction within the context of free movement of goods and the soundness of restriction is to be assessed by the European Commission; however, a more important issue within the context of this research is that the requirement to notify the European Commission has not been satisfied. Under Article 8 of the Directive 98/34/EB\(^4\) of the European Parliament and of the Council of 22 June 1998 laying down a procedure for the provision of information in the field of technical standards and regulations, the state must notify the European Commission of any draft technical regulation. In the case being analysed, the Law on Amendments to the Law on Alcohol Control which prohibits the sale of alcoholic beverages bottled in certain packaging and containing certain ethyl alcohol strength is to be considered as a technical regulation. The European Commission has not been notified

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of its provisions; therefore, a procedural breach has been committed due to which the Law on Amendments to the Law on Alcohol Control must not be applied.

In a particular case, after the receipt of the complaint against the above Law the European Commission drew attention to the already analysed case-law of the Court of Justice in the CIA Security case and noted that in the presence of a procedural breach these national provisions do not apply to private entities. Although according to the doctrine of the supremacy of EU legislation the Law cannot be applied due to the procedural breach committed, the Law is in effect until it is acknowledged to be null and void. Moreover, despite the fact that the Law conflicts with EU legislation, administrative authorities require to comply with the established restrictions of sale. In fact, the solution of this legal situation is in the hands of the legislative authority. It should be noted that there was an attempt to correct the situation and on 25 April 2013 the Revision of the Law on Amendments to the Article 18 of the Law on Alcohol Control which narrows the scope of application of prohibition established in the valid Law on Alcohol Control (the prohibition would not apply to alcoholic beverages bottled in glass, ceramic, wooden or metal packaging) has been adopted on the initiative of the group of the member of the Seimas. However, the obligation to notify is considered to have been breached again because on 24 April 2013 during a meeting the Committee on Health Affairs of the Seimas of the Republic of Lithuania approved the obligation to notify the European Commission of such a Revision and on 25 April 2013 the Revision was adopted during the plenary meeting of the Seimas. Taking into account the fact that the obligation to notify of a draft technical regulation appears in the preparatory stage when essential modifications can still be made, doubts regarding proper fulfilment of the obligation to notify arise.

The essential legal problem is that national entities, including public supervisory authorities, apply national law provisions being in effect, though they should not be applied due to procedural breaches committed. Accordingly, brewers which are subject to restrictions incur losses and could require compensation for losses from Lithuania. In addition, taking into account the fact that such a breach is continuous, i.e. the entity continues to incur losses due to the application of such national provisions, it would be quite logical to ask for provisional measures in court – to suspend the application of such a legal act until the settlement of the issue on its compliance with EU legislation.

Conclusions

The application of the doctrine of indirect effect of directives in horizontal relations by a national court may violate the principle of legal certainty if the national court, in interpreting national law in conformity with the objectives and the content of a directive, brings the content of the directive imposing obligations on private subjects into the national provision.

The obligation to disregard a conflicting national provision is not absolute. A provision of EU law must satisfy the conditions of direct effect (must be clear and unconditional). Provisions of EU treaties and general principles of EU law satisfying these conditions may determine the implementation of the obligation to disregard a conflicting national provision in horizontal relations as well. In case of a conflict with EU directive, such obligation arises only in vertical relations. With reference to the fact that the case-law of the Court of Justice in this case is casuistic, in case of any ambiguity a national court should ask for a preliminary ruling by the Court of Justice.

According to the classical rule of the *Marshall* case, a directive may not itself impose obligations on a private subject. However, after the judgement in the *CIA Security* and *Unilever* cases, it is necessary to separately consider directives that provide for the rights and obligations of private subjects that must be transposed into national law and directives that set procedural requirements for the states in adopting technical regulations (rules). Although the Court of Justice has drawn a clear line between different types of directives, a private subject is left in a situation of legal uncertainty. Even following the national provisions in effect, it may come out that they are inapplicable because of being adopted by violating the procedure for notification established in the directive.

Considering the fact that the case-law of the Court of Justice is multiple and sometimes ambiguous, it is to be claimed that proposal of acceptance of the possibility for a directive, satisfying the conditions of direct effect, to have a direct horizontal effect possibly could allow solving the currently relevant problem issues regarding the violation of the principle of legal certainty.

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COUNTRIES’ SUSTAINABILITY TO ECONOMIC SHOCKS: 
THE STUDY OF CENTRAL AND EASTERN EUROPEAN MARKETS

Arturas Jurgelevicius

University of Applied Sciences, Lithuania
jurgeleviciusarturas@yahoo.co.uk

Abstract

Purpose – to analyze economic “shock” impact on Central and Eastern European countries’ sustainable economic development.

Design/methodology/approach – Statistical data has been analyzed and sustainability theory has been applied to Central and Eastern European countries during economic downturn 2008 – 2012.

Findings – Findings suggest that commonly used macroeconomic indicators do not reflect stable social economic development. Moreover, usually high economic growth during economic cycle is determent by high level of recession in economic cycle. This finding suggests that investors and other financial decision makers should take into account the sustainability of economic performance before taking financial decisions so that during financial economic recession could mitigate risks and loses in Central and Eastern European markets. Also the impact of intangible capital on countries’ sustainability was identified. There is a relationship between social and economic sustainability and intangible capital.

Research limitations/implications – Research is applied in the theory of sustainable economic development. The economic and social performance is being considered in the research. Although the concept of sustainable economic development is quite controversial in scientific literature, the aspects of economic and social indicators are taken into account not considering much of ecological aspects of sustainable development. The research logic is based on sustainability as constant and smooth social and economic development than the development through natural limitations and human being needs combinations.

Practical implications – Practical implications might be broad enough. Identification of reaction of economies to natural economic “shock” during economic downturn might be applied for governments decision makers, investors, banks, exporters to evaluate future economic financial decisions in Eastern and Central European markets.

Originality/Value – Value of the research might be high for interested parties. Applying sustainability theory to economies in transition during financial economic downturn 2008-2012 is original and novel.

Keywords: economic development, sustainability, economic “shock”, Central and Eastern Europe.

Research type: research paper.
Introduction

The first decade of the third millennium was marked by fruitful events for economists. Most of the growth in the West was explained by real estate bubbles but not by the improvements in sustained productivity. Economic growth was followed by deep recession bringing new lessons to be learnt about economic processes and economic regulations. In the light of the economic downturn R. Shiller was awarded by Nobel prize in economics. The main idea of his research was that formal and informal institutions are not capable to regulate economic processes basically financial markets. In the context of sustainable development theory, in the paper sustainable economic system is treated as that system which is able not to diminish its wealthier during economic recession. In this way social and economic indicators are being analyzed in Central and Eastern European countries which response to economic shocks are undiscovered well yet. Central and Eastern European countries considered to be still the economies in transition because many social and economic indicators did not achieve the development level of advanced western markets neither in qualitative nor quantitative approach.

The economies in transition have been chosen for methodological matters. The economies are taken into account by analyzing social and economic indicators which should assess the performance of the economies during economic recession. Statistical analyses and econometric estimations are used in the research.

The concept of sustainable economic development

The sustainable economic development concept is widely spread and controversial concept in scientific literature. Classical understanding of economic development mainly related to economic growth and more or less equal involvement in economic activities of different social groups. Sustainable economic development concept is a relatively new concept in economic thought of history. In 1997, United Nations declared that development is a multidimensional undertaking to achieve a higher quality of life for all people economic development, social development and environmental protection are interdependent and mutually reinforcing components of sustainable development (United Nations, 1997). World Bank reported that sustainable development is the “development that continues” (World Development Report, 1992). Brundtland commission (1987) stated that sustainable development is the kind of development which satisfies the current needs without endangering the future generations to satisfy their own. The limited social, human, financial, produced and natural capital have to be used in a way that the future generations could not face with development restrictions because of previous generations’ activities. However, the essential point of market economy remains economic growth and assets or capital creation. The sustainability concept started to be discussed not only in economic but social, natural, human dimensions as well. Thus, sustainable development is not about a choice between environmental protection and social progress, but rather
more about striving for economic and social development that would be compatible with environmental protection (Ciegis et al, 2009).

The sustainable economic development put emphasis on “needs” and “limitations”. Needs are understandable as needs of combination of present and future generations and limitations are understandable as save consumption of present generation. Needs and limitations closely associated with production and consumption. Increased welfare in society demands new and better products that increase incentives for enterprises more to produce. In this place efficiency in society and economy is crucial (Rutkauskas, 2012). However, the use of natural resources might be put in different consideration in different economic structure societies. More service produce societies have more intensive for human and capital usage since these societies have already gained certain capital ratio in the market. In this case, such societies are more concerned about effective usage its educational systems, trainings and service sectors. Less developed or developing countries put emphasis more on usage of natural capital since market capital ratio might be relatively low.

Sustainable economic development provides with a few criteria – sustainable consumption (Repetto, 1986), the level of utility of society cannot be diminishing in time (Pezzey, 1992). This concept is a complex notion and treated by different authors differently. On one hand, sustainability provides various indicators and contributes to competitiveness on the given country (Balkyte et al., Tvaronaviciene, 2010). Also sustainability might be considered as sustained economic system and sustained governance (A. V. Rutkauskas et al., 2012).

However, the critics of sustainable economic development stress that the concept itself is vague, there are much of contradictions (Ruchi, 2009). Some authors suggest that sufficiency should be a goal but not efficiency (Lankauskiene et al., 2012). An economic growth should be combined with development, quantitative change with qualitative change (Du Pisani et al., 2006).

As mentioned above a number of literature provides three fundamental dimensions of sustainable economic development: economic, social and environmental (Pierantoni, 2004; Ciegis, Zeleniute, 2008; Ghosh, 2008; European Commision, 2009).

The economic sustainability concept is based upon Solow’s (1986, 1993) theoretical approach on capital convertibility and Hicks-Lindahl concept of maximum income which can be acquired by saving essential wealth (capital) resources for the benefit of future generations (implementing the principle of fair distribution among generations). Social sustainability seeks to reduce vulnerability and maintain the health of social and cultural systems, and their ability to withstand economic shocks (Chambers, 1989; Bohle et al., 1994; Ribot et al., 1996). Nerveless estimation of social capital raises many challenges. Different studies suggest with strong evidence that social capital is crucial element for socio-economic system stability. Sustained social capital resists to economic shocks, downturns and different economic financial crisis remaining the entire economic system stable.

Commonly used indicators should gain more qualitative approach rather than only quantitative approach, for example, GDP. For measuring sustainable development Commission suggests pay more attention on following criteria: real per capita produced capital rate, savings and consumption or income ratio, human development index, life expectancy, quality of living, social exclusion and people at risk of poverty, employment, etc.

The Specificity of development of Central and Easter European countries for the last 25 years

In Lithuania as in other Central and Eastern European countries without long discussions the neoliberal imitation to transformation was chosen for transition from centrally planned economy to market economy. Imitational orientation means that Western economic models were trying to adopt and neoliberalisation – associated with deregulation process almost in all fields of economic activities. That is to say in the beginning of the privatization process two thirds of state owned capital was privatized only in two years. According to many scholars, privatization should be the last stage of transition to market economy, only then when market economy institutes are created: social capital, human capital, rule of law, social trust, entrepreneurship skills, taxation system, etc. (Marangos, 2005). Of course, these processes take place decades as well as transition to market economy and require certain preconditions. Unfortunately at the time, political elite, some economists and probably the most important society were dreaming that neoliberal economic model would bring by itself (probably society was persuaded by Adam Smith’s “invisible hand” panacea and governing elite by strong international financial institutions pressure) fast transition to market economy, achieving Western economic indicators and quality of living for all social groups.

Extensively developed economy in Soviet Union collapsed and perhaps it was the main reason of it. It was necessary to direct the economy to free market oriented model of development and it was impossible without elimination of old political system (Kornai, 1995).

After the collapse of enormous and extremely difficult social and economic system mainly two approaches were possible for transition to liberal market economy: „gradualist“ approach or “step by step” or „shock therapy“ or extremely rapid destroy of old social and economic structures and provision to liberal market economy’s „invisible hand“. According to Nobel prize laureate Joe Stiglitz “invisible hand” is invisible because it is not there. Gradual transformation dominated in Belarus, Central Asia, in Russia after 2000, for some time in Bulgaria and Rumania.


After the collapse of planned market economy every country had to adopt to new market rules and specifications. It was almost impossible to make the right decisions not
only for politicians but economists as well. Every post-communist country choose its own path on the way to market economy. After 25 years of colourful changes the author of the article think that it is the right time to make some assessment on processes that were controversial at that time through sustainable economic development approach.

1 table shows the dynamic of global competitiveness index presented by World’s Economic Forum. That is to say three Baltic states were not taken into account in 2000. The number of assessed countries was expanded from 58 in 2000 to 148 in 2014. The methodology of global competitiveness index was reviewed a few times during analysed period but the authors of the article make assessment in the framework of officially provided methodology. Comparing global competitiveness index 2000 and 2014 the significant change is determined. Only one country’s (Lithuanian) competitiveness has improved over 14th years. Some others’ competitiveness index have slightly deteriorated (Poland, Estonia). Two of transition countries’ competitiveness has fallen by 10 positions (Latvia, Check Republic). Other countries’ in transition competitiveness have fallen more than double behind more than 30 additional countries (Hungary, Slovak Republic). How Lithuania has remained its competitiveness over 14 years while other countries’ competitiveness deteriorated and some of them deteriorated a lot?

Table 1. The dynamics of the global competitiveness index

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Notice: in 2000 global competitiveness ranking was estimated out of 58 countries comparing with 148 countries in 2014

Chart 1 shows GDP per capita in PPP 2005 comparing 2011 on data available in United Nations Development Programme’s database. As mentioned before essential premise of sustainable economic development states that capital should increase in time. Hungary, Latvia, Estonia and Lithuania have slightly increased their GDP per capita in PPP during 2005-2011. Meanwhile Slovenia, Czech Republic, Slovakia and Poland could be grouped as countries in CEE that made relatively high progress accumulating capital during financial economic downturn.
Baltic countries real GDP growth rates were the highest ones in all European Union estimating the growth of 7-8% rate on average. Accession to EU encouraged FDI in all countries. However the Baltic states were not exception among other countries. That is to say the growth was based on housing credits and supporting export initiatives very hardly investing in new technologies and innovations. Because of deep financial downturn in 2008-2009 Baltic states experienced one of the highest falling GDP rate in EU – Lithuania 17%, Estonia 14%, Latvia 18%. Only Poland remained a country which did not experience recession and during the peak of financial downturn Poland’s GDP growth rate was 1%. That is to say, Poland’s government twice devaluated zloty that made polish export competitive in European markets. Separate from Poland, Lithuania did not have even theoretical chance to devaluate Lithuanian Litas because of its exchange linking to Currency Board model. However, Baltic states sustainability considered as stability might be said that is poor enough accounting the highest GDP drop among CEE countries and EU-28. In this perspective short term investment are risky enough in these types of countries. However the Baltic states had recovered faster than any other CEE country and experienced one of the highest rates of growth in EU-28.
Chart 3 indicates the unemployment increase. Again the Baltic states demonstrated the highest absolute unemployment rates achieving from 16% up to 19% of all active labour force in the labour market. Extremely high level of labour forces demonstrates that economy is unstable and unsustainable since economic fluctuations directly reduce wellbeing in society. According to Chart 3 the highest unemployment rate change is seen in Estonia, Lithuania, Latvia, respectively 206%, 205%, 148% from the level being before financial downturn to its bottom line of the fall.

Source: Eurostat database, 2014

**Figure 3. Unemployment rate increase during downturn peak**

Moderate loss of labour force in the labour market in Czech Republic, Poland, Hungary, Slovak Republic and Slovenia could be explained by their capability to adopt to economic “shocks”. Also the great change in employment represents the quality of workforce skills, trainings, outcomes of educational system (International Labour Office, 2010). Qualitative educational and training systems in the country encourage workforce for innovations, better investments and business management in general. High level of unemployment contradicts to sustainable development concept’s premise that national capital should increase over time. High rate of unemployment restricts potential economic growth, does pressure on public finances and most important long term unemployment might cause mental or psychological problems. Another negative aspect of unemployment is that higher workforce supply reduce nominal wages of qualified workers. In a short period this phenomena might bring competitive advantage on cost, however, in a long period workers will lose their initiatives for more productive work. As it is seen from Chart 4 and 3 all three Baltic states has the highest rate of unemployment and unemployment rate change since the beginning of crisis till the pick of downturn of it.
Figure 4. Unemployment rate change comparing 2008 vs 2010

Chart 5 presents relationship between unemployment change and government spending on education. However, graphs shows opposite relations to expected – statistical correlation contradicts to thesis that the more government spends on education the more sustainable workforce is. However, the distortion of correlation might suggest that there is significant impact of efficiency of government. Some studies suggest that the efficiency of government is one of the main tools for implementing policies. The Baltic States and other CEE countries have poor government efficiency (The Strategy of Europe, 2012).

Figure 5. Workforce sustainability dependency on government spending on education

Human Development Index (HDI) estimated by United Nations could be analysed in Chart 6. It is seen that countries with less unemployment rate have higher level of HDI. Even though, there is a trend that all CEE countries have improved their social and economic development and all might be grouped as high developed countries, the
difference among them still exists. Slovenia has one of the smallest rate of unemployment and GDP downturn as well as Czech Republic. Latvia, Lithuania and Poland has the lowest rate of HDI making a progress in 7 years just for 0,02 HDI points.

Figure 6. Human Development Index dynamics in CEE countries

As seen from Chart 7, there is a correlation between Human Development Index and Unemployment ratio change since the beginning of economic downturn till its pick. Lithuania and Latvia have the highest unemployment rate of change and the least HDI, respectively 0,81 and 0,805. Poland, Hungary and Slovakia grouped as low unemployment rate change countries having high HDI. Czech Republic and Slovakia are grouped as the highest HDI ranking countries having the one of the lowest rates of
unemployment change. So it could be concluded that human development matters for labour sustainability as well as for economic development as well.

Conclusions

The research suggests following conclusion. CEE countries could be grouped in three main blocs. The first block of countries might be considered as able to resist to economic downturn saving relatively low social and economic losses during financial economic downturns. These countries are: Slovenia and Czech Republic. Another group of CEE countries are countries which have medium ability to adopt themselves to economic “shocks” and sustain social economic development: Hungary, Poland, Slovak Republic. The third group of countries that easily linked to economic and social fluctuations and less to resistance to economic “shocks” are the Baltic States: Lithuania, Latvia and Estonia. The amplitude of fluctuations of their social and economic parameters is the most radical among CEE countries.

The research suggests that intangible capital (social capital, human capital, institutional capital) is a significant component in the development of the countries as economic “shocks” mitigating factor. Economies that have higher level of intangible capital accumulation are more likely to bring less social, economic and financial loses during economic cycle’s recession period. However, the research field is relatively new and forward studies must be carried out for deeper understanding of intangible capital impact on countries’ sustainable development and ability to resist to economic “shocks”.

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A G20 Training Strategy.


EVOLUTION OF CUSTOMS LAW IN LITHUANIA AFTER THE ENTRY TO THE EUROPEAN UNION: TEN YEARS OF EXPERIENCE

Gediminas Valantiejus

Mykolas Romeris University, Lithuania
gvalantiejus@gmail.com

Abstract

**Purpose** – the aim of this article is to overview practical experience and problems of implementation of the European Union customs law requirements in Lithuanian national legal system after the accession to the European Union both at the level of application of law and at the level of law making.

**Design/methodology/approach** – analysis of relevant issues is based both on theoretical (analysis and synthesis, historical, systematic, comparative) and empirical methods (statistical analysis of data, analysis of documents, generalization of professional practice, in particular – practice of the courts). The article consists of an introduction, three chapters and conclusions.

**Findings** – becoming a member of the European Union, Lithuania has become a part of common market in which the free movement of goods, services, capital and people is established. The entry into force and direct application of the European Union regulations, in some cases, the European Union directives, has created a challenge for national courts to ensure uniform application of the European Union customs law. These process didn't create static legal environment in the area regulated by customs law as there is also a need for some further changes in customs legislation, including preparation of its official commentaries.

**Research limitations/implications** – article gives insights on changes in legal regulations of customs law in Lithuania and practice (case law) of their application since the entry of Lithuanian Republic to the European Union (yrs. 2004-2014).

**Practical implications** – article presents proposals for the improvement of current customs legislation, evaluates national Lithuanian experience of ensuring direct and effective application of European Union customs law and solving various other problems which was encountered by the customs after the entry to the European Union.

**Originality/Value** – article presents theoretical and practical legal problems of the recent changes and evolution of national customs law, which are not discussed in the Lithuanian legal doctrine and specific academic legal literature since all the main analysis was done before preparations to enter the European Union or immediately after the entry to the Union.

Article also discusses the main elements of concept and idea of the separate branch of customs law in Lithuanian and foreign legal doctrine since overall evaluations of importance and place of customs law in the overall system of law ranges from customs law as merely the institute of national administrative or finance law or relatively distinct branch of national legal regulations (Raišutis, 2005; Sudavičius, Medelienė, 2011), to separate branch of European Union
and international law (Lyons, 2005) or even the separate institute of trade law (trade regulation; Thuronyi, 2003).

Keywords: customs authorities, customs law, EU Customs Code, international trade, free movement of goods and services.

Research type: research paper.

Introduction

National customs policy play a crucial role not only in ensuring the national financial, fiscal and budgetary interests, the safeguarding of the state borders. European Union (further in the text – EU) customs policy is based on the ensuring of free movement of goods, persons, services and capital between the Member States. Republic of Lithuania became the member of the EU since 1st of May, 2004. This process has triggered many major changes in the national legal system, including legal regulation of customs policy, since Lithuania started the direct application of the Community Customs Code (further in the text – CCC) and other EU customs legislation, adopted the new version of the Law on Customs, regulating customs, their enforcement, duties and obligations of customs officials as well as rights and responsibilities of other persons concerned. Since the 1st of May, 2004 the new version of the Law on Tax Administration has also entered into force setting additional duties of the customs authorities to conduct certain functions of tax administration under this Law.

Following these recent changes national customs legislation establishes certain obligations for individuals (taxpayers) to carry out certain customs procedures in accordance with the laws of the EU customs legislation and defines the procedures which are carried out in order to calculate and pay the declared customs and other duties administered by customs authorities. The compliance of these procedures to the EU law ensures proper contribution of the national fiscal policies to the common EU customs policy. So after joining the European Union, no less important task is to organize the activities of customs authorities so that the proper implementation of the CCC and other customs legislation would be ensured at the same time without impeding legitimate business interests. Therefore, the aim of this article is 1) to define customs law as a legal institute and its place in the system of law; 2) to describe its place and importance in EU law and in particular – in Lithuania after the entry to the EU; 3) to summarize experience of Lithuania in transforming of its customs law according to EU requirements and to define achievements and challenges which may lie ahead.

For this reason various scientific methods were used (from the methodological point of view) – the first chapter of the article is based on comparative analysis of the concept of customs law in various countries, the second chapter is based on theoretical analysis of documents and legal doctrines which defines the place and the role of the customs law in Lithuania and the EU, and the third part includes generalization of professional practice and statistical analysis of data which describes transformations of the customs law in Lithuania after the entry to the EU.
Concept of customs law - an international perspective

Customs duties are taxes levied on the goods or personal use items which crosses the state border. According to its economic and legal nature customs are certain type of indirect taxes (consumption taxes) collected to the state from residents as part of their income when residents are buying essential goods. It’s necessary to mention, that customs are one of the oldest types of taxes as these fees were paid in ancient Egypt, the Roman Empire, Greece and China. Such duties were widely applied in Europe in the Middle Ages, as well as in the Grand Duchy of Lithuania. The most common customs types were as following: 1) customs on the imported goods, 2) customs on the exported goods, and 3) customs on goods in transit (transportation through the territory of the state). Accordingly customs duties have, of course, been a significant feature of commercial life for a long time (Lyons, 2005).

In present day terms, many countries of the world have renounced transit duties and are striving to increase transit of goods, because it ensures the better use of transportation systems, and the ability to get more revenue from transportation services. For this reason, under present conditions, the states usually does not complicate transit procedures with customs but often even promotes transit with various incentives. Customs on the exported goods are also narrowly applied as usually exported goods are not subject to any customs duties (Puškevičiūtė, 2007). So the main types of customs in most of the countries are customs on the imported goods, which performs the following functions - fiscal (state seeks to get as much of the budget income as possible) and socio-economic (the state seeks to meet its social and economic interests with the help of the customs policy).

In the legal literature, it is recognized that the legal regulatory framework of customs in each country is associated with certain compendium of public and private interests of the state and business (Povilauskienė, 2006). Public interest in the field of customs consists of application of customs tariffs, determining the origin of goods, valuation of goods, physical control over the supplies of goods which crosses the state border, application of the national requirements to declare the goods, administration and control over the debt to customs, the adoption of individual legal acts which are binding for the taxpayers. Meanwhile the private interests in the field of customs are as following: implementation of the rights of the private entity to have a favorable business and foreign trade conditions, right of the international business to be recognized as fair business according to national requirements as well as the right to be protected against unreasonable customs requirements and to use simplified and expedited custom clearance procedures. The rights and obligations of the state institutions and private entities (businesses or individual persons) related to transportation of goods across the border of the state are regulated by special legal norms which is usually called customs law.

Usually customs law is traditionally related to tax law since custom duties themselves satisfy even narrow definitions of tax since they are not compulsory payment to the government that does not constitute consideration for a service (the absence of...
individual remuneration). Accordingly a number of countries have found that it makes sense to consolidate tax and customs as an object of legal regulation, particularly given the importance of other indirect taxes related to customs, such as value added tax (further in the text – VAT) (this system of legal regulation is applied in such economically important countries of the world countries as the United States of America, China or Russian Federation). For example, in the U.S. the significant difference between regulation principles of customs (customs procedures) and/or other taxes doesn't exist since it does not have a VAT and has lowered its customs barriers (Thuronyi, 2003). In China administration of customs is considered as an integral part of whole tax administration procedure and is governed by uniform source of law – Law on the Administration of Tax Collection (Шепенко, 2004). The same tendency in recent years is observed in Russian Federation were customs duties are considered as an integral part of tax system which have a rather specific goal – to ensure unity of economic area (Лыкова, 2004; Винницкий, 2003). However there are also other point of views in worldwide legal practice because customs codes and tariffs are typically contained in separate legislation from taxes, besides that customs duties tend to be collected by an agency different from that responsible for inland revenue. This tendency is noticed in some European countries, such as Germany (Тимошенко, 2002; Витте, Вольфганг 2000; Romaškevičius, 2003).

There are also a certain legal point of view according to which customs law is considered as part of another special branch of law – trade law (or international trade law), which regulates the handling of international trade and sets restrictions and conditions on import or export of certain goods). It is unanimously agreed that one of the peculiarities of customs law is its international character. This tendency is observed due to the substantial harmonization of customs law through a number of international agreements over the years, and two international organizations, the WTO and the World Customs Organization, are in place to help manage the system. The classification of goods worldwide is based on the Harmonized Description and Coding System, which is used by over 176 countries¹. As it is noted by some legal analysts and scientists, contrary to the areas of other direct and indirect taxes, countries have not seen customs harmonization as threatening to fiscal sovereignty, given the relatively small importance of customs duties so the last decades of the 20th century and the recent years were marked by the success of international agreements harmonizing customs law, since many elements of customs regulations have been successfully included in international trade agreements ((Thuronyi, 2003).

Overall it can be pointed out that customs law in a worldwide practice and from the point of view of the comparative law could be considered as: 1) separate branch of law; 2) a part of tax law; 3) a part of international law (i. e. international trade law). This classification has not only theoretically importance but also a very clear practical importance, since the position of customs law in the legal system of the country defines the sources law which must be applied in order to regulate customs relations, their

mutual relationship in case of conflicts and collisions (e.g. international trade treaties vs. national/domestic legislation), and the dominant method of legal regulation (imperative or dispositive)\(^1\).

**Customs law as part of the European Union law and Lithuanian national legal system after the entry to the European Union**

Customs and customs law is usually defined as very important part of the European Union law because it is highly harmonized and is based on directly applied sources of law (regulations; i.e. CCC) which are effective on its own and not require any further implementation through national laws. This importance is due to the fact that the European Customs Union is the most important element of the common commercial policy and the single market, the system, ensuring the free movement of goods – one of the four freedoms of the EU single market. EU internal market actually began to function in 1993, when the CCC and its implementing provisions entered into force. All duties which are related to trade between Member States is hereby repealed and all Member States apply common customs tariff and trade policy to third countries (Terra, Wattel, 2012).

EU regulation on trading was not only intended to create an internal market without barriers to protect free and fair competition between the Member States. One of the goals of the EU internal market was also to create a single trading entity, that any subject which isn’t in the jurisdiction of the EU and is wishing to have business with someone inside the EU are subject to the same restrictions on trade regardless of which certain Member State he is dealing. The main Community instrument for this purpose was a common external tariff. The rules which ensures the functioning of the EU internal market and European Customs Union comprise EU customs law (Lyons, 2005).

The first EU customs legislation was Council Regulation (EEC) No 802/68 “On the Common definition of the concept of the origin of goods the common definition of origin of goods”\(^2\). However since 1993 all EU customs legislation has been put together and called the CCC\(^3\). The CCC is mandatory for all EU Member States and all national bodies (authorities) which are active in the field of customs. So at the national level of the Member States, when the question on the customs arise, the Code is mandatory and therefore, according to the practice of the European Court of Justice, the principle of the primacy of the Code must be applied in all cases (Case C-161/06, Skoma Lux, [2007] ECR

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\(^1\) According to the opinions of some legal scholars (Ražutis, 2005; Sudavičius, Medelienė, 2011), imperative method is used as dominating regulatory method in customs law, but other regulatory methods (dispositive method) could also be used since regulation of customs is based on the principle that no one may be restricted by law or prohibited to import or export of goods from customs territory of the state since international customs harmonization includes reducing of barriers to trade, including barriers of procedural nature (Thuronyi, 2003).


I-10841). Becoming the member of the EU, Lithuanian Republic has also become a part of common market in which the free movement of goods, services, capital, people has to be ensured. The entry into force and direct application of EU customs regulations, in some cases directives has created strong challenges for development of national customs law.

One of the key issues and problems in which were widely discussed in Lithuanian legal doctrine was the place of customs law in the system of law and the qualification of the customs legal relationships. A separate branch of law in legal doctrine is defined as a system of laws regulating qualitatively uniform (homogeneous) social relations. A separate branch of law is formed when: 1) a certain type of social relationships constitutes qualitatively uniform complex; 2) social relationships are qualitatively different from the relationships governed by the other branches of law; 3) there is a demand for the legal regulation of the complex of social relationships (Šatas et. al., 2004).

Legal scholars raised the questions whether the rules, applied to the group of this customs legal and social relationships, which can be found in sources of the tax law, administrative or even criminal law elements, does have an attributes of complex interdisciplinary and separate branch of law (Medelienė, Sudavičius, 2011). This question also have a very clear practical meaning since the correct answer to this question defines such matters as what regulatory approach (method) must be applied to customs legal relationships and which sources of law will prevail in case of collision of certain legal instruments or on which basis qualitatively similar sources of law may be simplified and codified (Vansevičius, 2000).

These matters are particularly important since the accession to the EU, which has changed regulation of customs to multiple regulation regimes applied according to EU law, international trade treaties with third countries and national law. According to the Law on Tax Administration which has entered into force since the entry to the EU (since 1st of May, 2004), customs duties are administered on the basis of Community customs legislation and national legislation (Law on Tax Administration) to the extent that they do not contravene the Community customs legislation, this principle is also applied to the primacy of international treaties with third countries. What are not covered by these rules may be provided by the national law, but only to the extent that they are consistent with the EU law. So after the entry to the EU national Lithuanian customs legislation was limited to a certain extent, especially if compared with the situation before the 1st of May 2004 when all customs relationships were governed by Lithuanian customs laws.

A discourse in national legal doctrine over the place of customs law were started even before the entry to the EU, because regulations concerning customs legal relationships since 1996 were codified in The Customs Code of the Republic of Lithuania, which regulated not only activities of customs, as public administration institution, but also carriage of goods across state borders, prohibitions and restrictions on international trade and etc. Accordingly, some scholars (Romaškevičius, 2003) proposed a definition that customs law – is a relatively independent variety of areas of law rules which are setting, changing and annulling the special and other legal entities' rights and duties,

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1 see Article 5 and Article 14 of Law on Tax Administration
2 Official Gazette, 1996, No. 52-1239.
legal relations which are related to the transportation of goods through the customs border, import, export and transit procedures, customs clearance, payment of customs, the system of restrictions and other control measures which determines international trade.

After the entry to the EU other scholars also have pointed out to the existence of separate laws regulating customs and the codification of these legal regulations in the separate codified document (CCC) at the EU level as well as originality and specificity of customs legal relationships and defined it as an newly emerging complex branch of law, which consists of state-sanctioned legal rules for the regulation of social relations in relation to transportation of goods and vehicles across the state border, the customs collection, customs clearance, customs control and other customs policy instruments, which are an integral part of the state of internal and external policy (Raišutis, 2005). Other authors (Povilauskienė, 2006) also followed this position on customs law as a separate branch of law but defined it more broadly as the separate complex branch of law (governed by both international and national rules) which regulates social relations related to the transportation of goods across the state border.

However after the entry to the EU there was no further detail discourse on the origin of customs law in Lithuania and its place in legal system. It should be noted that the Law on Customs, which has entered into force after the entry to the EU, defined customs legislation (or the acts of customs law) as EU customs legislation, the international treaties of the Republic of Lithuania and other legal acts which provisions are enforced by the customs authorities, as well as legislation which is enacted by custom authorities according to their competence and international agreements concluded by Lithuanian customs authorities with customs authorities of other countries. This definition describes the fundamental changes that has affected Lithuanian customs law since the entry to the EU, firstly, EU customs legislation was started to apply directly (as the direct source of law), and, secondly, codification of customs law on national level was withdrawn since The Customs Code of the Republic of Lithuania expired and came out of force since the entry to the EU.

How these changes affected the status of customs law in Lithuania? Did it became an integral part of the EU law or it could be considered as a national branch of law with its own subject of legal regulation? There are both arguments for and against – firstly, there is no detail theoretical background or studies which defines customs law as a separate and integral part of Lithuanian legal system; also there are no official commentaries on national customs legislation (contrary to the situation in tax law) and the existence of separate regulatory principles for customs law isn’t recognised in a case law formed by Lithuanian courts (Lietuvos vyriausiojo administracinio teismo praktikos, taikant mokesčių administravimą reglamentuojančias teisės normas, apibendrinimas (I ir II dalis), 2012). Secondly, after the entry to the EU customs law remained many of its independent peculiarities, such as 1) complexity of the object of its legal regulation (activities of customs authorities, procedures for supervision applied to the goods imported from third countries and exported to third countries and etc.); 2) codification at

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1 Article 1 of the Law on Customs
the EU level (direct application of CCC); 3) existence of international element (a very important sources of customs legislation are international treaties and international agreements); 4) existence of separate national sources of law which are applied only to customs (Law on Customs, other legislation which provisions are enforced by the customs authorities) and even separate concept of customs law (customs legislation) which is directly defined in Law on Customs (Part 5 Article 3).

Accordingly it can be agreed with opinion (Sudavičius, Medelienė, 2011) that Lithuanian customs law could be defined as an international and national statutory law governing the legal status and rights/duties of the relevant state bodies (institutions), as well as the legal relations related to the transport of goods and means of transportation to or from within the customs territory of the state, customs clearance, and calculating payments of customs duties and carrying of the customs controls, as well as the implementation of other state customs and international trade policy. Thus, after the accession to the EU and by subsequent transformations in this respect the national customs law may be defined as a relatively self-sustaining, complex branch of law, which includes elements of international, EU and national law.

Changes of customs law after joining the EU and prospects of its development

Historically regulatory processes on customs in Lithuania has been based on a clearly expressed strategy. Analysis of legal developments in Lithuania from 1990-1991 (the very first years of the Independence) until the entry to the EU suggests that the many customs reforms have been made in the absence of stable regulatory strategy and it was determined by the prevalence of subjective factors in the regulatory process (method of trials and errors/testing and debugging).

Although since 1995 the clear direction of the Lithuanian foreign policy was membership in the EU, the main sources of customs law, such as Law on Customs (1993)\(^1\) which in 1998 was changed by the Customs Code of the Republic of Lithuania as well as tariffs legislation (Law on Customs Tariffs\(^2\)) was not originally developed in accordance with the EU customs legislation (CCC). This meant that in order to achieve compatibility with the EU law national Lithuanian customs legislation was started constantly amended and changed thus creating the distrust of regulatory stability by the subjects of customs legal relations (Raišutis, 2005).

The final negotiating position of the Republic of Lithuania prior to the entry to the EU on the Customs Union was approved back in 2000. The position of the Lithuanian Republic Government was such that the Republic of Lithuania agrees to the entire Customs Union acquis and does not ask for any transitional periods or derogations (Povilauskienė, 2006). For this reason, the Lithuanian customs regulatory strategy and objectives has become analogous to the EU customs regulatory strategy and objectives. The accession to the EU has transformed the customs law and the most important change

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\(^1\) Official Gazette, 1993, No.15-376.

has been that since 1’st of May, 2004 any frontiers between Lithuania and other EU countries ceased to exist as the Common Market of goods and services and their free circulation inside the EU had to be ensured. Upon entering the EU in the Republic of Lithuania has initiated and implemented a number of other key regulatory innovations that changed customs law. Firstly, Lithuanian Republic has installed a complex tariff system LITAR, similar to the integrated tariff system of the EU (TARIC), which ensures the legal conditions for the classification of goods in accordance according to the same principles as in other EU countries. In conjunction with these changes followed the implementation of new customs declaration processing system (ASYCUDA), which effectively ensured the possibility to submit customs declarations electronically. On the other hand, the abolition of customs barriers between Lithuania and other EU countries, facilitated the transport of goods and simplified customs clearance procedures, but have introduced new obligations – to provide statistical data on the export/import to the EU countries (Intrastat declarations). In addition, based on the experience of other EU countries, national legislation introduced simplified customs procedures and other forms of cooperation between business and customs authorities. The Republic of Lithuania started to apply the EU unilateral and bilateral preferential tariff arrangements with third countries (Povilauskienė, 2006). Accession to the EU and becoming part of the Customs Union simplified and accelerated transportation and trade with the EU countries, the need for expanded freight forwarding services, especially to serve the transportation to the Eastern countries of CIS, created new business opportunities for operators of customs warehouses, free zones, import and export terminals, as well as increased export volumes in general (Slavickienė A., Jatkūnaitė D., 2006).

In this respect it should be noted that transforming of the customs law of Lithuanian Republic and its application in line with EU requirements created some challenges for national legal system, which could be illustrated by examples of the court practice. In particular, the application of customs law regulations after the entry to the EU has repeatedly raised the question of the relation between EU legislation and the national legislation. For example in the administrative cases No. A²⁶¹-939/2008 and A²⁶¹-1303/2012 the Supreme Administrative Court of Lithuania has settled the dispute on the relationship between national law (i.e. Law on Tax Administration) and CCC and its direct application in the tax dispute concerning the customs debt. The Supreme Administrative Court of Lithuania drew attention to the fact that the tax and customs duties under the Law on Tax Administration can be managed to the extent that its provisions are compatible with the EU customs legislation of the CCC and in respect provisions of the CCC shall have precedence over the Law on Tax Administration. In other cases translation versions of EU customs legislation in Lithuanian language which mismatched other versions of the EU customs legislation in another official languages of the EU (cases No. A²⁵⁷-298/2011 and A⁸-24/2007). In these cases, the Supreme Administrative Court of Lithuania, on the basis of the practice of European Court of Justice, drew attention to the fact that the EU legislation in the European Union must be

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1 Article 77 of the CCC.
2 Commonwealth of Independent States.
interpreted in the same way and has applied versions of customs legislation in other official languages of the Member States of the EU.

It should be noted that the problems of application of EU customs legislation in Lithuania is also revealed by the fact that after the accession to the EU, individual issues on customs legislation was dealt with even in the Constitutional Court of the Republic of Lithuania (Case No. 4/02) which examined the case on the legality (constitutionality) of national provisions of customs law describing conditions when contractual value is not to be considered as the customs value of imported goods. Constitutional Court of the Republic of Lithuania has recognized the legal validity of the national regulation directly based on the provisions of CCC, noting that the national legal regulations are basically identical to the ones entrenched in the legal act of the European Union.

These examples of legal practice clearly shows that accession to the EU and the fact that EU law became an integral part of the national customs law has created legal disputes concerning the fact which legal regulations shall prevail as the main basis of regulation of customs relationships. In such cases Lithuanian courts have firmly withheld the position on the primacy of the EU law over the national rules and have explained content of national rules according to the requirements of the EU law in customs cases.

Effects of legal transformations of customs law after the entry to EU, could be illustrated by some basic statistical data. It is obvious that while the period of integration to the EU or immediately after the integration (yrs. 2004-2006) was related to rapid changes in legal base since the number of newly enacted legal acts, related to the activities of custom authorities was the highest in whole nine year period (yrs. 2004-2013). However while in later years activity in the area of customs legislation have decreased, number of disputes in court concerning the application of customs law remained quite stable (see Figure 1), data is based on the information provided in the system INFOLEX.PRAKTIKA. Teismų apžvalgos, konsultacijos, nutarimai, sprendimai, nutartys [interactive]. [accessed 2014-03-10]. <http://www.infolex.lt/praktika/> .

![Figure 1. Changes related to the creation and application of customs law in Lithuania](image-url)
This correlation shows that the process of integration had clearly created a challenge for national courts and their practice (this conclusion is based on the fact that number of customs cases aren’t diminishing) and didn’t create static (stable) legal environment since fundamental questions on application of EU customs regulations (particularly concerning the relationship between EU and national legal regulations) remains to be constantly challenged in national courts.

The main obstacles and challenges for the development of customs law could be related to the processes which are ongoing in the EU¹, as well as some particular national peculiarities. However besides preparation for the implementation of UCC, there are other unsolved problems of the Lithuanian customs law which remains as an obstacle for the creation positive cooperation between business and customs authorities and serves as a threat for the effective prevention and settlement of disputes with taxpayers. This problem is the absence of the official commentary (–ies) on customs duties in general and/or other customs legislation. Given the fact that customs law has to be treated as an individual and separate branch of law in Lithuanian legal system, it clearly needs a more systematic approach to its implementation. It is important to mention that Article 12 of the Law on Tax Administration sets a legal background for the customs authorities to present and publish summarized explanations² of the laws regarding taxes administered by the customs authorities. Although the absence of such summarized explanations of customs law was noticed as the main problem for the regulation of customs relationships in Lithuania (Romaškevičius, 2003; Povilauskienė, 2006) it remains unsolved until nowadays since there are no published official summarized explanations of any institutes of customs law. The same problem encounters cooperation between taxpayers and customs authorities when there is a need for relevant tax consultancy³. Since the State Tax Inspectorate under the Ministry of Finance which acts as the main tax administrator has developed a sophisticated and detail consultancy services and a public database on relevant tax consultations⁴, this practice is not commonly used by the customs authorities. These issues remains as an objectives for the modernizing of application of customs legislation in Lithuania.

¹ The new Union Customs Code (UCC) Regulation (which must change the CCC has entered into force on 30 of October 2013, but its substantive provisions will apply only on 1 of May 2016. UCC is orientated at the creation of an electronic environment for customs and trade by the end of 2020. <http://ec.europa.eu/taxation_customs/customs/customs_code/union_customs_code/index_en.htm>

² According to the Part 1 of the Article 2 “Summarised explanation of the tax law” means the opinion presented, after coordination with the Ministry of Finance, by the central tax administrator (including Customs Department under the Ministry of Finance) on how the tax administrator understands and applies the provisions of the tax law

³ According to the Article 36 of Law on Tax Administration the right to receive consultancy on tax payment issues from tax administrator is the fundamental right of the taxpayer

Conclusions

Customs law in a worldwide practice and from the point of view of the comparative law could be considered as: 1) separate branch of law; 2) a part of tax law; 3) a part of international law (i.e. international trade law). Fundamental changes that has affected Lithuanian customs law since the entry to the EU, firstly, could be described as following: EU customs legislation was started to apply directly (as the direct source of law), and, secondly, codification of customs law on national level was withdrawn since The Customs Code of the Republic of Lithuania expired and came out of force since the entry to the EU.

Accordingly after the accession to the EU and by subsequent transformations in this respect the national customs law may be defined as a relatively self-sustaining, complex branch of law, which includes elements of international, EU and national law. Customs law remained many of its independent peculiarities, such as complexity of the object of its legal regulation; codification at the EU level; existence of international element and existence of separate national sources of law which are applied only to customs.

The process of integration had clearly created a challenge for national courts and their practice (this conclusion is based on the fact that number of customs cases aren’t diminishing) and didn’t create static (stable) legal environment since fundamental questions on application of EU customs regulations (particularly concerning the relationship between EU and national legal regulations) remains to be constantly challenged in national courts. In most custom cases Lithuanian courts have firmly withheld the position on the primacy of the EU law over the national rules and have explained content of national rules according to the requirements of the EU law.

However given the fact that customs law has to be treated as an individual and separate branch of law in Lithuanian legal system, it clearly needs a more systematic approach to its implementation since after the entry to the EU there are no prepared official commentaries on customs legislation and no developed services of public consultations on customs matters.

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THE PATTERNS OF THE INVESTMENT IN INTANGIBLE ASSETS

Ilona Bartuševičienė

Mykolas Romeris University, Lithuania
ilonabartuseviciene@mruni.eu

Evelina Šakalytė

Mykolas Romeris University, Lithuania
evelina.sakalyte@yahoo.com

Abstract

Purpose – Scientific studies have concluded that investments in intangible assets increase future output and consumption for the entire economy the key point again is whether an increase in intangibles yields returns at some point in the future in the form of higher production efficiency, improved product quality and effectiveness. The challenge relies around the uncertainty of what are the components of intangible assets that should have more attention regarding the size of the investment. Various economies use different approaches to assess their investment strategies, therefore the purpose of this article is to explore the investment in intangible assets patterns in OECD countries as well as Baltic States.

Design/methodology/approach – Scientific literature review, comparative and statistical data analysis.

Findings – According to the statistics department of Lithuania, investment in Research and Development as a share of Gross Domestic Product in Lithuania has increased starting 0,79 perc. back in 2006 up to 0,9 perc. in 2012. Konstatinos et all (2013) defended, that the size of the investment in R&D is not enough to get a grasp of the intangible asset essence and impact in the economy. Corado (2012) has adopted a model to assess the intangible investment potential valuation in Organization for Economic Co-operation and Development countries, where intangible assets are classified based on three categories: computerized information, intellectual property and economic competencies. The objective of this paper is to explore whether it is possible to apply adopted Corrado model in Lithuania.

Research limitations/implications – Statistics department of Lithuania measures the percentage of investment in Research and Development as a share of Gross Domestic Product. This indicator alone should not be used to identify the investment level in intangible assets in Lithuania, therefore adopted model, which includes various indicators, should be used to grasp real situation in the country. The challenge arise with macro data availability. Data limitation could affect benchmarking chances.
Practical implications – Investment in intangible assets valuation model would allow to benchmark Lithuania’s economy with countries such as United States, Denmark, Sweden and Japan.

Originality/Value – Lithuania’s policies regarding intangible assets follows traditional theories, therefore it is very important to identify the level of intangible investments, not recorded in the accounting books and define its impact on the economic effectiveness.

Keywords: intangible assets, intangible investment, economic growth

Research type: literature review, research paper.

Introduction

Many studies have concluded that investments in intangible assets increase future output and consumption for the entire economy (COINVEST, 2013; INNODRIVE, 2013, INTAN Invest, 2011). According to Corado et all (2012) the key point again is whether an increase in intangibles yields returns at some point in the future in the form of higher production efficiency and improved product quality. Webster and Jensen (2006) argues that intangible assets cannot be treated as investments at all, since they are not identifiable and the owner of these assets cannot always control access to them as use according to owner’s needs.

According to the statistics department data, investment in Research and Development (R&D) as a share of Gross Domestic Product in Lithuania has increased starting 0,79 perc. back in 2006 up to 0,9 perc. in 2012. Konstatinos et all (2013) defended, that size of the investment in R&D is not enough to get a grasp of the intangible asset essence and impact in the economy. Corado (2012) has adopted a model to assess the intangible investment potential valuation in Organisation for Economic Co-operation and Development (OECD) countries, where intangible assets are classified based on three categories: computerized information, intellectual property and economic competencies. Policies regarding intangible assets in Lithuania follow traditional accounting principles, therefore it is very important to identify the level of intangible investments, not recorded in the government accounting books and define its impact on the economic potential.

Due to salutatory evolution of intangible investment in different economies, the aim of the research is to explore the policies covering intangible investments abroad as well as in Lithuania and identify possibilities to measure its impact on future economic growth. The objectives: 1) to analyse intangible asset investment methods in advanced economies; 2) to explore intangible asset investment potential in Lithuania. Research methods – scientific literature review, research paper.

Investing in intangibles: challenges and possibilities

The world economy has moved form an industrial to a knowledge economy where intangible assets are key drivers for long lasting competitive advantage. Various studies
Corrado, 2012; Morrano, 2013; Suriñach and Moreno, 2012; Goodridge et al., 2012) have showed that tangible assets such as equipment, plant, office buildings are no longer playing an important role in today’s advanced economy. According to the reports from Organization for Economic Co-operation and Development (OECD), countries, such as United Kingdom, Japan and the United states, have already exceeded the investments in the intangible assets as a share of GDP compared to the investments in tangibles (OECD, 2013). If intangibles are playing such an important role in today’s economy, it is natural to raise questions, whether these investments are worthwhile, and how much should the economies invest to increase their effectiveness.

OECD’s Innovation Strategy, published in 2010, reported that many innovating firms do not invest in R&D, which is necessary to create and maintain long lasting competitive advantage and economic growth. Looking closer, the argument is quite debatable. Secretary-General of the OECD has released a study (OECD, 2013), which proposed, that innovation efforts are supported by investments in much broader range of intangible assets from software and large data sets to designs, firm-specific human capital and new organizational processes. Advanced economies such as Great Britain, United States, Sweden, Japan has exceeded their investments in intangible assets, compared to the tangible ones (see Figure 1).

**Investment in fixed and intangible assets as a share of GDP, 2010**

![Investment in fixed and intangible assets as a share of GDP, 2010](chart)

Source: OECD (2013), Supporting Investment in Knowledge Capital, Growth and Innovation.

**Figure 1. Investment patterns in OECD countries**

Traditional growth model derive from the production function evolved as a period-by-period analysis of the factors determining output along the growth path of an
economy. The model uses capital as predetermined, which might be misleading, since investments and savings are choice variables in a complete growth model. Choice dimension will determine the quantity of capital available at any time given; it also determines what counts as capital. The answer to the question, whether intangibles should be treated as capital is therefore a matter of embedding the production function–based sources-of-growth analysis in a larger model of economic growth. (Corrado et al., 2005, p. 17).

According to Webster and Jensen (2006) intangible assets cannot be treated as investments, since they are not identifiable and the owner of these assets cannot always control access to them as use according to owner’s needs. Corrado et al. (2009) argues that these concerns apply towards tangible capital as well, in addition these statements has no point at macroeconomic level, since the owner of the asset is not important. What matters here, is whether the investment in intangibles increase the output and consumption of the entire economy. Hulten (2001) explains that it is irrelevant whether the marginal product of some intangibles is zero. The key point again is whether an increase in intangibles yields returns at some point in the future in the form of higher production efficiency and improved product quality (Corrado et al., 2009).

OECD (2013) empirical study supported widely accepted intangible asset classification initially proposed by Corrado et al. (2005), which groups these assets into three types:

- Computerized information;
- Innovative property;
- Economic competencies

This approach has been used in various intangible asset related studies (Corrado et al, 2005; COINVEST, 2013; INNODRIVE, 2013, INTAN Invest, 2011; New Sources of Growth: Knowledge-based Capital, 2013) to assess the intangible investments of the economies (See Table 1).

Within the conventional System of National Accounts, expenditure on intangible assets, such as research and development or human and organizational capital, is not considered either as part of gross value added (GVA) or as investment. In the UK, Marrano et al. (2009) report increased market sector GVA figures by as much as 13% in 2004 after treating intangibles as investment (op.cit. Konstantinos et al, 2013). Broadly accepted concept of intangible assets states, that intangible assets claims to future benefits that do not have a financial or physical embodiment (Bianchi & Labory, 2004). According to Konstantinos et al (2013) this approach supports the claim that intangibles should be approached as investment given that they represent a sacrifice of the present level of consumption in order to produce more output in the future. In addition, if these investments produce returns at some point in the future, they should not be only treated as an investment but also included in GVA) calculations, given as much quantitative importance as inputs of tangible nature (Konstantinos et al, 2013).
Table 1. Classification of the forms of KBC (knowledge based capital) - knowledge intensive capital (intangible assets) and their effects on output growth

<table>
<thead>
<tr>
<th>Type of intangible assets</th>
<th>Mechanisms of output growth for the investor in the asset</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>COMPUTERISED INFORMATION</strong></td>
<td></td>
</tr>
<tr>
<td>Software</td>
<td>Improved process efficiency, ability to spread process innovation more quickly, and improved vertical and horizontal integration.</td>
</tr>
<tr>
<td>Databases</td>
<td>Better understanding of consumer needs and increased ability to tailor products and services to meet them. Optimized vertical and horizontal integration.</td>
</tr>
<tr>
<td><strong>INNOVATIVE PROPERTY</strong></td>
<td></td>
</tr>
<tr>
<td>Research &amp; Development</td>
<td>New products, services and processes, and quality improvements to existing ones. New technologies.</td>
</tr>
<tr>
<td>Mineral explorations</td>
<td>Information to locate and access new resource inputs - possibly at lower cost - for future exploitation.</td>
</tr>
<tr>
<td>Copyright and creative assets</td>
<td>Artistic originals, designs and other creative assets for future licensing, reproduction or performance. Diffusion of inventions and innovative methods.</td>
</tr>
<tr>
<td>New product development in financial services</td>
<td>More accessible capital markets. Reduced information asymmetry and monitoring costs.</td>
</tr>
<tr>
<td>New architectural and engineering designs</td>
<td>New designs leading to output in future periods.</td>
</tr>
<tr>
<td><strong>ECONOMIC COMPETENCIES</strong></td>
<td></td>
</tr>
<tr>
<td>Brand-building advertisement</td>
<td>Improved consumer trust, enabling innovation, price premia, increased market share and communication of quality.</td>
</tr>
<tr>
<td>Market research</td>
<td>Better understanding of specific consumer needs and ability to tailor products and services.</td>
</tr>
<tr>
<td>Worker training</td>
<td>Improved production capability and skill levels.</td>
</tr>
<tr>
<td>Management consulting</td>
<td>Externally acquired improvement in decision-making and business processes.</td>
</tr>
<tr>
<td>Own organizational investment</td>
<td>Internal improvement in decision-making and business processes.</td>
</tr>
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</table>

The patterns of investing in intangibles

Konstantinos et al. (2013) defended, that the size of the investment in R&D is not enough to get a grasp of the intangible asset essence and impact in the economy. After intensive discussions on the impact of intangibles on GDP (Corrado, Hulten, and Sichel 2005, 2006) the United States Bureau of Economic Analysis adopted a policy in July 31, 2013, where R&D were categorized as an investment on the government’s books rather than an expense (BEA, 2013). After the adoption of this policy the GDP of the United States should increase by 3 percent, in addition revised GDP calculation methodology will be applied to re-calculate economic indicators starting 1992 m. (BEA, 2013). OECD (2013) reported that investments in R&D has showed little or no change in France for the period 1995-2010. Within five years investment in R&D amounted for 1,9 percent of GDP, on the other hand, the investments in knowledge capital, organizational capital and other intangibles, which are not included into R&D has accumulated 7,4 up to 10,6 percent of GDP. These results supports Marrano et al. (2009) idea, that R&D is only one of many intangible assets, which impacts the effectiveness of our economies.

According to the statistics department of Lithuania, investment in Research and Development as a share of Gross Domestic Product in Lithuania has increased starting 0,79 perc. back in 2006 up to 0,9 perc. in 2012.

Figure 2. Gross domestic expenditure on R&D 2000-2010

Source: Eurostat

Figure 3. Annualized growth performance

Source: Eurostat

The size of the investment in R&D as a percent of GDP in Baltic States is much smaller compared to the EU(27) or the United States (See Figure 1). Lithuania and EU (27) performance follows consistent trend line in the investing practice compared to Estonia or the United States. Estonia also demonstrates high growth rates compared to all regions. For the year, 2004 – 2006 Estonia has increased its investment in R&D by 14 percent; starting 2009 investment trends are indicating the growth again (See Figure 2).
According to Eurostat data, GDP expenditure patterns on R&D by sector for the period 2005-2010 has been changing. Business enterprise sector has increased the investments in R&D in EU (27), all Baltic countries and the United States. Government investment in R&D within the same period in Lithuania has dropped slightly, yet investments in R&D in higher education sector in Lithuania has not showed any changes. Most of the funds to cover R&D expenditure in Latvia and Lithuania come from government institutions, although EU (27) and United States get most of R&D funding from business enterprise. Looking at the trends of R&D expenditure source of funds Lithuania follows the same pattern as EU (27) and the United States, which is, ascending financial resources from private sector and descending from the government.

Investment patterns in R&D as a percentage share of GDP presents intangible asset investment trends partially, since R&D is only one of many intangibles which impacts the growth of the economy.

**Conclusions**

Various economies use different approaches to assess their investment in intangible assets potential. United Kingdom, Japan, the United States and other advanced economies use Corrado et al. (2005) model, where intangibles are classified based on three categories: computerized information, intellectual property and economic competencies. According to the latest OECD report (OECD, 2013) the investments in intangible assets have already exceeded the investments in the tangibles as a share of GDP.
Baltic countries account their investment in intangible assets using the total expenditure on R&D. According to the statistics department data, investment in R&D as a share of Gross Domestic Product in Baltic countries is following a slow growth, same patterns are seen in the US as well as Europe Union countries. Although according to the research (OECD, 2013) R&D does not reveal investment in intangibles patterns completely, since R&D indicator is only one of many intangibles, which affects the growth of the economy.

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DISCREPANCIES AND CONTRADICTIONS OF INTELLECTUAL CAPITAL MEASUREMENT MODELS

Simona Survilaitė

Mykolas Romeris University, Lithuania
simona.fortress@gmail.com

Abstract

Purpose – the main idea of measuring intellectual capital is that organisations, institutions and enterprises can successfully manage and control intellectual capital with the consequences that it increases company’s value added and assures normal and stable activity. Nevertheless, many authors indicate that intellectual capital is a complex and sophisticated concept, which is difficult to capture, measure and manage. Intellectual capital measurement models are controversial due to inconsistent and different perspectives, point of views demonstrated by management, distinction between academic theory and practical execution. The main purpose of this scientific paper is to present contradictions appearing while trying to capture, measure and manage intellectual capital.

Design/methodology/approach – scientific literature review.

Findings – the knowledge era has brought a new perspective into every organisation, institution and management strategies are becoming more related with intangibility. The concept of intangible assets can be analyzed and investigated through intellectual capital point of view. Nowadays academic literature is full of intellectual capital scientific papers and can be categorized into three main groups: intellectual capital as a concept, intellectual capital structure and structural parts, intellectual capital measurement models. This scientific paper is prepared to analyze the third group, which concerns mostly of how to capture, measure and manage intellectual capital.

Research limitations/implications – the most challenging aspect is the discrepancies and contradictions in the measurement of intellectual capital. The differences of various enterprises broaden the perspective of intellectual capital and multiple points of view and attitudes are formalized into different methods of intellectual capital capture, measurement and managing.

Practical implications – the universal model of intellectual capital measurement could help enterprises to focus on the intellectual capital management itself. The main goal and concentration to the intellectual capital management and not to the understanding the concept would save time and increase the productivity and efficiency in every day’s procedural activities.

Originality/Value – the ability to understand and implement intellectual capital evaluation methodology is essential for every enterprise. As a consequence, the efficiency and productivity is increasing and the value of the company is growing.

Keywords: intellectual capital measurement models, knowledge based view, knowledge management, value creation.
Introduction

Economics is perceived as an important engine of welfare of the people and provides an indicator of the quality of life in multiple countries. The main input into the economic representation is added by various enterprises operating in different countries. Managers, directors and owners are using different methods in order to increase the value of enterprises. According to Mačerinskienė and Survilaitė (2012), enterprises faced the transition period from tangible assets point of view to intangible assets perception. Overall, intellectual capital is analyzed as a basis of intangible assets. Intellectual capital is a concept which is broadly investigated as a factor of company’s success and is considered as a value producer. What is more, many enterprises are measuring and calculating intellectual capital in order to increase their value. Nevertheless, many authors (Demartini and Paoloni, 2013; Mouritsen and Larsen, 2005; Hipp and Grupp, 2005; Mention and Bontis, 2013; Cabrita and Bontis, 2008; Collins and Clark, 2003; Sharabati et al., 2010) indicate that intellectual capital is a complex concept, which is difficult to capture, measure and manage. Intellectual capital measurement models are controversial due to inconsistent and different perspectives, point of views demonstrated by management, distinction between academic theory and practical execution.

• The problem of the scientific paper is how to evaluate and assess intellectual capital measurement models.
• The object of this paper is models evaluating intellectual capital.
• The aim is to compare various intellectual capital measurement models.
• The objectives of the article are as follows: to define intellectual capital assessment and evaluation models and to compare methods used to disclose intellectual capital.

Methods of research:
• comparative analysis of scientific literature.

Theoretical aspects of intellectual capital

The theoretical approach of intellectual capital can be defined in two different perspectives: from the definition point of view and from the structural point of view. The early intellectual capital literature corresponds to these perspectives. Many researchers of intellectual capital (Edvinsson, 1997; Bontis, 1998; Mouritsen et al., 2003; Mouritsen and Larsen, 2005) understand it as a bunch of knowledge, which belongs to a company and increases value of a firm. In addition to knowledge, intellectual capital is defined as the sum of experience, skills, technology, procedures and routines, customer relationship and business connections. As a consequence, all intellectual capital elements can be classified into larger groups in order to have a broad picture of the concept itself.
The discrepancies are appearing due to different point of views and attitudes adapted in the process of categorization of intellectual capital elements. Many authors (Saint – Onge, 1996; Stewart, 1997; Bontis, 1998; Roos, 1998; Brinker, 1998; Zéghal and Maaloul, 2010) indicate that intellectual capital is the composition of human capital, structural capital and customer capital. Nevertheless, other authors are classifying intellectual capital into similar, but not common groups. Bourdieu (1986), Putnam (1993), Swart (2006) specify that intellectual capital is the composition of human capital, structural capital and social capital. Ramirez et al. (2007) instead of social capital introduce relational capital. The difference between social and relational capital is slight and signify the same structural parts, such as social networks, trust and values, norms and sanctions.

Brooking (1996) is concentrating into intellectual capital as the aggregate of market assets, human centered assets, intellectual property assets and infrastructure assets. Robinson and Kleiner (1996), Edvinsson and Malone (1997) are investigating intellectual capital as a composition of two structural parts: human capital and structural capital. What is more, some authors classify intellectual capital into external and internal structure: Pettrash (1996) classifies intellectual capital into external structure, internal structure and human capital, while Sveiby (1996), O'Donnell and O'Regan (2000) classify intellectual capital into staff competence, external structure and internal structure. In addition to this, some researchers provide a focus on capital types regarding classification of intellectual capital. Draper (1997) categorizes intellectual capital as follows:

- Human capital;
- Structural capital;
- Customer capital;
- Organizational capital;
- Innovational capital;
- Process capital.

Van Buren (1999) also categorizes intellectual capital from the capital type point of view, but process capital has a broader perspective and comprises two types of capital: structural and organizational. Structure of intellectual capital, according to Van Buren (1999) is as follows: human capital, innovational capital, process capital and customer capital.

Sullivan (2001) categorizes intellectual capital into two main structural parts: human capital and intellectual property. Bounfour (2003) extends intellectual capital and divides intellectual capital into four main structural parts: human capital, structural capital, market capital and innovational capital. Namvar (2009) implemented a tree of categories explaining which type of structural part is created from:

- Human capital;
- Structural capital:
  - Relational capital;
  - Organizational capital:
    - Innovational capital;
Huang and Kung (2011) take into consideration the ecological aspect and indicate that intellectual capital structural parts are green human capital, green structural capital and green relational capital. The perspective is understood as a simple and usual intellectual capital, but with the presumption that ecological and nature-friendly decisions are taken into consideration during the annual goals creation, implementation and completion of a respective enterprise.

Dumay and Cuganesan (2011) emphasize that intellectual capital is a complicated network of knowledge resources that belong to a company. As all companies have multiple activities, are focusing on different strategies, their need for intellectual capital is also different.

Montemari and Nielsen (2013) state that evaluating and assessing intellectual capital is vital in value creation. Managers are implementing yearly goals in order to comply with strategies of the enterprise they are working in. The main task is to correctly identify and assess intellectual capital resources and how they are working in value creation. This assignment is not easy and requires a high level of knowledge and competency. Chiucchi (2013) approves opinion that intellectual capital is not measured appropriately and there is a gap in revealing how intellectual capital really works in practice. Tamošiūnienė and Survilaitė (2013) also accentuate the importance of intellectual capital in value creation and emphasize intangible aspect of value added of respective enterprise.

Assessment of intellectual capital

Montemari and Nielsen (2013) were using a causal mapping technology in order to investigate intellectual capital measurement and management. Intellectual capital is a dynamic concept and causal mapping technology helps to identify elements affecting and increasing value creation, in addition to this, relationship between each element is captured, assessed and controlled in a more effective and easy way. According to Montemari and Nielsen (2013), “cognitive maps have the potential to facilitate this task, by making explicit individuals’ knowledge of the way in which the company generates value”. The causal map was constructed using nodes and arrows, where nodes meant elements of intellectual capital and arrows meant the causality. Nodes are the value drivers and arrows the causal relationships. Researchers indicate that such causal mapping facilitates and visualizes interconnections between variables that help to increase the value of the company. As a result, managers can achieve their targets following the sequence of the map. Ambrosini and Bowman (2002) accentuate that causal mapping technology is a convenient way to analyze and investigate such complex and dynamic concepts as intellectual capital. The knowledge management helps to increase the effectiveness of intellectual capital disclosure and provides the feedback in order to comply with strategies and goals implemented by a respective enterprise.

Demartini and Paoloni (2013) is using a visual model in order to identify, measure and assess intellectual capital. Figure 1 shows main value drivers that foster and
increase value creation, indicators of intangible capital which can be measured and assessed in order to achieve desired and determinate goals. First of all, intellectual capital assessment must be performed through circular process from strategic planning of enterprise to intellectual capital measurement, assessment. The final step is to check for capitalization in order to give a feedback if strategic plan of an enterprise is going well and what additional steps are needed to perform further.

The intellectual capital in the model is understood as the composition of three elements: human capital, structural capital and relational capital. Intellectual capital assessment portion is completed with the help of resources that are needed to be acquired or reinforced in order to lead strategic purposes of a respective enterprise. The intellectual capital assessment is performed through calculation of intangible variables. Intellectual capital elements are expressed using financial statements; nevertheless, the issue is that meanings are approximate. Final step is performed using intangible asset report and capitalization report of the intangible assets. The evaluation and assessment is provided to management and stakeholders. Their decisions, discussions and remarks lead to solution if a respective enterprise is managing intellectual capital effectively and if any additional steps are needed to be taken further.
Grimaldi et al. (2013) proposed intellectual capital defining, assessing and managing tool. The advantage of the proposed tool is the ability for managers to identify value drivers that have the most significant impact on value creation. Figure 2 represents key value drivers which can be assessed, measured and managed in order to increase value added of the respective enterprise.

![Figure 2. The hierarchical structure of value drivers](source: Grimaldi, Cricelli and Rogo, 2013)

Grimaldi, Cricelli and Rogo (2013) evaluated the impact of value drivers using the analytic hierarchy process and pair-wise comparisons method. The difficulty appears while trying to transform intangible values into numeric values. The interpretation of value added drivers depends on the experience, education, professional and personal skills of responsible individual or a group of individuals. Precisely management board and stakeholders are taking all responsibility to understand and evaluate the process appropriately. According to Grimaldi, Cricelli and Rogo, the main drivers of intellectual capital are knowledge and management skills, creativity and innovativeness (human capital), innovation, intangible infrastructural assets, information technology, intellectual property (structural capital), customer relations, inter-firm relations, supplier relations, financial relations, institution relations, brand and image (relational capital).

**Conclusions**

The concept of intellectual capital is broadly investigated by academic community and business environment. The challenging theory can be interpreted in different point of views and perspectives. Researchers are mainly interpreting intellectual capital as a total amount of knowledge, skills, experience, motivation, education, policies and procedures, client and customer capital, intellectual property, routines, other structural
parts that belong to a respective enterprise. What is more, categorization of intellectual capital elements evaluating and assessing intellectual capital is a vital component of value creation. The main contradiction in various intellectual capital measurement models is the understanding of intellectual capital concept itself. Intellectual capital is defined differently by diverse scientists and economists and this discrepancy interfere with the evaluation of intellectual capital itself.

All in all, the assessment of intellectual capital depends on various aspects and can be analysed through multiple perspectives. The evaluation system is more connected with the type of a respective enterprise, size, activity company is performing and similar factors. The most important challenge for scientists and managers is to visualise the process of intellectual capital capture, assessment and managing. The visualisation of the process provides a feedback and a strong chain of tasks that need to be performed further in order to maintain and develop strategic goals of a respective enterprise.

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A LEGAL PERSPECTIVE OF THE SINGLE RESOLUTION MECHANISM

Tomas Ambrasas

Mykolas Romeris University, Lithuania
ambrasas@gmail.com

Abstract

As a result of the crisis it now seems that jurisdictions feel the need to have a special framework to deal with insolvent banks. Banking Union is a key part of the policy, economics, legal measures to put Europe back on the path of economic recovery and growth. It is a crucial step to overcome the current financial fragmentation and uncertainty, also to break the link between the sovereigns and the banks. 2013 July the Commission proposed a Regulation on a Single Resolution Mechanism1. It also could be said that SRM is a crucial step re-launch cross-border banking activity in the Single Market to the benefit of both Euro Area and non-Euro Area Member States. The SRM will apply the single rulebook on bank resolution set out in the Bank Recovery and Resolution Directive in respect of ailing banks of the participating Member States. However, notwithstanding the fact that European finance ministers approved a general approach2 on the single resolution mechanism (under the Lithuania Presidency period) it’s still one of the most sensitive and complicated files in EU co-legislators history. The paper reviews the file on the Single Resolution Mechanism (general approach), the legal perspective of that file in the context of Banking Union and identifies a legal perspective of SRM. This paper seeks to provide an overview and preliminary legal assessment of the SRM proposal from the legal perspective.

Purpose – to review the file on the Single Resolution Mechanism in the context of Banking union, the influence of that file and identify legal issues by implementing SRM.

2 It should be noted that the manuscript was presented for publishing just after the general approach was reached in EU legislation institutions. To add to, the paper was written from the perspective of Single Resolution Mechanism general approach text.

Design/methodology/approach– purposely to explore the actual meaning of legal norms and legislations as well as content and to analyze the literature the systematic and document analyses, synthesis, comparative, critical thought methods were used.

Findings– potential legal basis problems might go from the degree of the centralization and the appropriation with the primary law. First, SRM proposal might require changes to primary law. Second, it is unclear is proposal in line with the legal basis of Article 114 TFEU (especially suggested comprehensive transfer of executive competences from Member States to the Commission) which allows for the harmonization of law in the EU: Also it could cause the interest of conflict with state of primary law. Another possible legal issue: boundary between the Commission becoming the Resolution Authority. Further, legal risk pertains to resolution decisions that may factually impact on national budgets, it is reliable that much stronger budget protection must be given to participating Member States in order to ensure legitimacy and compliances with constitutional requirements of Member States: Last but not least, the legal issue might be in the context, whether the delegation of powers to the Board envisaged in the proposal is compatible with EU treaties and the general principles of EU law, as interpreted by so-called “Meroni” case law of the Court of Justice of the European Union etc.

Practical implications – Single Resolution Mechanism consisting of a Single Resolution Authority and a Single Resolution Fund, established to operate in tandem with the Single Supervisory Mechanism. SRM will establish a common institutional framework for the application of single rules in the participating Member States. It will encompass codification of supervisory practices and harmonization for national recovery and resolution regimes with a view to safeguarding taxpayers from the need of the future bail outs of banks.

Originality/Value – The single resolution mechanism, which will implement the rules on banking resolution as described in the bank recovery and resolution directive for all banks supervised by the single supervisory mechanism, placed under the responsibility of the European Central Bank, should be up and running by January 2015. However, many interested parties and member states expressed their initial views on the proposal and a few legal issues as legal base, litigation risk, centralization and decision making powers risks, etc. could be identified nowadays. These sensitive issues need to be identified in the scientific level in order to crystallize single resolution mechanism efficiency and credibility. As there is no theoretical framework on the subject yet the author makes the legal assessment of the SRM with the assistance of the relevant legislation, reports and jurisprudence.

Keywords: bank, bank insolvency, bank resolution, single resolution mechanism.

Research type: research paper.

Introduction

The financial crisis, which started in 2008 has shown that there is a significant lack of adequate financial markets regulation. Despite the improvement in funding conditions for sovereigns and banks in the vulnerable Member States, persistent financial fragmentation within the single market is one of the factors hampering bank lending, preventing adequate transmission of monetary policy and delaying economic recovery. Thus, the efficient shape for the financial system, in particular, is needed to prevent the European Union and global markets from recurrence of the crisis. The enhanced financial stability generated by the Banking Union will also boost confidence and the prospects for
growth across the internal market. Central and uniform application of prudential and resolution rules in the Member States participating in the Banking Union will benefit all Member States. The Commission presented on 10 July 2013 a proposal for a Regulation establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 of the European Parliament and of the Council (hereinafter, "the proposal")\(^1\). 2013 12 18 Council agreed general approach\(^2\) on Single Resolution Mechanism. It called on the presidency to start negotiations with the European Parliament with the aim of agreeing the regulation on the single resolution mechanism (SRM) at first reading before the end of the Parliament's current legislature (May 2014)\(^3\). It should be noted that it’s the last step in order to create the banking union. The SRM is strongly linked to the directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010 (hereinafter, "the BRRD proposal").

The proposal is founded on two pillars. First, a Single Resolution Mechanism (hereinafter, "the SRM") that will be in charge of applying a set of uniform rules on resolution defined by the proposal itself. Said set of uniform rules constitutes the material law to be applied by the SRM. Powers of resolution are conferred upon the Commission, Council of the European Union and the Board, that would be a newly created EU body with a full legal personality. The European Central Bank or national competent and resolution authorities would be in charge of executing certain resolution actions adopted by the Commission and by the Board. The Board, after its assessment, should adopt resolution scheme. The Council, on the proposal by the Commission, should have a right to object to the entry into force of the resolution scheme or address the directives to the Board in order to reformulate the resolution scheme. The Board should instruct the national resolution authorities\(^4\). The second pillar of the proposal is the Single Resolution Fund (hereinafter, "the Fund"), that would provide the necessary financing to resolution action pursuant to a number of pre-defined criteria. The Fund

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would be fed by ex ante and ex post contributions to be paid by the entities covered by the proposal. It would also be able to borrow, under certain conditions, from all other resolution arrangements within non-participating Member States or to contract borrowings or other forms of support from financial institutions or other third parties¹.

Interaction with other Banking Union files

Considering linkages with other elements of the Banking Union² the SRM proposal would complement the Single Supervisory Mechanism (hereafter - SSM), which would be operational since 2014. Pursuant to the SSM the European Central Bank (ECB) will directly supervise banks in the euro area. Other Member States also may join the SSM if they wish so. SRM is closely linked up to the Bank recovery and resolution directive (hereafter - BRRD), on which Council reached a general approach on 26 June 2013. SRM will use the principles and tools (bail-in³ tool) of the resolution pursuant to the BRRD, namely the losses at first should be allocated to the shareholders and creditors, except the covered deposits up to 100 000 euro. Before using the resolution fund for resolution purposes, it would be required that a minimum level of losses equal to 8% of total liabilities of the bank under the resolution including own funds has been imposed on an institution's shareholders and creditors⁴. SRM aims at ensuring efficient management (i.e. supervision and resolution are aligned at central level and backed by the financing arrangements – Single Resolution Fund) of resolution of failing banks in the euro area. If a bank subject to the SSM supervision faced serious difficulties, its resolution could be managed efficiently using privately raised resources with minimal costs to taxpayers and the real economy.

One of the overall aims of legislation and creating a Single Resolution Mechanism is consistent with the BRRD and deposit guarantee scheme directive (hereafter - DGSD). The June 2012 European Council endorsed the commitment to create a Banking Union to strengthen European Monetary Union and break the vicious circle between bank and sovereign vulnerability. The European Council affirmed that it is imperative to break the vicious circle between banks and sovereigns and agreed on a roadmap towards a more

¹ Explanatory memorandum of European Commission proposal for a Regulation of the European Parliament and the Council establishing uniform rules and a uniform procedures for the resolution of credit institutions and certain investment firms in the framework of a Single resolution Mechanism and a Single Bank Resolution Fund. P., 4
³ The bail-in tool would enable resolution authorities to write down or convert into equity the claims of the shareholders and creditors of institutions which are failing or likely to fail.
integrated financial framework, including setting up a Single Resolution Mechanism consistent with the BRRD and DGSD. Since the financial crisis, many Member States have established their own special resolution frameworks as a way to preserve financial stability and avoid contagion in the event of the failure of financial institutions and limit use of taxpayer funds. The BRRD will ensure that all Member States have a common minimum set of preventative powers and resolution tools. The DGSD adds to this to ensure a higher level of harmonisation among Deposit Guarantee Schemes in order to minimise distortions created by different levels of depositor protection in the event of bank failure.

Meanwhile the SRM would be a further step towards achieving objectives of financial stability. Even with an established SSM, the development of common resolution tools and harmonisation of depositor guarantees across Member States (achieved by BRRD and the DGSD), the failure of a systemic bank could place excessive burdens on individual sovereigns. This leaves open a channel which contributes to the ‘bank-sovereign’ feedback loop. Evidence over the past three years shows that the risks of such a feedback loop are heightened between the countries sharing a single currency. Therefore, it is argued that establishing an SRM with a common approach to resolution decision making and tools to complement common bank supervision in the SSM would help break the bank-sovereign feedback loop, especially in the euro area. Single Resolution Mechanism with a central decision-making body and a Single Bank Resolution Fund will provide key benefits for Member States, taxpayers, banks, and financial and economic stability in the entire EU:

- strong central decision-making will ensure that resolution decisions across participating Member States will be taken effectively and quickly, avoiding uncoordinated action, minimising negative impacts on financial stability, and limiting the need for financial support;
- a centralised pool of bank resolution expertise and experience will be more able to deal with failing banks in a more systematic and efficient way than individual national authorities with more limited resources and experience;
- a Single Bank Resolution Fund will be able to pool significant resources from bank contributions and therefore protect taxpayers more effectively than national funds, while at the same time providing a level playing field for banks across participating Member States. A Single Fund will prevent coordination problems arising in the deployment of national funds and will be instrumental in eliminating the dependence of banks on sovereign creditworthiness1.

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1 Explanatory memorandum of European Commission proposal for a Regulation of the European Parliament and the Council establishing uniform rules and a uniform procedures for the resolution of credit institutions and certain investment firms in the framework of a Single resolution Mechanism and a Single Bank Resolution Fund. P., 3-4.
Legal basis and the risk of litigation

The Single Resolution Mechanism must be created within the EU legal and institutional framework. The SRM will consist of uniform rules and procedures to be applied by the Single Resolution Board, together with the Commission and the resolution authorities of the participating Member States. However, the issue arises whether article 114 of the Treaty on the Functioning of the European Union (TFEU) is the suitable legal basis for adopting the proposed Regulation? The legal basis for SRM proposal is Article 114 of the Treaty on the Functioning of the European Union (hereafter TFEU), which allows the adoption of measures for the approximation of National provisions aiming at the establishment and functioning of the internal market. The proposal aims to preserve the integrity and enhance the functioning of the internal market. Also the proposal is based under the principle of subsidiarity set out in article 5.3 of the TFEU and under the principle of proportionality (the content and the form of Union action should not exceed what is necessary to achieve the objectives of the Treaties). Potential legal basis problems might go from the degree of the centralization and the appropriation with the primary law. Firstly, the proposal might require changes to primary law. Second, it is unclear is proposal in line with the legal basis of Article 114 TFEU (especially suggested comprehensive transfer of executive competences from Member States to the Commission) which allows for the harmonization of law in the EU so it is necessary to investigate Single Market principles deeper. Also, it could cause the interest of conflict with state of primary law. Another possible legal issue boundary between the Commission becoming Resolution Authority. It is questionable is Article 114 provide sound legal basis for raising levies from the European banking industry, alternatively it should be provided by and set out by Articles 310,311 or 352 of TFEU. Analyzing alternative legal basis in particular, it should be explored, whether the proposal should be considered as a necessary action in the meaning of TFEU 352 with a view of the aim of preserving financial stability in the participating member states, thus falling within the area of economic and monetary policy laid down in TFEU 119.

Furthermore, legal risk pertains to resolution decisions that may factually impact on national budgets, it is reliable that much stronger budget protection must be given to participating Member States in order to ensure legitimacy and compliances with constitutional requirements of Member States. Last but not least, the legal issue might arise in the context whether the delegation of powers to the Board envisaged in the proposal is compatible with EU treaties and the general principles of EU law, as interpreted by so-called “Meroni” case law of the Court of Justice of the European Union. Council lawyers say single market rules are right, as suggested by the

1 See cases 9/56, Meroni, [1957 and 1958] ECR 133,98/80, Romano [1981], ECR 1241, and Alliance for Natural Health, joined cases C-154/04 and C-155/04 and C-155/04, ECR [2005] P. I-06451. Meroni is a long established piece of case law which confirms the ability of the EU Institutions to delegate powers to EU agencies, but which also constrains the delegation of such powers where the use of them would require the exercise of wide discretion. The Court judgement laid down three key principles: 1) An
European Commission, Article 114 (concerning the single market) of the EU Treaty is, under certain conditions, the right legal basis for the single bank resolution mechanism (SRM)\(^2\). Nevertheless, it is still arguable whether article 114 TFEU may be a suitable legal basis for the establishment of the SRM and Single Resolution Fund and, it’s reliable that the legal basis of SRM in the future will be challenged in the court.

If the fundamental decision-making power for resolution of a credit institution remains with the Commission, the Resolution Board will have broad and independent powers to prepare resolution plans\(^3\) and resolution schemes\(^4\) and request their implementation. It is highly important that the SRM’s decision-making powers and voting modalities ensure efficient and timely decision-making, particularly during periods of financial crisis. The responsibilities of authorities involved in the resolution process should be more precisely defined to avoid any duplication or overlap of powers. With regard to the Resolution Board’s powers, a fuller description of how these powers will be executed would improve compliance with the Meroni doctrine, to the extent necessary, with the aim of ensuring, at the same time, that there is sufficient flexibility to deal with each individual resolution case\(^5\). Finally, the proposed regulation has to ensure that any actual resolution decision by the Commission is taken as prompt as necessary. However, it should be taken into account that as long as SRM mechanism responds to a genuine need of uniform application of the rules on resolution that could not be achieved through other methods of harmonization. On the other hand, in order to avoid legal risks it might be a case even to change EU treaties. Changing the EU treaties\(^6\) is a complicated and lengthy process. And once completed, several countries have a requirement to hold national referendums if there is a substantial transfer of competences from national to EU level.

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2 Supra note.

3 See Article 7 of the proposed SRM regulation.

4 See Article 20 of the proposed SRM regulation.


6 The Lisbon Treaty was created before the financial and economic crisis which itself resulted in several new pacts and reforms.
State aid issue

During the financial crisis, the Commission used the state aid framework to seek to preserve a level playing field across the internal market consistent with maintaining financial stability. According to Commission figures, between 2008 and 2012 nearly €1.5tn of State aid (over €5tn including guarantees) was approved to the banking sector to address the financial crisis. Of that, €950bn was approved for the eurozone (€3.3tn including guarantees)\(^1\).

The establishment of the SRM will potentially have a significant impact on the applicability of the banking State aid framework across the internal market and the current proposal embodies significant serious conflicts of interest given the different roles envisaged for the Commission. The Commission is a collegial body that adopts state aid decisions and will in the context of this Regulation also adopt resolution decisions and decisions concerning Single Resolution Fund aid. As it is stated in the SRM proposal “the decision on Union aid” would be “a separate decision from the one on the resolution framework”. Such decision would be subject to the general provisions set forth by Article 107 of the TFEU and to the same criteria laid down in the relevant communications adopted by the Commission on those grounds. Therefore, the Commission would assess, on a case by case basis, if the use of the Fund proposed by the Board in the context of a resolution procedure is compatible with the internal market. The Board would only decide on the resolution scheme once the compatibility of the use of public aid would have been positively assessed by the Commission. This approach seems inconsistent with the proposed Regulation as a stand-alone legal regime for banking resolution in the euro area. Indeed, its provisions already seek to find a balance between the objectives of not distorting competition in the internal market and safeguarding financial stability by establishing detailed requirements and conditions for the Single Bank Resolution Fund to intervene in a resolution context. A separate decision of the Commission on a case by case basis seems therefore not necessary, also considering that the Commission would have in any case the final decision making power on resolution.

Once the SRM will be fully operational, an involvement of the Single Bank Resolution Fund should therefore be treated as a form of public aid *per se* compatible with the internal market, provided that it has been approved and implemented in full conformity with the Regulation provisions. Following this option would not prevent the Commission from reviewing *ex post* the resolution scheme adopted to verify whether and to what extent the intervention of the Fund as envisaged in connection with a specific resolution tools, is in practice proportionate and compliant with the internal market, or appropriate corrective measures or additional safeguards (such as specific obligations or restrictions on the beneficiary entity), are to be further adopted by the Board.

Once the SRM is fully capitalised and has been established in line with the Commission's proposal, SRM interventions which involve the provision of assistance to banks in resolution from the Single Bank Resolution Fund (the Single Fund) would not constitute State aid for the purposes of Article 107(1) TFEU. Such assistance would not, as the proposed Regulation stands, involve "State resources" since the monies in question would not originate from the Member States and because those monies would not transit through a Member State or a body nominated by it for that purpose. Moreover, it is highly doubtful that such assistance could be considered as imputable to a Member State in light of the Puffer and Deutsche Bahn rulings of the Court and General Court respectively. Since such SRM interventions would not involve State aid, Articles 107 and 108 TFEU could not apply directly to them. In terms of the goal of ensuring a level playing field in the internal market, there would be a real risk of perpetuating or exacerbating distortions of competition if banks in resolution were treated differently depending on whether any public support which they obtained were received from the SRM or from a Member State. Such public support from a Member State is more than likely to constitute State aid, while public support from the SRM once it is fully operational would not constitute State aid.

In order to avoid State aid discipline issue, the legislator can decide that in order to ensure equal treatment the same set of substantive rules which ensure the compatibility of State aid with the internal market should be applied to SRM interventions. Without such a framework, there would be a real risk that banks under the SRM would be able to receive public assistance (albeit not State aid within the meaning of Article 107(1) TFEU) on a basis which was less onerous than that which would be applicable to public assistance from Member States to banks outside the SRM. Such a difference in treatment would jeopardise the unity of the internal market.

If extraordinary public financial support is necessary in the resolution of an entity, the Board will invite the relevant Member State to immediately notify it to the Commission under Article 108(3) of the TFEU. The provision of any extraordinary public financial support is decided solely by the Member State concerned. The notification from the Member State to the Commission triggers the assessment under State aid rules of the extraordinary public financial support (the State aid decision). This State aid procedure will run in parallel with the assessment by the Commission of the resolution of the concerned entity (the decision triggering resolution). To ensure consistency between those two decisions, also in this case, the State aid decision is a precondition for the decision triggering resolution, as stated in Article 6(2)(e) of the Commission's proposal. Both decisions are addressed to the Board, which adopts a resolution scheme in accordance with Article 20 of the Commission’s proposal. To conclude, this system requires the establishment of a continuous cooperation and exchange of information between the ECB, the national resolution authorities, the Board and the Commission for the competition of both procedures. Because all of the relevant decisions (namely, the

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1 See Case C-460/07 Sandra Puffer [2009] ECR I-3251, paragraph 70, on the right to tax deductions under the VAT system set up by the Union, and Case T-351/02 Deutsche Bahn AG v Commission [2006] ECR II-1047, paragraph 102, on tax exemptions required by Union law.
decision triggering resolution, the State aid "by analogy" decision and the State aid decision) are taken by the Commission, the goal of ensuring the homogeneous application of the substantive rules on State aid compatibility in relation to bank resolution measures with public support within and outside the SRM can be ensured.

Non contractual liabilities issue

The issue might arise with the arrangements for the payment of costs and non-contractual liabilities of the Commission and, where relevant, of the Single Resolution Board (hereafter-SRB) when performing tasks under the SRM. By way of Article 340 of the TFEU, similar to other areas of the EU policies, (including those where not all EU Members States are participating), the liabilities of the Commission would be covered by the general EU budget.

Non-contractual liabilities of the SRB arising in the course of the performance of its tasks under the SRM are to be met by the Board. In certain instances the SRB shall compensate national resolution authorities in relation to damages awarded against those authorities when acting in accordance with a decision under the SRM. In both cases the liabilities are to be met from the SRB's budget. However, it is concerned from the legal perspective that no similar provision is made in relation to costs and liabilities of the Commission when performing its tasks under the SRM. Therefore, it could be controversial that general EU budget should be immune from any possible cases of non-contractual liability of the EU bodies or institutions taking decisions in the SRM context. It should be taken into account that it should be clear who bear the cost in case of resolution having in mind that resolution in the one hand is a political decision and it might lead to the litigation. In addition, in case of large banks this may cause serious damages, so it should be considered whether the general EU budget should be immune from such liability.

Conclusions

Co-legislators purpose of the SRM is to safeguard financial stability and ensure an effective framework for resolving financial institutions while protecting taxpayers in the context of banking crises. Only with a legally credible mechanism of a failed bank’s creditors can be harness the forces of market discipline and take taxpayers from suffering the losses. Some of the issues where tried to solve with the General Approach in the Council, however, some of them are left and still could be disputed by the European Parliament. In both cases, legal issues could reduce the credibility of the SRM.

Powers to be transferred in the SRM proposal imply a high degree of intrusion in the private sphere (ownership, debt obligations) and important financial/fiscal impact. This need to be reflected in the solidity of the legal basis- otherwise it may be risk the
legal certainty of the decisions in respect to the SRM. Despite the fact that Council legal service agrees on solid legal basis of the SRM, litigation risk still remains.

Adopting TFEU 114 as the legal basis of SRM could result into far-reaching consequences for the future interpretations on EU law and particular the relationship between the single market legislation and the European Monetary Union.

The proposed SRM regulation is designed to ensure the preservation of the Commission’s State aid competences in all resolution cases involving support which is treated as State aid due to EU law. This will be achieved by running the State aid procedure in parallel to the resolution procedure. There is risk that resolution powers provided to the Commission would conflict with role of the Commission in exercising state-aid control, this should be more clarified in the proposal. Given decision making model may raise independence issues.

References


Explanatory memorandum of European Commission proposal for a Regulation of the European Parliament and the Council establishing uniform rules and a uniform procedures for the resolution of credit institutions and certain investment firms in the framework of a Single resolution Mechanism and a Single Bank Resolution Fund.


LIBRARY ROLES IN CHANGING SOCIETY

Laura Juchnevič

Vilnius University, Lithuania
laura.juchnevic@kf.vu.lt

Abstract

Global economy, the development of information and communication technologies, new customer requirements for the quality of products and services encourages organizations to expand their practices, to make innovations, to use creative solutions and to perform new functions – to take on new roles. In this changing environment together with other organizations we have information institutions – libraries. They serve the society, therefore they have to correspond the society needs (Shera, 1976).

Purpose – the purpose of this report is to analyze how changing society can influence the change of libraries roles in it.

Design/methodology/approach — research methodology based on the system and sociocultural systems theories (based on Grenier, 2005) and system approach.

The chosen theory to validate the analysis is the generation changing theory. It says that society consists of groups of different age and different life experiences (history, technologies, political events, etc.) individuals (Levickaitė, 2010). Marc Prensky (2001) claims that our current society can be divided into two groups.

Chosen methods: analysis of scientific literature, synthesis, comparison and summarizing.

Findings – The roles of libraries depends upon occurring changes in society. According to Marc Prensky (2001), it is possible to divide society in two groups, which are: the digital world immigrants and the digital word natives. The first group are the people born before the digital world establishment and expansion, they learned to use it at older age, usually at work or during their studies, and often they do not understand the necessity of new technologies in their lives (meaning they would not experience big discomfort without it). The second group, the natives of digital world, are people born after the expansion of information and communication technologies; they are able to see and also enjoy the meaning of using these technologies. It is lead to the library roles changing from library as the repository to the library as the place and information to the customer anywhere and anytime. Library itself can take and fulfill several roles simultaneously, while responding to various needs of society’s members.

Research limitations/implications – libraries are analyzed as a social institution in the dynamic environment.

Practical implications – it allows to analyze society influence on libraries activities and plan libraries roles changing.

Originality/Value – based on first try to research libraries roles in Lithuania systematically.

Keywords: library, libraries roles, digital native, digital immigrants.
Introduction

Global economy and the development of information and communication technologies together with economic and technological factors which stimulated those changes allow discussing about the formation of a new society. The changing society is examined through Manuel Castells (2000, 2005, 2006, 2007) Network society theory and Frank Webster's (2006) explanations of modern attitudes to society, originating from generations theory in demographical sciences as well as Marc Prensky's (2001) concept of Digital Native and Digital Immigrants. The change of society is analyzed in several dimensions, according to environments (i.e. technological, economic, social, and cultural) and turns in information's infrastructure. Along with a changing society, social institutions face changing needs of their creators. Library is not an exception. Enhanced requirements indicate to reconsider present roles of library in social system as well as adoption of new functions.

Transformation of Society

The analysis of changes in society is supported with Manuel Castells (2000, 2005, 2006, 2007), a Spanish sociologist who has an exceptionally sharp eye for occurring changes in society, Networking theory1, where the main difference from the other society explaining theories is not an increase in a quantity of information itself (which is, of course, not denied), but a social interactions (i.e. an appearance of a network and its intensification) mutation, initiated by technologies and technologies' expansion (Webster, 2006; Castells, 2000, 2005, 2006, 2007). In this concrete analysis, the technological, economic, social and cultural, information dimensions of environment are chosen in accordance with generation change theory, which assesses various generations by the main distinctive features, age of birth and period of juvenescence, historical events, together with experiences linked with them, and the distinction of events according to their importance (Lee, 2012; Rudzkiene and Černikovaitė, 2012; Pilcher, 1994), and etc. The popular name attribution method for generations (e.g., „Boom“, X, Y, Z, etc.), established by the U.S. scientists and used nowadays, is not always applicable in Lithuania. For instance, Boom generation, was named after a demographic bulge which took place after the Second World War in U.S. when many babies were born. Meanwhile in Lithuania there was a demographical „pitfall“ (the number of inhabitants had decreased due to the war and other repressions). It is important to emphasize that, in

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1 Scientists of various fields in the beginning of 21 c. noticed, that new information and computer technologies have stimulated changes in society. To characterize the society they began to use various definitions for this society in scientific fields and everyday life, e.g., „Society of information“, „Society of knowledge“, „Society of technology“, „Network society“ and etc.
this paper different generations' actions in society are analyzed not through generational conflicts but through substantial differences among them.

The divide between generations gives ability to draw clear criterion for identification of differences. Marc Prensky’s (2001) suggested Digital Immigrants and Digital Native definitions, which describe the first ones as the people, who were born before the digital world establishment and expansion, learned to use technologies at older age, and who often do not understand the possibilities of using digital technologies, while the second ones are/were born in digital era, thus knowledge and capable enough to use technologies (Prensky, 2001).

Different generations of people existed all the times but a structure of contemporary society varies from prior ones. Environment changes extremely fast and dynamically, which uncloses big generation gaps; if in feudalistic and industrial societies there was a clear hierarchical structure, in networking society they tend to vanish: actions become more "horizontal" as hierarchical mindset is replaced by network mindset (Laužikas, 2013). Therefore, it can be implied that a turn from agrarian to industrial society, are going further and from industrial to, so called, „information“, „knowledge“ or „networking“ society. An American scientist-futurologist Alvin Toffler claims it to be the third range, so called wave (Informacinių technologijų visuomenė, 2002, p. 36), where:

- **first wave** – agrarian revolution, which took place 10 thousand years ago (agrarian society), and draw out the fruit pickers and hunters society;
- **second wave** – industrial revolution, started with a steam engine appliance which anchored industrial society;
- **third wave** – revolution in production, which was started in XX century with a use of computers, electronics, information and biotechnologies and changed essentials of working nature, lifestyle, value system.

Toffler's division and essential moments of change coincide with Castells’ marked milestones, which have influenced changes in society while technological revolution in information technologies accelerated them even more. According to Frank Webster (2006) and Manuel Castells (2000, 2005, 2006, 2007) different insights on changes in society along with determined quantitative and qualitative changes, joined with Marc Prensky's (2001) proposed different features of society's members and taking into account dimensions of environment, it can be stated that transformations of society exist in:

- **Technological environment.** The amount of technology and its users increase due to advancement in information and communication technologies. Castells (2000, 2005, 2006, 2007) claim it to be one of the most important encouraging factors for changing social structure (Castells, 2005, p. 28). Advancement of technologies has influenced not only transformations in economic environment but everyday life also, for example new technologies allowed to communicate within large distances. Researches of technological expansion may help to foresee the outlook of society in the near future. McKinsey Global Institute (2013) scientists committed a research, trying to evaluate which and how technologies are going to affect the living, business and global economy (research „Disruptive Technologies: Advances that Will Transform Life, Business, and the Global Economy“, 2013). In dispute of the research, there were indicated twelve possible
technologies which may potentially make an influence until 2050, such as mobile, automation of knowledge work, the internet of things, cloud technology, advanced robotics, autonomous and near-autonomous vehicles, next-generation genomics, energy storage, 3D printing, advanced materials, advanced oil and gas exploration and recovery, renewable energy (McKinsey Global Institute, 2013, p. 17).

Marc Prensky (2001) insights on various generations attitudes towards modern technologies are valid in Lithuania’s case also; according to Lithuanian Statistics (Lietuvos statistikos departamentas, 2013), in 2010-2013 Lithuanian inhabitants up from the age of 16 m. there using computers more but there was a noticeable disparity in frequency of using the technologies between the youngest users (16-24 yrs.) and the older age people (65-74 yrs.). If during the same period of time the 65.5% of the first age group was using computers (2013 yr. – 97.6%), then the second group in 2010 was 9.9% (in 2013 the percentage of users increased to – 15.1%) (Lithuania’s department of statistics’ report „People that have used a computer and the internet in the last three months (2010-2013)”) (Lietuvos statistikos departamentas, 2013). Even though there is an increase in computer usage between older people, Prensky (2001) claims it does not necessarily mean they feel an urge for technologies and understand the benefits for their well-being.

- **Economic environment.** Changes also occur in economic environment while value is added with a help of information and knowledge. M. Castells (2000, 2005, 2006, 2007) believes, that after economies of the world have interlinked with each other economic, country’s and society’s relationships have harvested a new form, composing various configurations system (Castells, 2005, p. 17). Relevant is advancement stable integration growths strategy, which allow to create „growing“ society; the main regulations of it are stated in European Commission strategy „Europe 2020“ (2020 Europa, 2010), aiming the strategic goal to restore the growth until 2020, which would differ from pre-crisis period in a way of being stable and ensuring people’s occupation level, social and territorial cohesion (2020 Europa, 2010). The strategy is directly linked to European Commission program „Horizon 2020“ that enables to encourage economy and secure scientific and technological base (Horizon 2020).

- **In social and cultural environment.** Steady changes in environment have a lot of influence on working age people, i.e. if before the acquired knowledge was useful during all the work-life, now constant requirements are being established for the workers: new skills and competences related with advancement of technologies are constantly in request (Laužikas, 2013). Especially great difficulties are experienced by those who create service or educate younger generations (Prensky, 2001). Jeanne C. Meister and Karie Willyerd in their book „The 2020 Workplace“ (2010) define three forces which form a future job, they are globalization, demographics and social networks (Meister and Willyerd, 2010). The paradox occurs when job places (also in management) are filled with older generation members, which are classified as digital world immigrants, meanwhile products and services are created by younger generations, digital world natives, therefore it may happen that message addressed for the users may be „encoded“ in a „language“...
which is well understood by older generation but difficult to comprehend for younger ones (Prensky, 2001; Laužikas, 2013).

- **Infrastructure of information.** M. Castells (2000, 2005, 2006, 2007) does not deny the impact of the quantity to the being of society, but indicates that the society has been controlling information at all times (Webster, 2006), that is why the main difference is not the quantity of information, but its effectiveness in the network. The information that is in the network is global. In Christine L. Borgman’s (2003) opinion, it creates the infrastructure of information: networks of computers and communication allows to integrate work and activities, related with the search of information, creation and usage, to improve interaction of these types of activities and to make them more dependent on each other (Borgman, 2003, p. 36).

Christine L. Borgman’s (2003) insights complement M. Castells’ (2000, 2005, 2006, 2007) research and conclusions. In „From Gutenberg To Global infrastructure Of Information“ (Borgman, 2003) it is summarized, that infrastructure of information – is not the substitution of the telephone, radio and cable networks, computer systems, libraries, archives and museums, schools and universities, banks and governments, but a new derivative, which covers and complements all of these technologies and institutions, but is nor the cause for them to vanish (Borgman, 2003).

To summarize, we can state, that the changes in the society are being determined in technological, economic, social and cultural environments also in the infrastructure of information and the complexes of these environments.

**Library Roles for the Changing Society**

U.S. scientist Jesse H. Shera (1976) justifies the library as a wide part of a social system created by people, naming libraries as social institutions for the needs of the society (Shera, 1976). Because the library is a social infrastructure, changes in the environment make a huge impact on it. In this case – in the society, because the library is a conditioned and formed by social environment (Shera, 1976). So, the library is an inseparable part of the society, and the force that unites and supports the society – is culture, according to J. H. Shera (1976). Analyzing the system of the libraries as a part of social system - society, there is a vision given by the scientist, when culture is based on three components, connected to a triangle working as a whole (Shera, 1976):

- **Psychical Equipment.** Society uses it to fulfill and reach their goals. The equipment (the first to contemporary devices) reflects the variety of mankind’s experience (Shera, 1976).

- **Scholarship** that connects the sides as a factor that connects and stimulates the society to improve, philosophical system or that, which connects a person with other people and environment (Shera, 1976).

- **Social Organization** – the base of the triangle, to which is attributed the role of a cultural implementer through a certain system. Libraries also act as one of the parts of
the system in this part of the triangle, created and supported by the needs and expectations of the society, according to J. H. Shera (1976).

The three provided sides, according to the author of the theory, must work in harmony, but in the society little attention is given to knowledge, and all this does not reflect in organizations, it can “deform” the culture, that exists in the society.

In the center of the triangle J. H. Shera specifies „communication” – the mediator of culture, that passes on ideas (Shera, 1976), traditions, customs, and other components of culture. All this is happening regardless of time and space.

So in the social system the library works as an integrated cultural factor (in a wider sense), which according to David Reith (1984) distinguishes the roles, that have to fulfil social needs. According to the scientist, roles of the libraries consist of their performed functions (Reith, 1984):

1. **Repository role.** Storage and management of society’s documents by acquirement (collecting), preserving (conserving), describing the document created by humanity;
2. **Information role.** Dispersion of the collected data (information).
3. **Education role** connects the functions of the prompter of formal and informal learning, function of organizing teaching, also the educator’s of civil consciousness functions, etc.
4. **Social advocacy** covers functions such as dispersion of library’s resources in the society. This role relates to the document task of the library, effective services, inclusion of socially sensitive groups to social and cultural activities and other functions.

Similar roles are distinguished by Thorhauge, Larsen, Thun, Albrechtsen (1997). According to the scientists, libraries can fulfil several roles at the same time or one of them (Thorhauge et al, 1997):

- **The cultural center.** Libraries that fulfill this role, have to carry out the functions of: support and dispersion of cultural identity, versatile cultural understanding, support of the culture of local community, inhabitants’ inspiration to participate in the local society.

- **Education and the local learning center.** Libraries that fulfill this role support formal and informal education by supplying useful and the newest information, by supporting and stimulating grownups to learn for their whole lives, by providing opportunities to study, by organizing gatherings and by providing an environment suitable for learning;

- **General and special information service.** In this role, libraries fulfil these functions: they support and stimulate activities of local business, supports the local government and authorities, carry out the activities of research and education;

- **A shelter.** Libraries take the function of public space, in which socially vulnerable groups like children from problematic families and homeless people, etc., can find a place to be in.

The library fulfils its roles through a network of libraries. A network of libraries in the dictionary “Knygotyra” (1997) is defined as an entirety of libraries associated with certain attributes (a theory, a type, an area of science) (Knygotyra, 1997, p. 65). So, assessing the territorial arrangement of all working Lithuanian libraries, we can assign them all to the Lithuanian network of libraries. According to the statistics of Lithuanian
libraries (Lietuvos bibliotekų statistika 2013 m., 2014), in 2013 there were 2980 all kinds of libraries (including the main ones, branches, service points and mobile libraries). The network in Lithuania in the year 2013 has reached and had (Table 1. Lithuanian Libraries’ network in 2013 (Lietuvos bibliotekų statistika 2013 m., 2014)):

<table>
<thead>
<tr>
<th>Size of the fund (dec. 31)</th>
<th>Number of registered users</th>
<th>Visits (Number of users)</th>
<th>Number of professional librarians</th>
</tr>
</thead>
<tbody>
<tr>
<td>107 198 647 phys. units.</td>
<td>1 311 558</td>
<td>24 555 634</td>
<td>6004</td>
</tr>
</tbody>
</table>

Source: Lietuvos bibliotekų statistika 2013 m., 2014

According to the law of Lithuanian Libraries’ network (Lietuvos Respublikos bibliotekų įstatymas, 1995), Lithuanian libraries’ network consists of: Lithuania’s national library, county public libraries, public libraries, libraries of education institutions, school libraries, special libraries and others (Lietuvos Respublikos bibliotekų įstatymas, 1995). Also, there are five libraries that have a national importance status for their fulfilled functions and their accumulative funds’ exclusivity (Lietuvos Respublikos bibliotekų įstatymas, 1995): Lithuania’s library for the blind, Lithuania’s library of Vrublevskiu science academy, Lithuania’s library of technology, the library of Vilnius University.

So the Lithuanian libraries’ network consists of libraries of different types, dependency, etc., in example servicing different societies in accordance with their needs, and organizing different funds, that in a whole form Lithuania’s libraries’ serviced society and funds. Every library in the network fulfils certain social roles, that match the needs of the society, in this way forming an entirety of roles and by reaching members of the changing society. Theoretical assumptions, that different roles of libraries are relevant to different members of the society, are being made. According to M. Prensky (2001), by evaluating the change of the environment and the roles of the libraries, we might assume, that immigrants of the digital world, that are affected by changes in their environment such as entrenchment of information and communication technologies in all areas of their lives, disappearing professions, social – demographical society’s change, and abundance of information, stimulates libraries to take on and fulfil the roles that are important for this part of the society, such as the role of a mediator of information and knowledge, stimulator of education and life-time learning, supplier of common and special information (especially important to people that are creating a business), educator of digital literacy, etc. (Figure 1. Immigrants of the digital world and libraries (based on Pilcher, 1994: Meister and Willyerd, 2010; Levickaitė, 2010; Prensky, 2001; Selwyn, 2009; Lee, 2012; Rudzkienė and Černikovaitė, 2012; Laužikas, 2013)).

The situation of the natives of the digital world is different (information and communication technologies are being used intensely, innovations are accepted and absorbed quickly; selection of profession is difficult, because there is no guarantee, that after finishing your studies, the received education will be needed in the labor market;
intense usage of electronical social networks that change their view to communication, interaction, etc.; the quantity of information is not a disturbance to use it, but frequently information that is unreliable and “created by everyone” is used) that is why rising requirements for the libraries differs, which determines other assumed roles, such as inclusion to social and cultural activities, a place to be in, communicate, “third place”, shelter, stimulator of life-time learning, a helper in education and etc. (Figure 2. Natives of the digital world and libraries (based on Pilcher, 1994; Meister and Willyerd, 2010; Levickaitė, 2010; Prensky, 2001; Selwyn, 2009; Lee, 2012; Rudzkiene and Černikovaitė, 2012; Laužikas, 2013)).

### Table 1. Immigrants of the digital world and libraries

<table>
<thead>
<tr>
<th>Environment</th>
<th>Technological</th>
<th>Economical</th>
<th>Social</th>
<th>Infrastructure of information</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Immigrants of the digital world</strong></td>
<td>Usage of contemporary technologies at work, receiving services, goods, coming of alternative leisure</td>
<td>Changes in the labor market: disappearing professions, work at home, changes of salary payment, etc.</td>
<td>Low birth rate, high number of divorcements, emigration, etc. Disappearing hierarchy in social structures.</td>
<td>Increase of information, the need of digital literacy, the need of knowledge of how to choose accurate and quality information.</td>
</tr>
<tr>
<td><strong>Roles of the libraries</strong></td>
<td>Mediator of information and knowledge, stimulator of education and life-time learning, supplier of common and special information, digital literacy educator, etc.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: based on Pilcher, 1994; Meister and Willyerd, 2010; Levickaitė, 2010; Prensky, 2001; Selwyn, 2009; Lee, 2012; Rudzkiene and Černikovaitė, 2012; Laužikas, 2013

### Table 2. Natives of the digital world and libraries

<table>
<thead>
<tr>
<th>Environment</th>
<th>Technological</th>
<th>Economical</th>
<th>Social</th>
<th>Infrastructure of information</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Natives of the digital world</strong></td>
<td>Intense usage of contemporary technologies, alternative leisure, the need of new technologies and their entrenchment</td>
<td>Choice of profession (popular professions), the need of higher education, vision and planning of the future</td>
<td>Changes in family structure, integration to the society, changes of attitude towards education. Reticulate perception of the world, usage of el. social networks</td>
<td>Ability to process, analyze and use huge quantities of information, trust in common sources of information that are created by the society.</td>
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<tr>
<td><strong>Roles of the libraries</strong></td>
<td>Inclusion to social and cultural activities, a social space, “third place”, shelter for socially sensitive groups (also children); a part of the education system, stimulator of life-time learning and etc.</td>
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Source: based on Pilcher, 1994; Meister and Willyerd, 2010; Levickaitė, 2010; Prensky, 2001; Selwyn, 2009; Lee, 2012; Rudzkiene and Černikovaitė, 2012; Laužikas, 2013
Conclusions

Analysis of scientific publications revealed the relationship between the changing society and roles of the library. The change of society is related with its changing environment. While analyzing society’s technological, economic, social and cultural environments, also the infrastructure of information, it is notable, that not only quantitative changes (like abundance of information) are happening, but also qualitative changes: labor market’s requirements, coming of new professions, changes of the attitudes towards family and social relationships. Changes of the environment differently affects different members of the society. Based on natives and immigrants of the digital world concept, it becomes clear, that changing society has a different impact on them, in example contemporary technologies of information and communication are a necessity for the digital natives, but for the digital immigrant it is just another means, a tool, to carry out their work.

In this changing society (social system) there are social institutions, and the library is one of them. Being directly coherent with the social system, libraries create roles that match the needs of the society. The library, as a social institution, can fulfil one or more roles at a time (it depends on the needs of the serviced society). While analyzing the influence of the environmental changes, we can make a conclusion, that different roles of the libraries can be important for different members of society, in example, while the quantity of information is increasing, libraries as mediators of information becomes very important for the immigrants of the digital world, because it allows them to freely access and use quality information. On the other side, the natives of the digital world, that are constantly being surrounded by technologies and a huge amount of information, might need the library as a space to communicate, to be in, share their experiences etc. with their contemporaries, friends, and people with common interests.

The accomplished analysis has allowed to theoretically evaluate the influence to the roles of the libraries by the changing society. It is considered, that further empirical analysis is needed, to purify the roles of the libraries that match the needs and expectations of the changing society.

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RESPONSIBILITY TO PROTECT. QUALITATIVE CHANGE IN UNDERSTANDING SOVEREIGNTY?

Tomasz Lewandowski

_Adam Mickiewicz University, Poland_

_tolewan@amu.edu.pl_

**Abstract**

**Purpose** – This article analyzes and evaluates a conceptual switch in contemporary understanding of sovereignty under constitutional and international law. It mainly focuses on sovereignty as responsibility as provided by the concept of responsibility to protect.

**Design/methodology/approach** – Article answers this question in three parts. Firstly, it elaborates on traditional understanding of sovereignty as a state oriented concept. Secondly, it discusses the concept of responsibility to protect and how it challenges a state centered sovereignty. It concludes with assessing sovereignty as responsibility and consequences of such approach.

**Findings** – Sovereignty as responsibility has a dual character. Firstly, it is the government's responsibility for the well being of people it represents. Secondly, it is the responsibility of international community to protect populations from mass atrocities based on the idea of subsidiarity and international solidarity. While underlining the normative character of the former the article questions (at least now) its existence in case of the latter. Article leads to conclusion that sovereignty continues to evolve as the foundation for the entire international system and that protection of human rights only reinforces its quality and value.

**Research limitations/implications** – The main research limitation is a dubious character of responsibility to protect. Due to the controversial state practice it is difficult to assess its current normative character. This limits the research on the qualitative change of sovereignty and its impact on international relations.

**Practical implications** – Article underlines that any action taken by members of international community while protecting endangered population must follow international and constitutional norms. This would clarify the state practice and _opinio iuris_ which are the conditions to establish the customary character of responsibility to protect.

**Originality/Value** – Contrary to the majority of papers on intervention or sovereignty this article focuses on constitutional challenges for the successful implementation of the responsibility to protect. It analyzes constitutional principles governing the exercise of the concept by both state and international community.

**Keywords:** international law, sovereignty, human rights, responsibility to protect

**Research type:** research paper
Introduction

Many regard sovereignty as indivisible and inviolable attribute of each state. A sovereign state can independently exercise political power over a given territory and a group of people. It is free to choose its political, economic, social, and cultural system as well as to decide on its internal and foreign policy. However, this idea was always connected with the ability to guarantee the best interests of state's own citizens who are one of three elements of statehood. If a state could not act in their best interests, it could not be thought of as a sovereign state, simply it lost its legitimacy to have authority over the citizens. Thomas Hobbes claimed that: “the obligation of Subjects to the Soveraign, is understood to last as long, and no longer, than the power lasteth, by which he is able to protect them”.

This old requirement of sovereign's responsibility for the well being of its people has been questioned especially in Rwanda, Kosovo, Darfur, Libya and Syria. These examples show that sometimes sovereignty serves as an excuse for non-intervention in internal state matters especially when state commits mass atrocities against its people. It has raised a potential conflict between the values declared by international law of human rights (ex. human life, human dignity) and the value protected by sovereignty - state's reserved domain to make independent decisions as to its internal situation. The growing importance of human rights in international law gradually changes such interpretation of sovereignty. This trend has been mostly reflected by the concept of responsibility to protect which challenges Westphalian idea of state-centered sovereignty and characterizes it in accordance with contemporary functions of the state and international community, focused mainly on the protection of individuals.

In present article I analyze this qualitative change in understanding sovereignty in three parts. Firstly, I elaborate on traditional understanding of sovereignty as a state oriented concept. Here, I demonstrate the difficulties in defining sovereignty and in shaping its content. Secondly, I discuss the concept of responsibility to protect and how does it challenge a state centered sovereignty. In this part I present the development and the elements of responsibility to protect, which brings me to the conclusion about its impact on contemporary law. In the last part, I finish with the assessment of sovereignty as responsibility which proposes to understand sovereignty as the individual (or rather population) oriented concept. Here, I develop on a double character of this responsibility: national and international. Then I shortly describe the existing (popular sovereignty, representativeness) and emerging (principle of international solidarity and global governance) reasons for responsibility.

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1 See: Art. 1 of Montevideo Convention on the Rights and Duties of States from 26th December 1933, 165 LNTS 19; 49 Stat 3097.
The concept of sovereignty

It is not easy to define sovereignty. This task meets with “genuine intellectual difficulties”1 as the term itself is often described by different categories such as independence, non-intervention, exclusive jurisdiction, self-determination or reserved domain. This can result in a vicious circle of committing an ignotum per ignotum error. As Koskenniemi criticizes: “to define sovereignty with independence is to replace one ambiguous expression with another”2. Even stronger critique on defining sovereignty comes from such highly qualified scholars as Henkin who proposes to “slowly ease the term out of polite language of international relations”3 or Lauterpacht who questions its meaningful specific content4. Despite these conceptual problems sovereignty stands as the foundation of international law and relations. It is considered as its “basic norm”5, “global covenant”6 and “cornerstone”7.

The classic characterization of sovereignty comes from the 1928 arbitration award by Judge Huber in Island of Palmas Case, where he declares that “sovereignty in the relations between states signifies independence: independence in regard to a portion of the globe is the right to exercise therein, to the exclusion of any other state”8. Formula expressly underlines that sovereignty is an attribute of state which can be freely exercised within its borders. Does it mean it is only limited by sovereignty of other states?

The Permanent Court of International Justice in its famous Lotus verdict explains that “unless specific prohibiting rules exist state sovereignty – the sphere of its legitimate action is unlimited”9. Then the basis to limit state sovereignty is provided by international law enshrined in treaties, customary law and general principles recognized by civilized nations. The growing range of international regulations and development of international relations tends to question the classical shape of sovereignty. Sovereignty has to adapt and undergo these significant changes. By limiting its original exclusivity, international law accompanies it with clearly defined obligations which takes sovereignty out of the world of fogged illusions. “The essence of the law is not to allocate competences

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9 The Case of the S.S. Lotus, France v. Turkey, 1927 P.C.I.J. (ser. A) No. 10 (Sept. 7).
but to establish duties as exceptions to the initial liberty. It is not sovereignty that
determines the extent of State's legal rights, liberties and competences – it is latter which
determine the extent of its sovereignty”\(^1\).

Although sovereignty still enjoys a special position, it does not mean it is now a sole
foundation of international order. Contemporary, globalized system of international rules
is based on many values of great importance and different character. Except sovereignty
international arena is designed by peace, security, justice, human rights or development.
There is no possibility to focus all international efforts to protect and promote only one of
them. Such approach will only cause the destruction of other values. International norms
based on these values help understand modern notion of sovereignty. Modern trend in
international law is to treat international values as a whole, to interpret and apply them
in accordance and respect towards each other. This effects in different attitude towards
the classic, sacrosanct understanding of absolute sovereignty by determining it through
the lens of human rights obligations and safeguarding the well being of people. This
humanized approach focuses not on what sovereignty was but what function it has here
and now. One of such approaches is exampled by the concept of responsibility to protect.

**Responsibility to protect**

On September 2001 International Commission on Intervention and State
Sovereignty presented a report titled Responsibility to Protect\(^2\). This document presents
a new approach to deal with mass atrocities around the world. According to authors State
sovereignty is not a privilege; It means responsibility of moral and legal nature · to
protect its citizens from genocide, war crimes, crimes against humanity and ethnic
cleansing\(^3\). If the state is unable or unwilling to fulfill this obligation, the international
community shall assist or replace it in doing so. Responsibility to protect was developed
to reach two goals: to prevent and stop core human rights violations and to establish a
platform for such reaction in accordance with the principles of international law.

ICISS Report examines the concept of responsibility to protect in three parts:
responsibility to prevent, responsibility to react and responsibility to rebuild. Through
prevention both state and international community should address the root and direct
causes of conflicts that put populations at risk. Democracy, rule of law, peace building
and human rights approach · these are the possible preventive methods. Responsibility to
react is not a new terminology for describing humanitarian intervention. Advocates of
Responsibility to protect underline that it is not a license for intervention but rather an
international guarantor of international accountability\(^4\). Such approach moves the center
of gravity from the right to intervene to the interests of the people waiting for help.

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3. ICISS Report, Par. 2.4.
Reaction is wider than intervention. If the preventive measures fail, international community must react through different diplomatic channels. Military intervention is *ultima ratio* here. It must respect the principles of: right intention (to halt or to avert human suffering), last resort (exploration of peaceful means), proportionality (minimum necessary to secure human protection objective) and reasonable chance of success. The last component, responsibility to rebuild is not discussed as loudly as the preceding two. It is mainly caused by the common agreement on its necessity and importance. In this part Commission’s report focuses on help with recovery, reconstruction and reconciliation as methods to guarantee stable and permanent resurrection of the human rights capacity and rule of law.

The idea developed by the ICISS was later adopted by UN General Assembly in 2005 World Summit Outcome Document par. 138 and 139\(^1\) which findings on responsibility to protect may be synthesized as follows: Each and every state is responsible for the well being of its citizens. It must prevent them from suffering mass atrocities like genocide, war crimes, crimes against humanity or ethnic cleansing. In case of failing to do so the international community’s responsibility to react starts. This Document has officially put responsibility to protect at the United Nations forum as a new tool to combat mass atrocities\(^2\). Despite of that warm recognition by General Assembly and its further development under the leadership of Secretary General\(^3\) and his Special Representatives on Genocide and Responsibility to Protect, practice of implementation has shown that there is no common understanding of the concept among member states. Especially, its controversial exercise in Darfur and Libya, and ongoing conflict in Syria show there is still much to be done.

While responsibility to protect has moved rapidly within the international arena, it does not have the degree of acceptance that would justify its description as legal norm. However, it continues to evolve both politically and legally. It touches upon some vital principles of international law, namely those of the sovereign equality of states, non-interference with the internal affairs of states, of the use of force by states in international relations and their interrelationship with respect for human rights. Responsibility to protect does not challenge the legal significance of sovereignty. The concept protects the sovereignty, however, not of any kind but national sovereignty ideologically determined by well being of population – in other words - responsible sovereignty. Responsibility to protect does not discuss “whether sovereigns have

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3 See: SG’s Reports: Implementing the Responsibility to Protect from 12 January 2009; Early Warning, Assessment, and the Responsibility to Protect from 17 July 2010; The Role of Regional and Sub-regional arrangements in Implementing the Responsibility to Protect from 27 June 2011; Responsibility to Protect – Timely and Decisive Response from 20 August 2012; State Responsibility and Prevention from 5 August 2013.
responsibilities but what these responsibilities are and how they are best realized and what role international society should play”1.

**Sovereignty as responsibility**

Sovereignty understood as responsibility first appeared in Deng’s book „Sovereignty as Responsibility: Conflict Management in Africa”, in which author pointed that sovereignty is not merely the right to be undisturbed from but responsibility to perform tasks expected of an effective government2. Responsible sovereignty may be seen as a consequence of the humanization of international law as described in the first part of this article. A. Peters sees two major consequences of this process as to the sovereignty: firstly, external state sovereignty requires, just as internal sovereignty, a justification, and secondly, sovereignty implies responsibility3. Responsible dimension of sovereignty consists of two levels: national and international. The former is a privilege dependent on the fulfillment of responsibilities towards own population and international community, while the latter should be exercised by international community in case of state's failure at the national level. Given this, sovereignty as responsibility should be understood within two leading categories:

1. Each state exercises its sovereignty in certain manner which is protected and governed under by law;
2. This exercise encounters a limit exposed by the obligation of states to protect fundamental rights of their population which in some cases may be enforced by international community.

Correspondingly, responsibility to protect is a shared obligation of state and international community. What are the legal explanations for this responsibility?

a) *Explanation for State's responsibility*

Responsibility to protect emphasizes that “sovereignty should not be seen as control but as responsibility in both internal functions and external duties of states4. This is not anything new. Popular sovereignty demands governments not only to protect people from atrocities but to effectively represent their interest. This good representation serves as the main legitimacy of any government. When it fails to perform this task by letting mass atrocities happen, it ceases to be legitimate on internal (towards population) and international (towards international community) level. Responsible execution of sovereign rights and duties acquires that government is an agent of its people as it is

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1 A. Bellamy, *op. cit*, p. 32.
bound by social contract. Mass atrocities are the most invasive violation of this contract. Agents should exercise sovereignty while bearing in mind that they can be held accountable not merely before its people (who when oppressed may not even have such ability) but (and this the new spirit provided by responsibility to protect) before international community. As a principle Nation as a sovereign has the absolute right to remove the government (exact executors of its sovereignty) from the power through inter alia impeachment, non-regular elections or even to fix/change the constitutional order. However, the problem appears when it is practically unable to do so because the government abuses its right to execute the power in the name of Nation. This is the case of mass atrocities when the Nation is depraved of their sovereign status by a governmental group. Then how to prevent such extreme violation of sovereignty by state government? Responsibility to protect concept states that it requires human rights capacity building performed by state in assistance of international community.

Human rights capacity may be achieved mainly by democratic means\(^1\), which should focus on finding and eliminating root causes of atrocities. Constitution building is of great importance here because it juxtaposes the duty to rebuild with future atrocities prevention. Responsible sovereignty demands for democratic pluralism, political participation and finally protection of minorities\(^2\). Firstly, the pluralism in the execution of state sovereignty is of absolute necessity. Human rights order cannot be reached without a consensus among different state and non-state actors. It is often achieved through constitution drafting in which the representatives of all communities should participate, which leads to the second element of political participation of local communities. Constitution should guarantee that in the rebuilt society everyone has a possibility to actively act in the political sphere through ex. fair elections, assemblies, associations and free speech. Thirdly, as the atrocities sometimes result from conflict between communities constitution must seek for the fair agreement between majority and minority of citizens. In this manner constitution functions as a sui generis peace treaty on which further democratic processes are based.

Therefore, it is the constitution as compilation of fundamental principles organizing the state's relation towards the people, which should serve as an explanation of state's responsibility to protect. It is a Constitution which serves as a foundation for the protection of the sovereignty of nation from the governmental abuses. In the case of mass atrocities performed by state, nation seeks to reestablish their status with the help of international community. It is a result of the fact that government violated the constitutional order and there is no possibility for the nation to held the government accountable for this violation.

\(b)\) Explanation for responsibility of international community

\(^1\) This poses another doubt about responsibility to protect as a concept which limits state's choice of political system to the one which corresponds with democratic ideas.

Subsidiarity is an organizing principle, stating that interests ought to be dealt by the lowest, or least centralized authority capable of addressing these interests effectively. It stands as one of the founding principles of the European Union\textsuperscript{1}. Responsibility to protect establishes that primary responsibility for the well being of population (in other words protection of the sovereign will of nation) lies within the form of state. International community has to take steps only when representatives of nation are unable or unwilling to do so. This may be done either by regional organizations or United Nations as organization. Such construction can be characterized as subsidiary because it actualizes only when the lower level of protection is not effective. This is followed by the idea of global governance\textsuperscript{2}, which aims at solving problems that affect more than one state or region when there is no power of enforcing compliance. Global governance may be really useful in developing the idea of responsible sovereignty as shared responsibility. However, right now it lacks strict normative background. It is rather political approach, although attractive it depends more on good will than obligation of the states.

Responsibility of international community to assist states in protecting their populations is also reflected by the idea of solidarity among its members. It is still doubtful whether it is a customary norm or a general principle of international law but moral obligation to help weaker states in achieving certain goals has long been accepted either in form of humanitarian or financial aid. Can international altruism serve as an explanation to assist foreign populations within responsibility to protect?\textsuperscript{3}. Peltonen seeks its origins in earlier concept of states as 'good international citizens' that “subscribe to such principles as democracy, human rights, and good governance practices, and practice these within their domestic jurisdiction”\textsuperscript{4} and are ready to safeguard these principles elsewhere in the name of global good. Constitutional reflection of the principle of solidarity can be found ex. in the Preamble of Polish Constitution: "Aware of the need for cooperation with all countries for the good of the Human Family, Mindful of the bitter experiences of the times when fundamental freedoms and human rights were violated in our Homeland, Desiring to guarantee the rights of the citizens for all time (...), Recognizing our responsibility before God or our own consciences(...)\textsuperscript{5}. This is not a provision of binding character but it clearly provides some guidelines on policy directions towards responsibility to protect.


\textsuperscript{5} Konstytucja Rzeczypospolitej Polskiej [Constitution of the Republic of Poland], Dz. U. z 1997 r. Nr 78, poz. 483.
Does it explain why international community of states is bound by responsibility to protect endangered populations everywhere? Responsible sovereignty presupposes that members of international community are somehow responsible for well being of people globally\(^1\) because they share some universal principles. Although universal character of these principles is disputed\(^2\), some of them are valid independently of anybody's acceptance as in the case of prohibition of genocide, war crimes, crimes against humanity and ethnic cleansing. Values such as human dignity, human solidarity are definitely not against active participation in applying responsibility to protect as long as it reflects legal standards. Contemporary legal obligations question moral principle of solidarity. First of all constitutional law protects everyone within the territory or under jurisdiction of given state. Moral solidarity with foreign populations meets an obstacle of 'solidarity' with own population, which members have a legal stand to expect a proper realization of their interests.

Any international assistance may result in harm towards own citizens, so it is not an easy task for government to decide upon such matter. The mere solidarity with victims of mass atrocities may not be enough to explain the costs of assistance and intervention. This is not only the question of soldiers who die during missions but mainly economic costs which often destabilize budgetary balance. This may cause internal troubles with effective governance in fields like public health, or education. It implies that any government should ask itself whether it can afford its international assistance. Given that the more powerful states have a far greater economic, diplomatic, logistical and military capacity their responsibility to respond and react to mass human rights abuses is arguably greater. However, practice of world powers directly shows that often it is a self-interest which governs their decision making. This is the reality of international relations. It cannot be judged since every state acts in their capacity to obtain as much gain as possible. Therefore, for better implementation responsibility to protect should be explained in terms of state's interest. Mass atrocities definitely demonstrate a threat to global peace but first of all they impose great financial costs on international community especially on neighborhood countries which often have to deal with mass influxes of refugees or bear other trans-boundary risks.

**Conclusions**

The concept of responsibility to protect explains that sovereignty can not legitimize actions such as genocide, war crimes, crimes against humanity or ethnic cleansing. Sovereignty is not a license to mistreat populations. Today's sovereignty should be exercised responsibly and in accordance with human rights commitments of the states.

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\(^1\) See: idem, p. 82.

As the actors of international relations they should act as responsible representatives of nations. Opponents of the concept believe that the use of human rights as a value equal to or even more important than sovereignty leads to the erosion of the system of values of the international community. It definitely leads to evolution of this system. Responsibility to protect is an ally of sovereignty not an adversary, no transfer and no dilution of state sovereignty but necessary re-characterization involved.1

Evolution requires states to treat responsible representation of sovereign nation as a legal not only a moral duty. International level is only one side of the coin. Necessary state practice must be attached to constitutional framework of policy making in each and every state. Responsible sovereignty touches upon it from two perspectives. Firstly, it requires constitutional systems of countries in which there is a risk of mass atrocities to develop a human rights capacity to protect its population. Secondly, it challenges constitutional law of assisting countries, particularly as to the constitutionality of the potential participation in the external assistance or intervention. The former is based on the popular sovereignty and legitimacy of representativeness, which have customary background, while the latter are based on flexible ideas of solidarity and global governance which still lack the legal recognition by international community. Nevertheless, sovereignty continues to evolve as the foundation of the entire international system. Its evolution answers growing needs of people. Respect and protection of human rights only reinforces its quality and value.

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NETWORK APPROACH TO THE MANAGEMENT OF INNOVATION SYSTEMS

Lina Skeberdytė

*Mykolas Romeris University, Lithuania*

*lina.skeberdyte@mruni.lt*

**Abstract**

*Purpose* – the purpose of this paper is to analyze the context of the public governance changes with an emphasis on networks and to identify the key features of how these changes influence the transformations of the innovation system management.

*Design/methodology/approach* – analysis of scientific literature.

*Findings* – the paper reveals that the combination of high level of collaboration actions and intense level of knowledge flow is considered as a central point of competitiveness in the network system.

*Research limitations/implications* – The paper analyses the environment of the public governance changes and its influence to the innovation system management with an emphasis on the unique features of knowledge networks.

*Practical implications* – the article describes a holistic view on network approach to public governance, based on two contrasting perspectives on networks: network as *logic of organizing* and network as *analytic perspective*. The synthesis of both perspectives is used to analyze the transformations of innovation system.

*Originality/Value* – The study integrates the network governance and knowledge-based collaboration streams of reasoning to give a unique contribution towards the understanding of the fundamental network factors that are essential to the contemporary knowledge-based management of innovation systems.

*Keywords*: innovation management, inter-organizational networks, network governance, knowledge networks, knowledge transfer.

*Research type*: conceptual paper, literature review.

**Introduction**

If we accept that knowledge is the key driver in today’s economy and a fundamental condition for economic growth it means that constant knowledge-seeking, knowledge absorption, knowledge creation and knowledge transfer are the most important sources to obtaining long-term competitive advantage.
Last two decades of the XX century were marked by significant structural transformations influenced by the emergence and diffusion of information and communication technology. The world was connected into a global, informational and networked social structure called network society (Castells, 2005).

Networks and networking have been recognized as key factors in strengthening the innovation capacity of a country and responding to the challenges of increased international competitiveness (Rampersad, 2008). According to Badaracco (1991) the central domain in the age of the constantly proliferating knowledge “is a social network that absorbs, creates, transforms, buys, sells, and communicates knowledge. Its stronghold is the knowledge embedded in a dense web of social, economic, contractual, and administrative relationships”. This stream of reasoning has directed the research of innovative modes of governance and knowledge management towards the creation of new forms of intersectoral collaboration, various types of partnerships, networks and networking techniques. (Raipa, 2011; Domarkas, 2011).

This article provides a holistic view on the management of innovation networks suggesting the combination of knowledge management and networking as background for the successful development and management of innovation networks in order to be competitive in the world system.

The purpose is to analyze the context of the public governance changes with an emphasis on networks and to identify the key features of how these changes influence the transformations of the innovation system management. The object of the paper is the transformations of public governance and their influence on innovation management. Key tasks: (1) to analyze the network approach to public governance; (2) to explore the changes of the scientific society influenced by the network governance, (3) the change of the essence of the architecture of the innovation networks and (4) Change of the essence of social relations between actors.

Network approach to public governance

Prior to any study on networks, the definition of what is meant by the term network is necessary because despite the growing amount of literature on network and networking but no unified definition is formed.

In order to describe a holistic view on network approach in the context of the organization and management literature Powell ir Smith-Derr (1994) suggested two contrasting perspectives on networks – networks as logic of organizing and networks as analytic perspective (Saz-Carranza, A. 2007).

The logic of organizing approach refers to the main conflicting images of governance modes (Williamson, 1975): markets, hierarchies and networks as the means of governing the relationships between the different organizations (Lowndes and Skelcher - 1998).

Network as an analytic perspective emphasizes the relational aspects of actors, and uses the term as a metaphor for conceptualizing and understanding social reality (Dowding 1995). This use of the term focused mostly on embeddedness of the actors in a network and various forms of social relations.
The synergy of the two perspectives describes a holistic understanding on the network approach to public governance.

The logic of organizing perspective refers to the evolution of the modes of governance and the contrast between networks and the traditional forms of markets and hierarchies (Powell 1990). These forms may be roughly characterized by governance through competition, direct governance, and governance through cooperation. (Hewitt 2000)

Early research on network governance focused on defining the network model as a separate paradigm: the third mode of governance. In recent years, however, large amount of literature conceptualized networks as a hybrid form of organization that merges two extremities: hierarchy and networks (Thorelli 1986; Siebert 1991; Sydow 1992) because it contains characteristics of both forms (Tamyko Ysa, Ferran Curtó & Marc Esteve). In the scientific literature most authors refer to this hybrid model as governance, holistic governance, or occasionally network governance,

Agranoff (2007) proposed a term of collaborarchy. Klijn (2008) argues that both concepts refer to the same thing. Walker, O'Toole and Meier (2007) define network as “a pattern of interdependence among social actors in which at least a portion of the links are framed in terms of something other than superior - subordinate relations. Parts of this network may include hierarchical arrays, but at least some portions of the pattern are linked in another fashion”. (Walker et. al. 2007)

Pure cooperation is not the background of network as a mode of organization. The unique idea of the network governance lies in the synergy of the principles of hierarchy and market. Therefore network approach is compared to social constructionism in the sense that each case/project/situation is regarded as unique therefore it requires relevant unique treatment (Hjelt et al., 2008). Network governance combines vertical/horizontal coordination; control-command/competition/collaboration etc. According to van Dijk (2006) mutual trust and the reputation of participants are the cornerstones of the progress and internal accounting of networks.

In recent years, high attention is brought to the analytic approach to the networks in order to understand how the networks operate and how the knowledge is absorbed, created and shared among the actors of the network. In large amount of scientific literature this approach refers to the social network theory that focuses on social relations between actors.

Broadly speaking, a network can be loosely defined as a set of actors connected by ties, where two or more agents, at least in part autonomous, which are interdependent and give rise to an exchange relationship, according to certain modalities and forms”. (Understanding Supply Chains, 2004)  

Transferred to management studies, a network of organisations can be understood as a set of “formal and informal relationships that shape collaborative actions” (Atkinson & Coleman, 1992: Dredge, 2006b) among all the actors of public, private, non-government sectors: individuals, groups, organizations, collectives of organizations, sectors as well as regions, countries etc. According to D. Carson, A. Gilmor and S. Rocks (2004), a network is a form of partnership and collaboration. It unites the individuals, groups and organizations that have common goals and empowers them to exchange resources, information and knowledge in order to improve the efficiency of their activities. Networks
have been analysed from different approaches and various theoretical perspectives in organization studies (Nohria, 1992; Oliver and Ebers, 1998). Researchers tend to distinguish two levels of analysis: the structural properties and the processes involved in developing and sustaining networking relations also known as networking (Alter and Hage, 1993). Networking is a fundamental component that connects the dimensions of a network and covers a variety of collaborative actions in order to exchange/transfer knowledge and information. Networking is defined as a process by which two or more organizations and/or individuals collaborate to achieve common goals (Waring 1997). Vilkas and Bučaitė (2008) proposed that networking should be defined as “purposeful action to shape network”.

In order to structurize the network concept, four network dimensions can be distinguished: node, link, network as the entity and networking as the dynamic component. The classification of the basic components of the network, points out the following four constituent dimensions of characteristics of structural and social-relational features of the network components:

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<td>Network</td>
<td>Embeddedness</td>
<td>Set of nodes and ties;</td>
<td>Size, density, distance, bridges, Redundancy (structural holes)</td>
</tr>
<tr>
<td>Social</td>
<td>Networking</td>
<td>Process of interaction</td>
<td>What is exchanged and how;</td>
<td>Exchange of goods (work flow networks); exchange of information, knowledge and ideas (communication networks); affect or linking (friendship networks).</td>
</tr>
</tbody>
</table>

Source: Adaptation based on various sources.

Structural qualities of the networks can be used as important tool for the explanation of the performance and outcomes of the network, because they reveal relational and social information of the process of interaction of the network. The analysis of these elements provide important information such as how actors are or are not connected, who are the effective central key players, who create/absorb/share the highest levels of knowledge and information etc. These different measures allow us to make value insights and assumptions about the way that information and knowledge flows are organized in a network.
Centrality is one of the most important concepts in social network analysis. It is an index related to the potential importance of a node and is directly related to the process of networking.

![Diagram showing the relationship between the level of interaction, level of knowledge flow and centrality.](image)

**Figure 1. Relationship between the level of interaction, level of knowledge flow and centrality**

Network centrality can be considered as the index of an important structural source of power of the organization (Ibarra, 1993). Central position can only be held by controlling the highest level of information and knowledge flows. Some nodes have greater “influence” over others compared to the rest, or are more easily accessible to other, or act as a go-between in most node-to-node communications. This dynamic creates a hierarchy of networks in networks. Figure 1 illustrates a model of centrality conditions based on the analysis of the two-folded network conception. Central position should be understood as a highest level of competition where knowledge is the basic advantage. A high level of knowledge-based interactions is the key condition and the key of competitive advantage in a contemporary networked economy.

On the ground of the analysis of the two folded concept of network, three flows of changes are distinguished as for further analysis of the networks implications to innovation systems:

- Change of the essence of scientific society.
- Change of the essence architecture of the innovation system.
- Change of the essence of social relations between actors.
Change of the essence of scientific society

The essence of the changing scientific society was explained by distinguishing two contrasting modes of knowledge production. Gibbons et al (1994) argue that global changes of societies transformed the process of knowledge creation and led to the emergence of a new form of knowledge production, Mode 2 alongside Mode 1. Mode 1 represents traditional university research performed, established and governed by closed academic community with strong hierarchies and isolated disciplines. According to Viliūnas (2006), Mode 1 represents the generation of knowledge within a disciplinary, primarily cognitive, context where problems are set and solved by the, largely academic, interests of a specific community.

Here Mode 2 is seen not as a contrast to Mode 1 but rather as the globalization-influenced evolution of the same paradigm. There are five fundamental principles that reveal the nature of knowledge creation in contemporary knowledge-driven network society: (1) knowledge is produced in the context of application; (2) transdisciplinarity; (3) heterogeneity and organizational diversity; (4) quality control and (5) social accountability and reflexivity (Nowotny et al. 2001). Scientific questions rise from the practical needs and the value of knowledge is estimated by its applicability impact on economy (Viliūnas, 2006). Innovation becomes a general incentive to encourage the creativity of the society, transparency, trust, changes in management that create added-value and long term advantage (Mosta, 2009). In Mode 2 science is applied, technologies are transferred and knowledge is managed. The key drivers of Mode 2 paradigm are not only the generation of new knowledge, but also configuration of existing knowledge, knowledge transfer and application. Contrary to Mode 1 where the function of knowledge creation was attributed exclusively to researchers of the universities/institutes, Mode 2 promotes heterogeneity and focuses on the mutual integration of private and public research. This led to the emergence of new transdisciplinary fields of research (biotechnology, information technology etc.).

Change of the essence of the architecture of the innovation networks

In the context of National systems of Innovation, Etzkowitz & Leydesdorff (1995-2000) explained the emerged institutional arrangements of university–industry–government relations by introducing a Triple Helix model. The authors distinguish three stages of intersectoral collaboration evolution.

First two stages, the so-called “etatistic” model and the “laissez faire” model of university–industry–government relations can be compared with the hierarchic mode of governance in the sense of the vertical control and the strong influence of the government in shaping research and industry sectors. There was a weak or no connection between the sectors. All strategic initiatives came from the government as well as the decisions on the finance, policy etc. (Etzkowitz, H., Leydesdorff, L., 2000). With the emergence of market ideas in the public governance, and later – the network governance – the transitional
“laissez-faire” stage of university–industry–government relations evolved into the Triple Helix stage that promotes interdependent connections between university–industry–government by blurring boundaries between disciplines, research fields and functions as well as by introducing new forms of dynamic collaboration and communication initiatives such as joint projects, interorganisational institutions, Complex research and innovation programmes, centres of excellence etc., in order to promote innovation development in all sectors on all levels (Kiškiene, 2010).

Aside of the original functions each sector acquires the qualities and characteristics of the other two. The state becomes a collaborator, “enabler” (Etzkowitz, Leydesdorff, 2000; Etzkowitz, 2002). A special attention is payed to the changing role of universities and public research institutions. In addition to education and research functions they are attributed by a so-called Third Mission (Kiškiene, 2010). This view highlights knowledge transfer responsibilities and activities (Martinelli, Meyer & Tunzelmann 2007; Bramwell & Wolfe 2008) and focuses on the external outcomes of entrepreneurship such as new venture creation and commercialization of research findings. This function requires cardinal re-thinking of the strategies in order to compete for external research funding and emphasizes business-like efficiency (e.g. Liesner 2006). Industry sector becomes an important actor in shaping public governance, national economies.

Change of the essence of social relations between actors

The free flow of knowledge and information is a key characteristic for innovation networks, where interactions typically occur between the nodes in the networks. According to Powell, Koput, and Smith-Doerr (1996), sources of innovation do not reside exclusively inside firms: instead, they are commonly found in the interstices between firms, universities, research laboratories, suppliers and customers.

According to Granovetter (1985), all economic processes are socially embedded, consequently innovation is considered to be the outcome of interaction among firms as well as between these and local institutions. Various types of relationships exist among the actors of a network ranging from highly informal, flexible and trust-based relations to more formalised and stable arrangements, such as partnerships. However, beneath every formal network (research co-operations, joint ventures, etc.) lies a sea of there are various informal networks that give it life and sustainability.

Regarding the ties among universities, incubators and industry, Rothschild and Darr (2005) observe that informal networks play a central role in the development of emergent technology and are more important than formal connections. These informal relations can be considered as networks inside the networks in the networked society. Blau and Scott (1962) observed that the influence of the informal relations must be taken into account and evaluated in order to describe a holistic view on processes within the formal organization. Martins (2009) emphasizes that social networks are the key to transforming the individual resources into organizational resources. Breschi and Lissoni (2004) and Singh (2005) observed, that the researchers that work together on the same invention or project form social networks that correlates with the variance in citation
patterns within and across regions (Cartoni, D., Gardim, N., Caballero, S., Silveira, M. A. 2013). In this perspective, different authors (Vasconcelos & Campos, 2010; Tomaél, Alcará & Di Chiara, 2005) argue that informal social networks promote innovative activity by maintaining channels and information and knowledge flow in which the connection between actors is developed by fostering trust, reliability and respect. According to Schmidt (2007), observed that the literature on informal R&D collaboration and the channels of information and knowledge flows are very closely related. Meyer-Krahmer and Schmoch (1998) highlight the importance of informal contacts and collaborative research as channels of communication between firms and public institutions.

It is fair to state that successful informal collaboration is the key to successful formal collaboration. Therefore it is important to develop both forms especially when innovations are concerned. Here formal relations are being created in a way that they would also encourage the development of informal relations.

However despite of the importance of social relations, little research has been done in exploring the relationship between formal and informal collaboration, the processes of the development of informal relations as well as the collaboration mechanisms for facilitating networking and their influence on innovation clearly needs to be investigated further.

Conclusions

The two-folded concept of a network is based on organizational and analytical perspectives. The contemporary networked society is considered as a hybrid mode that contains the features and means of hierarchy governance and market governance and it is considered as a network of networks where the capability of networking in order to absorb, create, share and transfer knowledge is becomes the most important competitive advantage.

Central position in this system of networks depends on the actors’ capability to intensively interact in the network by combining the maintenance of high level collaborative actions and the capability to effectively control knowledge flows.

The changing environment of public governance changes the essence of the scientific society. Knowledge creation becomes an interactive process of the information management and it goes together with knowledge transfer and collaborative actions because in the contemporary knowledge-driven networked society science is applied, technologies are transferred and knowledge is managed.

The change of the essence of the scientific society implicates the institutional transformations: changing roles, functions and relationships between university, industry and state. From the highly vertical construction governed by state actors this relation becomes an interdependent network of public-private-non-government organizations that interact through the various forms of formal and informal collaborations.

Informal collaboration becomes a field of interest regarding the management of innovations. Informal collaboration has been recognized as an important factor of
innovation process and one of conditions of successful formal collaboration. Formal relations are being created in a way that they would also encourage the development of informal relations. Despite this fact, the relationship between formal and informal collaboration, the development of informal networking relationships, the collaboration techniques for enabling networking and their influence on innovation clearly requires further research.

**Recommendations**

As it was argued in this paper, formal and informal forms of collaboration and the relationship between these forms are clearly an important topic for further research on networks and network centrality and should be taken into account when analyzing competitive advantages of the organization.

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HOMESCHOOLING IN POLAND? LEGAL STATUS AND ARGUMENTS USED IN POLISH DEBATE OVER HOME EDUCATION

Szymon Paciorkowski

Adam Mickiewicz University, Poland
szymon.paciorkowski@gmail.com

Abstract

Purpose – the purpose of this article is to summarize the legal aspects of home education in Poland, with particular emphasis on the evolution of the provisions of the Polish School Education Act 1991 and selected jurisdiction of Polish administrative courts.

Design/methodology/approach – research was based on the analysis of legislation, including legislation drafts, published studies and other scholarly works as well as published opinions. The scientific approach was based on investigating which legal aspects of homeschooling have raised most controversies and have been thoroughly discussed.

Findings – the main findings of the research focus on presenting the evolution of the Polish education law regarding the issue of home education and the reactions – both from the legal doctrine and the practitioners of homeschooling – to changes of law. Practical aspects of implementation of the provisions were also shown on the examples of the verdicts of Polish administrative courts.

Research limitations/implications – article is based on already published works, but it proves that a clear evolution of Polish government’s approach to home education can be observed. However, the adoption of more accurate and clear provisions does not mean that they are less restrictive, although the recent amendments remove some of the obligations. Practical implications – article may be helpful for scholars interested in analysis of the Polish regulations applied to the home based education, offering them a summarized history of regulations and a selection of publications devoted to this subject. At the same time it points to the necessity of preparing more unbiased publications pertaining to the matter.

Originality/value – the article is has the form of literature review; it is mostly based on already published articles and selected verdicts. Its value lies in a summarized presentation of the direction of the evolution of Polish regulation considering home education.

Keywords: the right to education, homeschooling, administrative law.
Introduction

The essence of home education (also known as homeschooling or home based learning) was accurately summarized in six points by a noted researcher Dr. Brian D. Ray in his article published in conference materials – “Szkoła domowa. Między wolnością a obowiązkiem” (2011, edited by J. Piskorski). Three of these points are particularly worth quoting: “Education based on home and family includes: 1. Parental obligation of their children’ upbringing and education. 2. Education, for which the family home constitutes the main basis and supply network and which takes places under the parental supervision. (...) 4. Teaching in home environment rather than in institutional class in school”1. Home education is especially widespread in the United States. European countries observe a diverse approach towards home based learning depending on the attitude of a given government: from tolerant regulations, considering homeschooling as alternative to mandatory public school system (e.g. Great Britain) to highly restrictive provisions, which allow it only under exceptional circumstances (e.g. Germany)2.

The key to the understanding of the Polish education system is to distinguish between two terms: the broader concept of “compulsory education” and the narrower concept of “compulsory school attendance” or “school obligation”3. In accordance with Article 70 of the Constitution of the Republic of Poland of 2nd April 19974 education to the age of 18 years is compulsory and the manner of fulfilment of schooling obligations (compulsory school attendance) is specified by statute5. The constitutional provisions were repeated in the Article 15 of the Polish School Education Act of 7th September 1991 (hereinafter referred to as: SEA)6, which regulated the education system in Poland after the political transformation in 1989. Its current version clarifies the notion of compulsory school attendance: “Compulsory school attendance starts with the beginning of the school year in this calendar year, in which the child turns seven and continues to the completion of the education in the gimnazjum (lower secondary school), but no longer than to the age of 18 years”7. A further explanation of this matter is comprised in the provisions of the Article 16 SAE. According to Article 16 Paragraph 5 SAE compulsory schooling is fulfilled by the attendance at the Polish public or non-public primary and lower secondary school

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2 Polish Eurydice Unit prepared a special report on the status of home education in various European countries (Edukacja domowa, 2007), based on a questionnaire sent to 31 Eurydice Units and answered by 14 of them.
5 Cf. Banaszak (2012); Skrzydło (2013) – commentaries on article 70 of the Constitution of 1997; cf. M. Mozdżer-Marcinkowski (2008), pp. 478-482. Noteworthy is that according to Article 48 of the Constitution parents have the right to rear their children in accordance with their own convictions.
7 After recent changes in Polish education system primary school will be mandatory for 6 year old children.
and according to Article 16 Paragraph 5a SAE after the completion of a lower secondary school the compulsory schooling is executed by attendance at a public or non-public upper secondary school or by employer-provided vocational training in accordance with separate regulations. It should be noted that according to Article 14 Paragraph 3 SAE from school year 2004-2005 every child is obliged to attend either pre-school classes or kindergartens during one year of obligatory pre-school education1.

**Difficult beginnings**

A short regulation dedicated to the admissibility of home education also appeared in the SAE. In the original text of the Act from 1991 Article 16 Paragraph 8 read as follows: “At parents’ request the school head may give his permission for fulfilling the school obligation out of school. A child fulfilling the school obligation in this form may attain the primary school leaving certificate on the basis of classification examination conducted by the school, which head had given permission for this form of school obligation”. The SAE and the provisions of Article 16 Paragraph 8 underwent multiple modifications within the next decade. Some of them were combined with the education system reform in 1999 and the introduction of new lower secondary schools (gimnazjum), others affected the matter of the school head relevant in issuing permission for home education2. However, there was still a lot of uncertainty in applying the provisions of the Article 16 Paragraph 8 SAE. Discretionary decisions issued by the school heads were common. In the consolidated text of SAE, which was published in 2004, Article 16 Paragraph 8 sounded: “At parents’ request the head of public primary or lower secondary school, in the school district where the child lives, may give his permission for fulfilling the school obligation out of school and determine the conditions of its execution. A child fulfilling in this form the education or school obligations accordingly may receive a certificate of promotion to a higher grade or a school-leaving certificate on the basis of the classification examination conducted by the school, which head had given permission for this form of school obligation”3.

In the first decades after the introduction of SAE of 1991 the issue of possible home education affected only a handful of Polish children. However, some groups of active parents interested in this form of education have emerged over the years. Subsequently they took measures to organize themselves. Additionally, the first publications on the subject of homeschooling, based also on rich literature from abroad (particularly from the United States) began to appear on the Polish market. Highly important in those fields were the activities of Marek and Izabela Budajczak, who practiced home based learning since the mid-1990s. In his book “Edukacja domowa” (first published in 2002) Marek Budajczak – a researcher at Adam Mickiewicz University in Poznań first focused on the pedagogical and sociological aspects of homeschooling. However, M. Budajczak referred

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3 Consolidated version of Polish School Education Act, Dz. U. 2004, No. 256-2572.
also to everyday practice of application of the provisions of Article 16 Paragraph 8 SAE of 1991 by public school heads and the educational officers at local and regional levels, while describing many years of struggles for obtaining permission for homeschooling and promoting his children to higher grades. Budajczak’s book became a model for next publications. Hitherto the most comprehensive of them has been an anthology edited by Marzena and Paweł Zakrzewski (2009). It contains a collection of over 25 articles, devoted to various aspects of home education. Majority of them were written by parents active in homeschooling. In addition to historical, psychological, sociological and pedagogical issues of home based education, its legal aspects were discussed as well. Some authors presented the everyday problems associated with applying unclear provisions of education law and the ordeal of regular classification examinations. Other articles analyzed the general issues of legal status of homeschooling in Poland. Finally, two articles brought to attention applying home based education to chronically ill children.

Although the matter of homeschooling involved only a small group of students, the vague nature of the provisions of the SAE of 1991 led to prolonged legal conflicts, which sometimes found their conclusions in courtrooms. Such conflicts were – for example – related to the obscure legal nature of the permission for home education granted by the head of the relevant school. This problem became also a subject of litigation before the Supreme Administrative Court in Warsaw. The analyzed case started in April 2007, when the parents of a minor applied – on the ground of Article 16 Paragraph 8 SAE – to the head of the relevant primary school for a permission to conduct home education in the school year 2007/2008, while determining the conditions of its execution. The first request was denied by the school head. The subsequent application contained detailed reasons for the permission, but the school head failed to respond to the substantive content of application. In the absence of the school head’s decision about the permission for homeschooling the parents decided to submit a complaint about the inactivity of administrative authorities to the Voivodship (Regional) Administrative Court in Warsaw. However, the complaint was rejected by the Court as the judges stated that emphasized in the statement of reasons for the decision, that “(...) the school head’s permission for fulfilling the school obligation out of school, (...) neither occurs in a form of an administrative decision, nor constitutes a specific type of act or different action of public administration, that would concern the entitlements or responsibilities arising from the legal regulations. (...) it should be stated, that the complaint about the inactivity of administrative authorities is not possible in this case, since it does not address any of the aforementioned forms of activity of the administrative authorities”.

The child’s parents refused to give up and filed a complaint of cassation. In its decision from 11th September 2008 the Supreme Administrative Court in Warsaw set aside the contested ruling and referred the case back for reconsideration to the

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3 Chłodna (2009); pp. 105-118; Zielińska (2009), pp. 475-490.
4 Jachimczak (2009), pp. 221-254; Pastuszek-Lipińska (2009), pp. 291-302
5 Decision of the Voivodship Administrative Court in Warsaw, 21 May 2008 (case No. I SAB/Wa 24/08).
Voivodship Court which issued the previous ruling. The Supreme Administrative Court took a completely different view on the legal nature of school head’s permission, as it was stated in the statement of reasons: “since (...) the school obligation (compulsory education) is an administrative obligation, so the case concerning its fulfilling out of school is an individual case decided by way of proceedings before public administration bodies” – and moreover – “the material law regulations do not need to (...) indicate the direct form of dealing with the administrative case. The indication of the public administration body’s jurisdiction to settle the case with a specific verb form, allows reaching a conclusion, in what form the public administration body should deal with this case”. Therefore, the Supreme Administrative Court held that the school head’s permission for fulfilling the school obligation out of school is expressed in the form of an administrative decision, which can be subsequently challenged with a complaint about the inactivity of administrative authorities1.

Towards major changes. Act of 2009

The state of legal uncertainty, which examples have been described above, proved that fundamental change in existing regulations were necessary2. Long expected changes in the field of home education were introduced during the Polish Sejm’s 6th term of office (2007-2011). However, these changes seemed to be overshadowed by much discussed reform important for the whole education system: the lowering of the age of commencement of compulsory education from 7 to 6. The draft legislation from November 2008, proposed by the Donald Tusk’s government provided also for significant changes to Article 16 SAE. In the statement of reasons of the draft legislation it was emphasized, that the proposed amendments would aim to extend the parents’ right to be given permission for conducting home based education. The aspiration to clarify the conditions necessary for obtaining such permissions and to eliminate the discretionary nature of school heads’ decisions in those cases was also pointed out. The statement of reasons of the draft legislation referred also to the issue of the mandatory classification examinations. It was noted that – in accordance with the demands of homeschooling practitioners and expert opinions – their frequency should be reduced3.

1 Decision of the Supreme Administrative Court of 11 September 2009 (Case No. I OSK 1077/08).
2 In the years 2006 – 2007, when the Ministry of National Education was headed by right-wing minister Roman Giertych, attempts were undertaken to amend the SAE of 1991 and to liberalize the procedures regarding home based education in Poland. However, due to the shortening of Polish Sejm’s term of office and the change of government the works on the amendment were left unfinished (cf. Śliwerski (2009), pp. 361-374). The situation of Polish families practicing homeschooling became a matter of concern also for the Polish Ombudsman and the Ombudsman for Children. Both officials issued a joint statement in January 2007, in which they requested the Minister of National Education to undertake actions in order to ensure equal educational opportunities for the children, whose parents would like to fulfill the compulsory education in form of homeschooling. The statement contained references to the Constitution and the international treaties ratified by Poland, v: Statement from 16.01.2007 (No. ZBA-500-3/07/KB) – cf. Polaszek (2011), pp. 62-63.
After a few months of the legislative process and introduction of some changes the Act of 19 March 2009 amending the SAE of 1991 was adopted by Polish Sejm. The new regulation came into force on 22 April 2009. Article 16 SAE was thoroughly restructured in order to clarify the procedure of obtaining the permission for homeschooling and subsequently conducting it. The bulk of regulations adopted in 2009 have remained in force up to this day. According to the new wording of Article 16 Paragraph 8 at the request of parents the head of a kindergarten or a primary, lower secondary and upper secondary school, to which the child was admitted, may permit, by way of decision, fulfilling the obligation mentioned in Article 14 Paragraph 3 SAE [one year of obligatory pre-school education] out of kindergarten, pre-school classes, other forms of pre-school education, as well as school obligation or compulsory education out of school. In accordance with Article 16 Paragraph 10 SAE (in the original version of Act of 2009), the permission, referred to in Article 16 Paragraph 8 SAE might have been issued after meeting certain conditions by the applying parents: 1) request for permission had to be filed until 31st May; 2) the application had to be accompanied by the following documents: an opinion from a psychological and pedagogical counselling center, parents’ statement about providing the child with conditions enabling the completion of core curriculum obligatory for specific level of education and a parents’ commitment, that while fulfilling the school obligation or compulsory education their child would take an annual classification examination during each school year. It should be noted that in accordance with Article 16 Paragraph 14 the permission would be withdrawn in occurrence of one of the following situations: 1) at the request of parents; 2) if the child for any unexplained reasons did not attend the annual classification examinations or did not pass them; 3) if the permission had been issued with violation of law.

Coming into force of the amendments of 2009 was met with mixed feelings by the Polish practitioners of home education. Those concerns were visible in online discussions, newspaper articles and other publications. Good examples of such doubts raised by the experts are two articles published by Anna Zielińska and Andrzej Polaszek. In her article, Anna Zielińska pointed at various possible shortcomings of the amended SAE of 1991,
mentioning for instance: the unclear scope of opinion issued by the psychological and pedagogical counselling center as well as the unspecified nature of ground for withdrawal of the permission based on non-attendance or “negative result of classification examination” – particularly in relation to the youngest pupils\(^1\). More extensive criticism towards the amended SAE came from Andrzej Polaszek, who stressed in his article that “the amendments did not remove the fundamental flaws of the existing regulations”. In particular, the necessity of obtaining a special permission allowing the home based education from the school head by parents (which was also kept in force after coming into force the Act of 22\(^{nd}\) March 2009) and the parents’ obligation to have their child admitted to a public or non-public school prior to their application for the homeschooling permission were assessed negatively. As in Anna Zielińska’s article harsh criticism was directed also against the unclear legal nature of the parental obligation to submit an opinion from the psychological and pedagogical counselling center and the inevitability of attending mandatory annual certification examinations\(^2\).

Finally, it should be noted that proponents of home education emphasize the fact that – in accordance with the current regulations of 2009 the permission for homeschooling may be issued not only by the school head from the district the child lives in, but also by every head of a public or a non-public school to which the child has been admitted. The homeschooling practitioners also note that the matter of recognizing the school head’s permission as an administrative decision – with regulated appeal proceedings – has been finally clarified\(^3\). The amendments of 2009 went therefore in the same direction as the jurisdiction of Supreme Administrative Court already described above. However, other commentators (Król, Kuzior, Łyszczarz, 2011, p. 183) have noticed that issuing homeschooling permission by heads of all non-public schools and kindergartens, may raise doubts about possibility of equaling these “decisions” with the term of “administrative decisions”, as referred to in the Polish provisions.

**Current situation and new amendments**

Over the past decade the issue of home based education has experienced growing interest from the legal scholars’ perspective, although the number of publications is still unimpressive. Apart from legal commentaries on educational law a few articles devoted

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1 Zielińska (2009), pp. 483-490.
2 Polaszek (2011), pp. 66-68. Both aforementioned authors dedicated separate paragraphs of their articles to the issue of the legal nature of school head’s permission to conduct home based education, as described in Article 16 Paragraph 8 SAE. They appreciated the fact of removing from the amended Act the head’s entitlement to “define the conditions” of fulfilling the compulsory education out of school. This removal – as the authors stressed – reduced the interference of the administrative bodies in the process of child’s education. At the same time A. Polaszek was disappointed with the final shape of the amended Act and the use of phrase “may permit” referring to the school head’s competence to issue a permission, since the original draft legislation had contained a more restrictive phrase: “permits – by the way of administrative decision”.
to this matter should be noted. Tomasz Bąkowski analyzed the issue of homeschooling, basing on the principle of subsidiarity, while Adam Bochentyn searched for the connections between home based education and process of privatization of public tasks. Other authors mentioned this issue within broader research focused on compulsory education. An article by Michał Moźdżeń – Marcinkowski is worth noting, since the author concentrated on the matter of administrative policy and Constitutional background for homeschooling.

Despite recent amendments to the SAE of 1991, parents’ attempt to conduct home school education can still lead to lengthy litigations in Poland. One of such cases started some time before the adoption of Act of 19th March 2009 when the pupil’s parents applied for the permission to teach their daughter out of school. After the amended regulations of CAE came into force, the school head required the parents to file an opinion from the psychological and pedagogical counselling center – as referred to in the new Article 16 Paragraph 10 SAE. However, the child failed to attend the examination in the allotted time and – because of the absence of the opinion – the school head refused to issue permission for homeschooling. After the decision was upheld by the public administration body at higher level (Regional Education Superintendent), the parents filed a complaint to Voivodship Administrative Court in Lublin. They pointed that they had applied for the permission for homeschooling before the amendments to SAE were adopted in March 2009, so the administration body (school head) should have had applied the provisions which had been in force at that time. However, their complaint was dismissed. The Administrative Court was of the opinion that because the Act of 19th March 2009 did not contain transitional provisions, the new provisions – more rigorous – were applied also to the cases started before the adoption of the amendments. Therefore filing the psychological opinion was necessary for obtaining the permission.

Subsequently, the parents filed a complaint of cassation. The complaint was successful and the Supreme Administrative Court in Warsaw set aside the contested verdict and referred the case back for reconsideration to the Voivodship Court, because of the violation of procedural provisions – particularly the provisions of the Polish Code of Administrative Proceedings (hereinafter referred to as: CAP). In particular the administration bodies made in this case no use of an already existing opinion from the psychological and pedagogical counselling center about this particular student, which had been prepared a few years earlier and remained at the disposal of the school administration. The case returned to the Voivodship Administrative Court, which followed the Supreme Administrative Court’s interpretation of law and revoked the

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5 Consolidated version: Code of Administrative Proceedings, Dz. U. 2013, Pos. 267 (with further amendments).
6 Verdict of the Supreme Administrative Court, 17 August 2010 (case No. I OSK 898/10).
challenged decisions. The Regional Education Superintendent attempted to contest the verdict, but the complaint of cassation was dismissed\textsuperscript{1}.

The ongoing legislative work aimed to partially meet further expectations of Polish homeschooling practitioners. One of such matters was the resignation from the obligation of applying for the permission to conduct home based education in the next school year no later than by the 31\textsuperscript{st} May. Draft legislation, concerning the multiple amendments of various aspects of SAE of 1991 was introduced by a group of Sejm deputies in January 2014 and received support from Donald Tusk’s government. According to the proposed amended version of the SAE the permission for home based education could be issued “before the beginning of the school year or during the school year”, so the parents would be able to apply for the permission during the whole year. In the statement of reasons of the draft legislation the intention to expand the scope of parents’ role in child’s education was emphasized, as well as the importance of the proposed regulations for some specific groups of families – like children returning to Poland after living abroad or starting their compulsory primary school education at age of 6. The proposed Act was passed by Polish Sejm in March 2014 and some subsequent amendments were adopted by the Senate\textsuperscript{2}. The Act came into force in June 2014\textsuperscript{3}.

Conclusions

As indicated above, the Polish legislation in the field of home education has evolved considerably since the introduction of SAE in 1991. Currently, homeschooling in Poland finds itself in a very interesting situation. As pointed by pioneering Polish practitioner of homeschooling, M. Budajczak, the number of parents interested in this form of education has significantly increased within the last few years\textsuperscript{4}. Although it is difficult to verify these data, it should be stated, that the issue of home based education in Poland no longer affects only an extremely small group of parents. This trend will probably continue in next years because of aforementioned new factors (like the beginning of compulsory primary school education at age of 6), which may prompt some parents to undertake homeschooling. In author’s opinion the amendments of SAE (of 2009 and 2014) have simplified the procedure of applying for homeschooling permission, although some obstacles (like the discretionary nature of school head’s decision) still remain. Time will tell if the current provisions concerning the obligatory opinions from psychological and pedagogical counselling centers as well as classification examinations prove efficient and not too harsh for the parents.

Finally, a question should be asked, whether the recent amendments of 2014 are only a step forward in the process of gradual liberalization of the education law provisions? It is

\textsuperscript{1} Verdict of the Voivodship Administrative Court in Lublin, 9 December 2010 (case No. III SA/Lu 444/10) and Verdict of the Supreme Administrative Court, 8 June 2011 (case No. I OSK 385/11).

\textsuperscript{2} Sejm Paper No. 2132 from 24.01.2014 (7h Term of Office), pp. 15-17 – with further opinions etc.

\textsuperscript{3} Act of 24 April 2014 amending the Polish School Education Act, Dz. U. 2014, pos. 458

important to note that the issue of home education is attracting a growing interest from Polish legal scholars, so it can be expected that the future will bring more balanced studies on the legal aspects of home education in its wake.

References

Abstract

**Purpose** – to analyse and evaluate the activities of Pasvalys municipality in terms of safety development in the district.

**Methodology** - Document analysis and empirical qualitative study. Semi-structural interviews were conducted with representatives of the main institutions ensuring safety in Pasvalys district. 12 interviews were completed with experts from the Police Headquarters, Pasvalys municipality, Fire and Rescue Board, Wards, Ministry of Internal Affairs.

**Findings** – while going deeper into the problem itself on theoretical level, it was established that equally important roles are played both by local societies and local institutions.

After having analyzed the activities of Pasvalys district in terms of residents’ safety it was found, that institutions involved in safety issues interact in analyzing risk factors and the main risk groups, collaboration between institutions is efficient. Statistic data shows the movements towards positive changes in some safety areas. Such change can be understood as a reflection of effectiveness of safety measures.

There are some areas where the municipality could put more efforts. The Concept of Safe Municipality is not fully implemented. There is lack of motivation in collaboration between nongovernmental organizations. Establishment of volunteer organizations is not encouraged within municipality. District lacks youth centers. Here is not enough information spread for public about the results of activity in safety field.

**Research limitations/implications** – in this research paper there are mentioned different preventative measures, programs, analyses, but, alas, they do not allow to evaluate the real effectiveness of all those measures, as safety situation depends not only on preventative steps made, but also on physical safety measures. For example, educational work can be hardly measured, since it is very challenging and requiring other studies to evaluate how an individual masters the given information. Therefore, the research pictures general trends in safety development rather evaluates overall effectiveness of safety development activities in Pasvalys district.

**Practical implications** – referring to theoretical and practical investigation premises, some offers are done to institutions ensuring safety in Pasvalys district in order to make safety measures improved.

**Value** – the investigation is exceptional the way it investigates and evaluates how in a concrete local place (in this case in Pasvalys district municipality) safety assuring institutions
work to ensure safety among local residents. Also an outline of possible threats and actual risk
groups in this particular region in presented.

**Keywords:** safety, municipality, safe municipality.

**Research type:** research paper.

### Introduction

Safety is one of the major human existence elements. To ensure safety of citizens, property, and environment not only different safety assuring institutions (hereinafter – SAIs), such as international organisations, government, municipality, but also citizens, should act together. Such collective action should be purposefully directed towards the common goal, i.e. to increase citizens’ safety feeling. There is not a single municipality in Lithuania, which does not face the problems in the field of public safety. This is proved by the statistical data including information on crimes, fires, mortality rate caused by external factors and injury extent. Government, municipality institutions and organisations related to security assurance assess the importance of safety promotion to community members. All these organizations implement projects and programs helping to improve the present situation. Some programs do not ensure a long – term influence and only partly reduce some risk factors. Consequently, it is important that all institutions functioning for safety assurance would work for common goal and implement means reinforcing local communities, because their contribution to safety assurance might be very significant (Pitrënaitė, 2011).

The aim of this article is to analyse and evaluate actions of SAIs for increasing citizens’ safety in Pasvalys district Municipality. The objectives are:

1. Define theoretical aspects of safety assuring;
2. Investigate actions of SAIs and municipality for increasing citizens’ safety in Pasvalys district.

To achieve the objectives, the activity and results of SAIs are presented, the implementation of Safe Municipality Concept in Lithuania and in Pasvalys district are reviewed. The research covers analysis of scientific literature, legal acts and other relevant documents such as decrees of local institutions, plans, reports, statistical data, projects, and programs. Along with document analysis semi-structured interviewing method was applied. The interviewees were representatives from the most important SAIs in Pasvalys district. There were done 12 interviews with experts from The Police Headquarters, Pasvalys municipality, Fire and Rescue Board, Wards. One more interview was conducted with employee of the Ministry of Internal Affairs who is monitoring the public actions to increase the safety.A questionnaire for interviews was designed of several blocks of questions: questions related to the exposition of risk groups, actions of SAIs, citizens’ information/involvement, and evaluation of safety condition in Pasvalys. Interview data was analysed by grouping it according to the categories and sub – categories. The main interview categories have been excluded: safety/safety risk factors, process, collaboration and result.
Safety Assuring Peculiarities on the Municipality Level

The perception of safety is widely interpreted, and this is influenced by education, social dependence and age. Therefore, due to effects of these factors, safety is treated differently. According to Šlapkauskas (2005), safety is a state of defence and protection against the danger and confidence in your own knowledge. Scientist investigating trauma prevention, define safety as a „state or situation characterized by adequate control of physical, material, or moral threats” (Nilsen, et al., 2004). Moreover, it is observed, that safety helps to create environment which accelerates economic growth, service is provided effectively, social exclusion is being decreased (Mikuskienė et al, 2011). Anyway, it is acknowledged, that safety in different dimensions is a high priority requiring phenomenon.

Contemporary safety activities are being executed on a few levels: international, national, local, group and individual (Buzzan 1997; Babachinaitė, 2006, Matulionyte, 2008). Going through history, safety insurance of citizens, property and environment has been government’s responsibility for a long time, but new threats and risk factors occur on the local level (Quarantelli, 2001). Municipality institutions are closer to a person. As a result, they have to involve communities into common activities, providing knowledge and capability which could help to struggle against the rising threats. It is very important to develop the communication between different sectors and organizations, to involve more implementers into safety promotion activities, and encourage more community members get involved into these activities (Merzel ir D’Afflitti, 2003). Such integrated community safety has potential to prevent community from various threats, giving adequate reaction to occurring threats.

In Lithuania different means are applied, programs and projects that are oriented to the increase of citizens’ safety are implemented. In public discussions, related to the safety promotion, insufficient action towards assuring safety on the governmental level is mentioned (Astrauskas et al., 2012). Some of the factors reducing efficiency of safety promotion are lack of resources needed to implement these activities, failure to apply systematic approach to safety, lack of inter – institutional collaboration, slow community involvement.

Analysis of performance of safety assuring institutions in Pasvalys district

The research results demonstrate that every safety assuring institution in Pasvalys district directs its activity towards several phases: risk evaluation and assessment, identification of risk groups, preparation and implementation of threat and risk management measures, monitoring of security state and its changes.

The results of empirical research have revealed which areas require bigger concentration in mitigating the safety risk factors and reducing their evidence probability. The factors mentioned above reduce citizens' safety feeling and aggravate the
quality of life. Three categories of safety risk factors have been distinguished in Pasvalys district: 1) social, e.g. crime, violence, assault, accidents; 2) technological, i.e. incidents in manufacturing and processing companies; 3) natural factors, i.e. karst phenomena. The results of the research relate exposure to social factors with individuals, belonging to social risk groups, i.e. lonely, antisocial mothers with many children, people having served a sentence, juvenile who belong to the children risk groups and are watched by the police. These groups are a great concern not only for SAIs, municipality and ward, but for the community and every citizen as well.

Safety assuring is a goal which has not been reached yet. The research shows, that SAIs highlight their activities towards:

- Management of the most relevant social risk factors;
- Protection of social groups at risk.

Pasvalys district SAIs in general and Municipality in particular implement diverse measures to achieve goals in aforementioned areas: measures to reduce crime, educational – preventive activity, safety measures for home environment, traffic safety, assuring measures, the role of municipality in the safety area, safe municipality concept and informing of society.

**Measures to reduce crime.** The research depicts the implementation of a wide range of threat preventions pursued by SAIs. The priorities are reinforcement of children and juveniles’ safety, safe home, establishment of safe environment, citizens’ involvement. SAIs implement numerous socially directed preventive programs. The biggest program to be mentioned is “Be safe”. This preventive program includes a lot of elements, i.e. organizers, directions of a program, and is based on the principles of collaboration. This program is implemented by Pasvalys Police Unit in collaboration with not only state institutions, active rural communities, but also with police supporters, citizens intolerant to crime, and others.

**Educational – Preventive Activity.** The research revealed the outcome of the activity implemented by Pasvalys district Municipality, Police Unit, Fire and Rescue Department, educational institutions, showing shared commitment of all institutions in public safety education. It includes organization of civil defence days at schools, organizing trainings of traffic safety, safe behaviour in streets and safe behaviour with fire. Interest in safety is encouraged by youth involvement into the shared activity. Juvenile delinquency is one of the most relevant insecurity areas. Therefore, Pasvalys Police Unit applies different measures to reduce juvenile delinquency (see Table 1). Police Unit implements program encouraging young people to join groups of police supporters. Despite the fact, that this program provides good results, it is difficult to find a positive correlation with the improvement of the state of crime.
Table 1. Educational – preventive activity

<table>
<thead>
<tr>
<th>Implemented measures</th>
<th>Respondents’ attitude</th>
<th>Outcome</th>
</tr>
</thead>
<tbody>
<tr>
<td>-Organization of civil protection days;</td>
<td>It is necessary to choose the equivalent between relevance of information and its perception and correct interpretation for different age groups. “…in understandable language explain children how they shouldn’t behave…” “…the development of youth centres in urgent…” “…it becomes a tradition to visit the first graders…”</td>
<td></td>
</tr>
<tr>
<td>-Traffic safety,</td>
<td></td>
<td>Positive changes noticed:</td>
</tr>
<tr>
<td>-Trainings of traffic safety and safe behaviour with fire;</td>
<td></td>
<td>-The number of police supporters grows rapidly;</td>
</tr>
<tr>
<td>-Youth involvement into the shared activity;</td>
<td></td>
<td>-The decrease of the number of juveniles suspected of (charged with) criminal offences;</td>
</tr>
<tr>
<td>-Individual conversations;</td>
<td></td>
<td>-Prevention directed towards age groups;</td>
</tr>
<tr>
<td>-The youth are invited to volunteer in service.</td>
<td></td>
<td>-Collaboration;</td>
</tr>
</tbody>
</table>
| Safety measures for home environment. Two measures are being implemented for safer homes. The first is oriented on protecting home from burglaries. In collaboration with the Municipality, Police Unit, mobile service providers, one button press devices were provided to social groups at risk, i.e. to pensioners and disabled. The second direction is home protection against exposure to fires. To achieve this goal, representatives of Fire and Rescue Department visit farmsteads according to the list, which are compiled by the representatives of borough. During such visits preventive advice is provided, electrical installations are inspected, the state of heating system is evaluated. It is noticed that non – governmental organizations pay attention to people who belong to social risk groups. Fire detectors are installed in homes of socially supported families and lonely mothers of many children. Effectiveness of the implemented measures is illustrated by the fire statistics. The number of fires recorded from 2002 to 2012 decreased three times (from 360 fires in 2002 to 109 fires in 2012, Department of Statistics, 2013).

Table 2. Safe home environment assuring measures

<table>
<thead>
<tr>
<th>Implemented measures</th>
<th>Respondents’ attitude</th>
<th>Outcome</th>
</tr>
</thead>
<tbody>
<tr>
<td>-One button press devices were provided.</td>
<td>„We hope that tight and friendly collaboration and the measures mentioned above will decrease the amount of fires“</td>
<td>The benefit of collaboration with the non-governmental organizations.</td>
</tr>
<tr>
<td>-Visits to farmsteads – preventive advice was being provided,</td>
<td></td>
<td>Effectiveness of the measures is illustrated by the statistics.</td>
</tr>
<tr>
<td>-Inspection of electrical installation, heating system,</td>
<td></td>
<td>Prevention according to the risk groups:</td>
</tr>
<tr>
<td>-Fire detectors were installed.</td>
<td></td>
<td>-according to the direction.</td>
</tr>
<tr>
<td>-Raids in youth places of entertainment,</td>
<td></td>
<td>-safe neighbourhood groups are being created.</td>
</tr>
<tr>
<td>-In crowded places.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Traffic safety assuring measures. Traffic safety in the district is assured by organizing raids in youth places of entertainment, single inspections of vehicles and drivers, active citizens. This is depicted by the growing number of trust calls, when the citizens inform about possibly drunk drivers or criminals. This phenomenon illustrates the increase of citizens’ consciousness, however, it does not show measure influence on traffic safety, because in the reports of Police Unit there is no sign of the decrease in accidents caused by drunk drivers (Activity of Public Police Unit, 2013).

**Table 3. Traffic safety assuring measures**

<table>
<thead>
<tr>
<th>Implemented measures</th>
<th>Respondents’ attitude</th>
<th>Outcome</th>
</tr>
</thead>
<tbody>
<tr>
<td>-Systematically organized raids:</td>
<td>“Even if sometimes the calls do not confirm, people gain courage, confidence, they are not afraid to call and clearly state their opinion”.</td>
<td>-Growing number of trust calls.</td>
</tr>
<tr>
<td>-single vehicle inspections,</td>
<td></td>
<td>-A tendency of decrease in accidents caused by drunk drivers.</td>
</tr>
<tr>
<td>-drivers’ sobriety inspection.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The role of municipality in the safety area. Municipality (as institution) is expected to carry out a few roles in the field of safety development at local level. The Municipality initiates the common actions of diverse SAIs in order to achieve better results, calls the meetings, where the representatives of SAIs can share important information, acquire knowledge, and make strategic decisions. On the Municipality’s initiative, different trainings are being organized, where it is evaluated, how every SAI can effectively work in case of an emergency. Striving to increase an operative and effective reaction to possible emergency, Pasvalys District Municipality has signed plans of mutual assistance with Panevėžys District Municipality and Pakruojis District Municipality, and project of a plan has already been prepared with Biržai District Municipality.

**Table 4. The role of Municipality in increasing safety**

<table>
<thead>
<tr>
<th>Objective</th>
<th>Methods</th>
<th>Respondents’ opinions</th>
<th>Expected/present results</th>
</tr>
</thead>
<tbody>
<tr>
<td>Focus of all safety assuring bands</td>
<td>Call of meetings</td>
<td>It is important to strengthen the bands of SAIs</td>
<td>-on-going collaboration -exchange of information -exchange of knowledge</td>
</tr>
<tr>
<td>Observation of activity</td>
<td>Training during emergencies</td>
<td>It is observed how the institutions react in case of an ecologic emergency.</td>
<td>Real reaction time is being observed.</td>
</tr>
<tr>
<td>Teaching</td>
<td>Complex training</td>
<td>„We only participate, however we do not govern”.</td>
<td>Inter-institutional collaboration is being observed and evaluated.</td>
</tr>
<tr>
<td>Reinforcement of the Municipality role in the safety area</td>
<td>Implementation of safe municipality concept</td>
<td>-Safe municipality concept – theory. -Lack of resources.</td>
<td>-Usual activities are being declared as measures of safe municipality concept.</td>
</tr>
</tbody>
</table>
Safe municipality concept (further – SMC). In order to integrate activity of institutions operating in safety area, and involve local citizens, on the initiative of The Ministry of the Internal Affairs in February, 2011 safe municipality concept was established regarding the resolution of the Government of the Republic of Lithuania (Safe municipality concept, 2011). SMC allows enhancing the abilities and roles of the municipalities in safety promotion area, involving citizens into safety reinforcement activities. The document covers possible directions for activities in safety promotion in municipalities and recommendations for their implementation. Reviewing the reports of SMC implementation in 2011 and 2012, it was observed, that the number of municipalities, where the SMC anticipated objectives were reached, has increased in 2012 comparing with results of 2011. This illustrates, that the implementation of the concept of safe municipality becomes a more important priority in the municipalities.

Analysing results of SMC implementation in Pasvalys district Municipality, some means were introduced from SMC: Coordination Commission for children and youth socialization programs were established, Anti-corruption Commission and Traffic Safety Commission were established. Moreover, measures oriented to safety development were determined in the Strategic plan: the increase of long – term continuous programs, directed towards prevention of children and juvenile delinquency, their social education and common crime prevention; installation of video cameras in potentially dangerous places in Pasvalys; preparation of public order protection strategy with the involvement of a society (shared patrols and so on). Increase of collaboration between social partners, by involving initiatives of communities and private sector into the implementation of measures; also by involving the representatives from communities and non – governmental organizations into the work of commissions. The implemented measures show, that the Municipality acknowledges the importance of safety to human welfare. However, like most municipalities in Lithuania, Pasvalys District Municipality does not undertake to implement the regulations of SMC to the whole extent. However, it tends to declare some obligatory measures set by other laws as the measures under SMC implementation.

Informing of society. Continuous information and involvement of society is being organized with the help of media. In the local newspaper and in the website of The Municipality, citizens are informed systematically about the threats and safety assuring activities. It is difficult to evaluate the effectiveness of the media, because changes of safety state are influenced not only by preventive factors, but by physical security measures as well. Information of the society is very significant for the development of self – defence culture.
Table 5. Informing and involving of society

<table>
<thead>
<tr>
<th>Implemented measures</th>
<th>Respondents’ attitude</th>
<th>Outcome</th>
</tr>
</thead>
<tbody>
<tr>
<td>· Presentation of information in the local newspaper “Work”;</td>
<td>“It is important not only implement preventive activities, but educate citizens with the help of all public information measures about possible emergencies and ways to avoid them”.</td>
<td>It is informed:</td>
</tr>
<tr>
<td>· in the website;</td>
<td></td>
<td>· Personally;</td>
</tr>
<tr>
<td>· in information stands.</td>
<td></td>
<td>· In media;</td>
</tr>
<tr>
<td>· Giving information about threats related to seasons;</td>
<td></td>
<td>· On the Internet.</td>
</tr>
<tr>
<td>· Polls in the Municipality, in the website.</td>
<td></td>
<td>· Information is not only educational, but it is motivating as well.</td>
</tr>
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<td></td>
<td></td>
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</tbody>
</table>

SAIs in Pasvalys district strive to solve safety problems in their responsibility area. However, it can be observed, that it is performed unsystematically in some cases. To eliminate rising problems, proposals of activity improvement are given (see Table 6).

Table 6. Proposals to improve activity of SAIs

<table>
<thead>
<tr>
<th>Area to be improved</th>
<th>Proposal</th>
<th>Expected result</th>
</tr>
</thead>
<tbody>
<tr>
<td>Implementation of Safe Municipality Concept (SMC) in Lithuania and in Pasvalys District.</td>
<td>Ministry of the Internal Affairs – create interactive platform on the Internet for the implementation of Safe Municipality Concept.</td>
<td>Exchange with the good practice, information about the rising problems, a tight interaction between governmental level institutions and municipalities – higher motivation to develop SMC.</td>
</tr>
<tr>
<td></td>
<td>Ministry of the Internal Affairs – organize annual events to discuss the results of SMC.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Pasvalys District Municipality – together with the social partners consider the possibilities to activate the implementation of SMC.</td>
<td>More effective and more efficient activity of safety promotion.</td>
</tr>
<tr>
<td>Antisocial and/or criminal behaviour which is a threat to citizens in Pasvalys District.</td>
<td>Control risk groups systematically.</td>
<td>Decrease of antisocial activity.</td>
</tr>
<tr>
<td></td>
<td>Develop activity of youth centres.</td>
<td>Decrease of juvenile delinquency.</td>
</tr>
<tr>
<td></td>
<td>Activate the establishment of voluntary associations.</td>
<td>Abundant resources, stronger force.</td>
</tr>
<tr>
<td></td>
<td>Work together with non – governmental organizations more actively.</td>
<td></td>
</tr>
</tbody>
</table>

The research shows that Safe Municipality Concept is vaguely implemented not only in Pasvalys District, but in all Lithuania. To solve the mentioned problem a bigger effort
to implant ideas of the concept is needed, not only from controlling institutions, i.e. Ministry of the Internal Affairs, but from the municipalities as well. After having solved the problem it is believed, that safety promotion activity would become more effective and more efficient on the municipality level.

Decrease of threats of antisocial and criminal behaviour would make the present safety state better. Therefore, it is proposed to control risk groups, develop activity of youth centres. The implementation of measures would decrease antisocial activity of youth and other risk groups.

Safety conditions in the district depends not only on the activity of SAIs, but also on the citizens’ self - defence culture. Therefore, in order to create a safer environment, self - defence culture should be enhanced. This could be achieved by some measures, i.e. informing society to a larger extent, involvement of citizens to the decision making process and activating of the establishment of volunteer associations. These measures would help to not only educate the citizens’ consciousness, but get additional resources as well when society is involved.

Conclusions

The concept of public safety focuses on three areas: the security of inhabitants, their property and environmental protection. It is necessary to assess the fact that insecurity is not only criminality. It is a broader concept and covers areas of safe traffic, children’s safety, fire – prevention, threats of natural disasters etc. To solve problems connected with security and protection in a combined way, there is a necessity to join diverse institutions for the common purposes. Such tasks are to be solved not only by the institutions and by their territorial subdivisions of national level, but also by municipal subordinate institutions and offices, and by the municipality itself. Other institutions, such as cultural, educational, religion-related and other organizations could contribute to safety promotion as well.

In order to hold risk factors under control and reduce possible danger for inhabitants, their property and environment, the Pasvalys’ district municipality together with other preventative institutions in the district territory make all possible attempts to ensure and enhance safety. The statistic data of a security alteration show the positive changes on security in the district.

An extreme and constant attention is needed to mothers with many children, single mothers, anti – social mothers, those just returned back from imprisonment, also to delinquent children. These groups of people are concerned as the main risk groups that require much more municipality’s attention than all the rest. To achieve better results, responsible institutions analyze and evaluate risk factors and risk groups, since each factor requires a different combination of activities of certain institutions.

In Pasvalys district municipality and in most other district municipalities throughout Lithuania the concept of safe municipality takes idle steps forward. Taking into account that the concept stimulates the cooperation of different institutions and inhabitants to achieve common goals, it would be purposeful to activate the introduction
of the concept into practice. Ministry of Internal Affairs could put more proactive efforts to stimulate implementation of the concept of safe municipality, not only collect and analyze the results of the concept realization.

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Viešosios policijos skyriaus veikla. 2013. Panevėžio apskrities vyriausiojo policijos komisariato Pasvalio rajono policijos komisariato veiklos už 2012 m. ataskaita.


SOCIAL ASPECTS OF THE REFORM TO THE EUROPEAN UNION PUBLIC PROCUREMENT LAW

Roberta Lukošiūnienė
Mykolas Romeris University, Lithuania
roberta.lukosiuniene@yahoo.com

Laurynas Lukošiūnas
Law firm SORAINEN and partners, Lithuania
laurynas.lukosiunas@yahoo.com

Abstract

Purpose: the article aims to analyse the reform of the European Union public procurement law on social aspects in different stages of the reformed public procurement procedures. Comprehensive reform of the European Union public procurement law was approved by the European Parliament in January 2014, adopted by the Council in February 2014, and legislative acts published on 28 March 2014. The current directives 2004/18/EC on procurement in public works, supply and service contracts, as well as 2004/17/EC on procurement in the water, energy, transport and postal services sectors were updated. Additionally, the new directive 2014/23/EU on the award of the concession contracts providing an orientation previously given only by the case law of the Court of Justice of the European Union was adopted. Among other things the reform is highly focused on greater scope of social issues to be addressed in the public procurement procedures. The authors’ aim to analyse the way social issues are being tackled under the new directives.

Design/methodology/approach – logical systematic method will be used in order to ascertain the content of the laws within the scope of the social aspects, whereas comparative method will be applied to ascertain national and European Union legal acts. On the basis of analytical method conclusions will be drawn.

Findings – the authors will focus on legal analysis and considerations on social aspects in different stages of the reformed public procurement procedures ie in the stage when deciding on the subject-matter of the contract and the technical specifications, in the qualitative selection, in applying the award criteria and in the stage of performance of the contract.

Research limitations/implications – the new directives also set new mandatory grounds related to the infringements of social and labour laws for excluding suppliers from the competitions for contracts, though the Paper will not analyse in-depth the legal issues of the labour law.
Practical implications – the authors will be focused on some of the most important aspects of the new reform of the European Union public procurement law. The reform is new and approved at the beginning of this year thus there are no much consistent analysis of the social aspects in different stages of the reformed public procurement procedures. The Paper will be relevant to the public and private sectors, academic society and jurisprudence of Lithuania as well as European Union.

Originality/Value – the authors will present in-depth legal analysis of the social aspects of the new directives. Such logical systematic analysis will help to correctly interpret the laws.


Research type: research paper.

Introduction

The use of government contracts to put social policies into effect has a long history. The attempts to link social justice issues with procurement can be found back in the 19th century in England and other industrial countries (Bercusson, 1976). However, in the past, public procurement was seen much more frequently as an instrument of securing national economic and social policies (McCrudden, 2004).

Although the promotion of social cohesion is one of the European Union (EU) objectives, social sector, which has weathered the economic crisis much better than others (Monzón, 2012), only recently is gaining recognition at the European level.

Since directive 71/305/EEC in 1971, the White Paper in 1985, the Beentjes judgement in 1988, social aspects of EU public procurement are being tackled by the European legislator and the Court of Justice of the European Union (CJEU), but to some extend only.

After lessons of the crisis were learned greater emphasis were given to the social aspects in the Europe 2020 strategy, and appropriately in the Green Paper. It was declared that all energies and capacities should be mobilised and focused on the pursuit of the priority of economic, social and territorial cohesion.

Few years of consultations and debates resulted in the comprehensive reform of EU public procurement law. The reform was approved by the European Parliament in

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1 For example, in 1891, a resolution on fair wages was passed by the House of Commons in the United Kingdom. This committed government departments to include a stipulation in all agreements with private sector employers that workers must be paid generally accepted rates for the job

2 Summaries of legislation. The founding principles of the Union: http://europa.eu/scadplus/constitution/objectives_en.htm#OBJECTIVES

3 Concerning the coordination of procedures for the award of public works contracts (OJ No L 185, 16.8.1971, p. 5)

4 White Paper from the Commission “Completing the Internal Market” COM(85) 310 final

5 Case 31/87, Beentjes and Commission v France

6 EUROPE 2020 A strategy for smart, sustainable and inclusive growth. COM/2010/2020 final

7 Green Paper on the modernisation of EU public procurement policy towards a more efficient European Procurement Market COM(2011) 15 final
January 2014\(^1\). The Council on 11 February 2014 adopted the legislative package for modernisation of public procurement in the EU\(^2\). And finally on 28 March 2014 in Official Journal three directives were published: i) a directive 2014/24/EU on public procurement (replacing directive 2004/18/EC on procurement in public works, supply and service contracts); ii) a directive 2014/25/EU on procurement by entities operating in the utilities sectors: water, energy, transport and postal services (replacing directive 2004/17/EC on procurement in the water, energy, transport and postal services sectors); iii) a directive 2014/23/EU on the award of concession contracts\(^3\).

Among other things, the reform is highly focused on greater scope of social issues to be addressed in the public procurement procedures. Significant changes made in respect of social matters in all stages of the procurement. Therefore, in this paper the most important (to the opinion of the authors) social aspects of the reform are being examined via technical specifications, award criteria and contract performance clauses.

**Aim of the reform as regards social aspects**

The reformed directives provide wide reasoning of the new regulations related to social issues.

In all the new directives it is emphasised that: compliance with obligations in the fields of environmental, social and labour law should be ensured (Article 37, Article 52 and Article 55 of the preambles\(^4\)); control of the observance of the environmental, social and labour law provisions should be performed at the relevant stages of the procedures (Article 40, Article 55 and Article 58); contracts should not be awarded to economic operators in cases of non-payment of taxes or social security contributions (Article 100, Article 105 and Article 69 of the preambles); economic operators which have proven unreliable, for instance because of violations of environmental or social obligations, can be excluded (Article 101, Article 106 and Article 70 of the preambles) etc.

From the above it is clear that one of the most important aims of the reform as regards all these directives is promotion of socially and environmentally responsible public procurement.

In both the repealing directive 2004/18/EC and the repealing directive 2004/17/EC it is emphasised that: innovation, including social innovation, are among the main drivers

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\(^{3}\) OJ L 094, 28.03.2014

\(^{4}\) References to the articles in this paragraph are given in following order: article of the preamble the repealing directive 2004/18/EC, article of the preamble of the repealing directive 2004/17/EC, and article of the preamble of the concession directive
of future growth (Article 47 and Article 57 of the preambles); contracting authorities that wish to purchase works, supplies or services with specific environmental, social or other characteristics should be able to refer to particular labels (Article 75 and Article 85 of the preambles); contracting authorities should be allowed to use award criteria or contract performance conditions relating to the works, supplies or services to be provided under the public contract in any respect and at any stage of their life cycles (Article 97 and Article 102 of the preambles); rejection should be mandatory in cases where the contracting authority has established that the abnormally low price or costs proposed results from non-compliance with social, labour or environmental law (Article 103 and Article 108 of the preambles) etc.

These two reformed public procurement directives are clearly focused on social and environmental issues (i.e. repealing directives 2004/18/EC and 2004/17/EC), it can be seen that almost majority of the changes are related to social aspects in one or another way.

However, indicated aims of the reform correspond not to all opinions of the most important players in the social economy arena, which participated in the public consultations. For example, Social Enterprise Coalition (UK) insisted on focusing EU public procurement towards the aim to ensure that the public sector gets the greatest value from its economic transactions. This could be requiring contractors to create local employment opportunities for disadvantaged groups, put something back into the local community, or create a positive environmental impact by reducing waste or carbon emissions. To the opinion of the authors of this Paper, although the aim was not fixed on indicated proposals of the parties involved in the consultations, similar results could be achieved in using the tools present reform provides.

It is important to mention that from the point of view of successful international trade usage of public procurement as a tool for promoting social and environmental objectives may be treated as a barrier (Arrowsmith, 2010). Therefore, aforementioned strong social focus of the new directives may have not only positive effect for the future growth, but on the other hand may negatively affect the economy of EU in the sense of competitive worldwide trade.

**Social labels**

Despite of potential usefulness and practical benefits, till the reform there has been confusion about how third party verifications (labels, certifications) can be used in public procurement processes in a way that is compatible with EU law.

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1 References to the articles in this paragraph are given in following order: article of the preamble of the repealing directive 2004/18/EC, and article of the preamble the repealing directive 2004/17/EC
On one hand, it was recognised that contracting authority can take considerations related to sustainable development (social labels and the implications for ethical trade)\(^1\). On the other hand, CJEU, based on the principles of transparency and equal treatment, gave preference to detailed characteristics rather than referring to specific labels\(^2\).

Social labels were addressed in Article 43 of the repealing directive 2004/18/EC and in Article 61 of the repealing directive 2004/17/EC, which states that “where contracting authorities intend to purchase works, supplies or services with specific environmental, social or other characteristics they may, in the technical specifications, the award criteria or the contract performance conditions, require a specific label...”. This clause stipulates that a specific label can be required. However, the next Parts of Article 43 and appropriately Article 61 specifies conditions that label requirements should be based on objectively verifiable and non-discriminatory criteria etc., and contracting authority should accept all equivalent labels (alternative evidence of the fulfilment of the requirements of the specific label, such as manufacturer’s dossier).

Provided wording of the above articles obviously restricts the ability of contracting authority to request particular social label\(^3\) and above indicated confusion remains. It can be difficult to put into practice the use of specific labels.

It even can be consider that the requirement to accept a manufacturer’s own dossier completely removes the ability of a contracting authority to insist upon third party certification regarding the environmental or social characteristics of the product they are buying (Semple, 2012). Progression from the uncertainty in usage of specific labels is rather small.

### Exclusion for violations of social obligations

In addition to previously existed exclusion grounds the reform provides new exclusion grounds related to violation of applicable obligations in the fields of environmental, social and labour law established by Union law, national law, collective agreements or by the international environmental, social and labour law provisions of International Labour Organization (ILO) and other precisely indicated conventions (listed in the annexes of the reformed directives).

Violation of the above obligations is stipulated as an exclusion ground from participation in a procurement procedure if such violation can be demonstrated (Articles 18(2) and 57(4) of the repealing directive 2004/18/EC, Articles 36(2) and 76(6) of the repealing directive 2004/17/EC) and in case of abnormally low price due to noncompliance with the aforementioned obligations (Articles 18(2) and 69 (3) of the repealing directive 2004/18/EC, Articles 36(2) and 84(3) of the repealing directive 2004/17/EC).

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\(^2\) Case C-368/10, Commission v The Kingdom of the Netherlands

\(^3\) For example, labels such as: Fair Trade, Max Havelaar, Utz, Rainforest Alliance etc.
compliance with the same obligation should be taken in accordance with the concession
directive also (Article 30 of this directive).

It seems that a great while argued stronger connection with international social and
labour principles (ensuring such rights as safe work environment (Ahlberg, 2012)) was
made in EU public procurement, but with few limitations.

First of all, distinction is made as regards application of the violations in different
cases of exclusion. Exclusion right is optional for contracting authority in the event of
application of Article 57(4) of the repealing directive 2004/18/EC “Exclusion grounds“ and
appropriately Article 76(6) of the repealing directive 2004/17/EC “General principles“1,
but is obligatory in the event of application of Article 69 (3) of the repealing directive
2004/18/EC and appropriately Article 84(3) of the repealing directive 2004/17/EC
“Abnormally low tenders“2. The distinction seems to have no clear justification. Based on
such regulation, despite of all the emphasis given in the new directives, it will be possible
for contracting authority to award the contract even when international social and labour
principles are breached.

Secondly, some relevant international conventions are not mentioned in the list of
international social and environmental conventions, provided in the annexes of the new
directives3. For example, ILO Conventions 94 “Public Contracts, Labour Clauses”, 95
“Protection of Wages”, 138 “Minimum Age” and many others are not included into the
list. Issue of the ratification could be the answer to the question regarding narrowness of
the list, but nevertheless limitations of the social protection given are obvious.

Thirdly, practical application of the obligations under EU law and international
conventions to the third countries and subjects from such countries raises doubts.
Countries non-members of EU and the conventions will not be legally bounded. Some
authors keeps to the position that said provisions will be difficult to implement and they
are more of a political message to third countries than mechanism intended to be put into
actual practice, in the same way as Articles 58 and 59 of directive 2004/17/EC4, which
have never been applied (Van den Abeele, 2012).

Social criteria of contract award

For years the award of public contract were based on two criteria: i) the lowest price
or ii) the most economically advantageous offer. Although contracting authorities have
absolute discretion in adopting the award criterion (Bovis, 2012), the assortment, as it is
interpreted in the case law of CJEU5, not always correspond to the contemporary needs.

1 Construction with „may“ is used
2 Construction with „shall“ is used
   of the concession directive
4 Articles: “Tenders comprising products originating in third countries“ and “Relations with third countries
   as regards works, supplies and service contracts“
5 In cases as Case C-513/99, Concordia Bus Finland v Helsingin Kaupunki, where it was articulated that
   award criteria for public procurement contracts must be linked to the subject-matter of the contract
By the reform the most economically advantageous tender is promoted. What is more, this criterion is adjusted in the way that it shall be identified on the basis of the price or cost, using a cost-effectiveness approach, such as life-cycle costing, and may include the best price-quality ratio, which shall be assessed on the basis of criteria, including qualitative, environmental and/or social aspects, linked to the subject-matter of the public contract in question. The criteria may comprise for instance social, environmental and innovative characteristics (Article 67 of the repealing directive 2004/18/EC and Article 82 of the repealing directive 2004/17/EC).

Although greater attention is actually given to social aspects, the request for connection with the subject-matter of the contract remained. This provides some uncertainty about future case law of CJEU under reformed criteria.

Life-cycle costing (Article 68 of the repealing directive 2004/18/EC and Article 83 of the repealing directive 2004/17/EC) is considered to be the most promising change as regards the award criteria. Broad demand for new cost-benefit rationale that translates into life-cycle costing under the criteria of the most economically advantageous tender to replace the lowest initial cost rationale exits (Edler, 2007). Procurement processes and decisions have to move beyond considering the purchase price of a good or service, for the purchase price does not reflect the financial and non-financial gains that are offered by environmentally and socially preferable assets as they accrue during the operations and use phases of the asset life-cycle. It is expect that the best value for money across the asset life cycle can only be assured by purchasing green and socially preferable alternatives.

Regardless of high expectations, life-cycle costing, as it is regulated in the reformed directives, seems potentially complicated and cumbersome for contracting authorities.

Contract performance clauses related to social considerations

The reformed directives provides that contracting authorities may lay down special conditions, which would include environmental, social or employment-related considerations, provided that they are linked to the subject-matter of the contract and indicated in the call for competition or in the procurement documents (Article 70 of the repealing directive 2004/18/EC and Article 87 of the repealing directive 2004/17/EC).

The above regulation provides opportunity to include different kind of environmental, social or employment-related clauses. For example, requiring that goods has to be delivered outside peak traffic times to minimise the contribution of deliveries to traffic congestion, requiring application of specific management measures and many other.

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However, large degree is thus required to develop contract clauses which are appropriate to achieve specific social or environmental objectives – without being either over or under-ambitious. As contract conditions do not form part of the assessment of tenders¹ (other than by as simple declaration of acceptance), tenderers may not in fact take adequate account of these requirements in their tender price and delivery terms. The delivery of the contract can be compromised if the cost of compliance outweighs the margin of profit achieved by successful tendered (Van den Abeele, 2012).

Effective verification of the link to the subject-matter and other requirements of social and environmental aspects when the contract (full text of it) is not being attached to the procurement documents can also be problematic. Question of appropriateness of some requirement potentially can be raised only in performance of the contract.

In our view, inclusion of social as well as environmental and employment-related considerations in contract performance clauses should match conservative approach.

Conclusions

In this Paper, we have outlined social aspects of the reform to EU public procurement. The reform obviously involves social and closely related issues. Even the aim of the reform considered to be directed socially. EU public procurement gradually developed to the point where social matters are being tackled more than ever. In none of each stage of the procurement social aspects are left behind.

New and important regulations related to social labels, exclusion for violations of social obligations, social criteria of contract award, social considerations in contract performance clauses and other are provided by the reform. Much more emphasis on social issues is expected in further development of public procurement.

Already today it is clear that there will be many questions regarding practical application of analysed clauses. Certain clarity and completion is missing, but some of that should be provided by expected CJEU cases law. Not all opinions of interested parties were, and of course could be, taken into account in finding final texts of the new directives. Nevertheless big step ahead is made towards promotion of social cohesion.

Strong aim of focusing public procurement on the social aspects is expected to ensure sustainable growth of the EU economy, but the competition in worldwide commerce may negatively influence approach of EU as well as individual member states when it comes to actual application of appropriate tools promoting social and environmental objectives.

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¹ In accordance with implications provided in the Case C-225/98, Commission v France


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THEORETICAL AND PRACTICAL ASPECTS
OF LIQUIDATED DAMAGES AND APPLICATION
UNDER THE LAW OF THE REPUBLIC OF LITHUANIA

Simas Vitkus

Mykolas Romeris University, Lithuania
simasvitkus@gmail.com

Abstract

Purpose – the purpose of this article is to analyze the theoretical and practical aspects of liquidated damages in the light of commercial contracts and evaluate the potential application of liquidated damages under the law of the Republic of Lithuania.

Methodology – in the research theoretical methods (analytic, systemic and historical) are applied.

Findings – within the common law the traditional approach, under which the enforceability of liquidated damages rests upon difficulty of proof of loss and the disproportion of the agreed sum, compared to the anticipated or actual harm, is relatively rigid from the point of view of commercial contractors with equal bargaining power that seek for a legal instrument conveying information about a party’s intent or capability to perform under the contract. Recently adopted commercial justification test applicable to liquidated damages that exceed genuine pre-estimate of loss seems to resolve this problem to some extent. The Civil Code of the Republic of Lithuania¹ (hereinafter “CC”) establishes a limited list of grounds to void agreements, so unless the legislative process separating liquidated damages from penalties as a separate form of liability and incorporating additional grounds on voiding stipulated amounts takes place, there will be no other judicial tool available for Lithuanian courts to control unreasonably excessive and/or unfairly agreed amounts, rather than reducing them.

Research limitations – in this article the research is limited to the analysis of theoretical and practical aspects of liquidated damages in the contemporary legal relationships between commercial parties that of relatively equal bargaining power. The author analyzes and evaluates potential application of liquidated damages under the law of Lithuanian Republic, only when liquidated damages are integral with the commercial justification test.

Practical implications – the article initiates a discussion whether adopting a similar test to commercial justification that would apply to penalties under the CC would enhance the legal certainty and parties’ autonomy in contractual relationships in Lithuanian Republic, or perhaps a more radical solution is required, such as establishing liquidated damages as a separate form of liability, with additional grounds for voiding the liquidated damages clause, based on the unreasonableness of the agreed amount and/or unfairness of the contract process.

Originality – there are only few scholars that analyzed the concept of liquidated damages and dealt with some aspects concerned with the application of liquidated damages under the law of Lithuanian Republic. Meškys (2012) separated liquidated damages from penalties and considered that the Supreme Court of Lithuania established liquidated damages as an independent form of security of obligations under CC 6.70(1), whereas Bublienė and Truskaitė-Paškevičienė (2013) disagreed with this position by concluding that deterrence of the breach and securing contract performance is incompatible with the purpose of liquidated damages and that under the Article 6.256(2) of the CC liquidated damages may only function as a penalty. Nevertheless, the questions, such as whether liquidated damages together with the commercial justification test meet the needs of today’s commercial world in terms of legal certainty and parties’ autonomy in contractual relationships, furthermore, what exactly prevents liquidated damages from being applied under the law of Lithuanian Republic, remain unanswered.

Keywords: liquidated damages, penalty, equal bargaining power, commercial justification.

Research type: general review.

Introduction

In the first chapter of this article the concept of liquidated damages is introduced, and also the criteria determining the validity of the liquidated damages clause are defined. It is important to note that within the common law realm the justification of paternalistic approach towards penalties (unenforceable liquidated damages) lies in ideas, such as equity, protection of a weaker party, efficient breach, however, one of counterarguments raised in the first chapter is that when determining the enforceability of the liquidated damages clause a fair amount of consideration has to be given to the sophistication of parties and their equal bargaining power. In the second chapter the case law, which indicates a shift in common law jurisdictions from a strictly paternalistic approach towards a softer approach, is reviewed. The main reason of this shift lies in the commercial justification test, so further the main characteristics of this test is analyzed. In the final chapter the liquidated damages clause and penalty under the CC are compared, as well as some conclusions on potential application of liquidated damages under the law of Lithuanian Republic are drawn.

The Dunlop Test and Intervention with Parties’ Autonomy

The contract law allows independent individuals voluntarily participate in legal transactions and impose upon each other rights and obligations that correspond to their own will. This is ensured by the principle of parties’ autonomy, in accordance of which courts should fully enforce contracts the way they are negotiated between parties. Nevertheless, the principle of parties’ autonomy is not absolute because certain criteria have to be satisfied to make the contract valid and enforceable, for instance, generic requirements of genuineness of assent, consideration, capacity and legality (DiMateo, 2006). Moreover, specific clauses, such as liquidated damages, have certain requirements that are applicable particularly to them.
The main focus of this article is precisely on liquidated damages, which are a common law remedy ensuring compensation for breach of the contract. Liquidated damages are considered to be a genuine pre-estimate of likely loss flowing from breach. The advantages of this clause are that non-breaching party avoids the obligation to prove its loss and escapes certain expenses, such as litigation costs. The restriction of the clause is that courts may render it unenforceable, provided stipulated amount is grossly disproportional in the light of anticipated or actual harm caused by the breach, and also in case there is no difficulty of producing the proof of damages or measure – and thus prove – the presumable loss (Hatzis, 2002). Within the common law liquidated damages rendered unenforceable are qualified as penalty (in chapters I and II of this article the term “penalty” is particularly used to define unenforceable liquidated damages).

The line of authority, based upon which courts determine the enforceability of liquidated damages, was first established in the Dunlop case1. In this case the dispute arose between the manufacturer and dealer, who made an agreement concerning the sales of tyres. The agreement stated that the dealer was only allowed to sell tyres that it bought from the manufacturer for the price, which is not less than the list price. The parties had also agreed that if the dealer breaches this condition, it would have to pay liquidated damages in £5 per each tyre. The House of Lords held that the stipulated amount was not a penalty because damages were impossible to forecast and the amount to be paid was a genuine pre-estimate of the likely loss flowing from breach.

The roots justifying paternalistic intervention with parties' autonomy lies in equity law (LaFiura and Sager, 2001). The initial motivation for rendering penalties unenforceable was the protection of weaker parties. Later on a less paternalistic idea contributed to justify the non-enforcement of penalties. This idea is based on the principle of “efficient breach”, which is best explained with the following: “if parties are free to break their bargains should a better deal come along, rational actors will break their first contract, pay the expectancy damages to the obligee, and pursue the more lucrative alternative. Presumably, this will have a net benefit to society because resources are being channeled to the user who values them most” (Solorzano, 2011). So from the economist’s point of view it is considered that the ban on penalties and predominance of the principle of “efficient breach” serves society, as long as a party, who concludes that they would incur a greater economic loss by performing under the contract, is entitled to voluntarily breach that contract and pay either damages or agreed amount, which is a genuine pre-estimate of loss. However, this is a general idea that cannot be viewed as a specific standard enabling courts to evaluate paternalistic arguments in every individual case, as only in this way the limits of paternalism can be defined and its legitimacy established (Kronman, 1991).

We could agree that the refusal to enforce penalties is reasonable to some extent, especially considering the protection of weaker parties. However, the same level of protection should not apply to commercial parties, such as large corporations, that are sophisticated and have equal bargaining power. The question is why a court should necessarily concern itself with the matter and display parental solicitude for large

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1 Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd [1915] AC 79.
corporations by refusal to enforce penalties, provided the clause was freely bargained. It seems that the law of liquidated damages fails to distinguish a highly negotiated clause between parties of relatively equal bargaining power and a clause that is not a product of negotiation, such as in an adhesion contract between parties of unequal bargaining power.

The Dunlop test, in accordance of which the enforceability of liquidated damages mainly rests upon difficulty of proof of loss and the disproportion of the agreed sum, is relatively rigid from the point of view of commercial contractors that seek for a more versatile legal instrument. How can liquidated damages allocate risk, provide compensation in the event of breach and convey information about a party’s intent or capability to perform under the contract? It is possible, only if courts applying the Dunlop test would start taking into consideration the relationship between the parties, the sophistication of the parties agreeing to the contract, or other contextual factors relating to the inclusion of the stipulated amount. As the recent case law within common law jurisdictions indicates, the commercial justification test applicable to liquidated damages that exceed genuine pre-estimate of loss seems to resolve this problem to some extent. The application and characteristics of this test are further analyzed in the following chapter.

The Commercial Justification Test and Strengthening Parties’ Autonomy

As it was noted in the previous chapter, traditional criteria determining the enforceability of liquidated damages are the difficulty of proof of loss and the disproportion of the agreed sum to the anticipated or actual harm. One of the recent cases, in which the court did not follow the traditional approach, is the Azimut case\(^1\). The English High Court established a new line of authority, in accordance of which it must be decided whether liquidate damages are in fact a penalty and therefore unenforceable by applying the commercial justification test. This test rests upon two criteria: firstly, the court must be convinced there is a commercial justification for the difference between the agreed sum and likely loss; and, secondly, it must be persuaded that the clause does not have the dominant purpose of punishing or deterring the breach. If both criteria are satisfied, the liquidated damages clause will not be invalidated as a penalty, merely based on the difference between the agreed sum and likely loss.

In the Azimut case the dispute arose between the yacht builder and buyer. According to the terms of the contract, the yacht builder was obliged to build up a 60-meter long yacht, whereas the buyer was obliged to pay for it £38 million in installments over the period of 3 years. The contract included a provision entitling the yacht builder to retain (or recover) 20 percent of the contract price as liquidated damages, provided there is a late payment on part of the buyer. The contract also stated, if the yacht builder chose to terminate the contract in this way, it was obliged to return any other part of the contract price it had already received. This kind of formulation of liquidated damages

\(^1\) Azimut-Benetti SpA (Benetti Division) v Darrel Marcus Healey [2010] EWHC 2234 (Comm).
provision stroke a balance between interests of the parties. After the buyer failed to carry out its obligation to pay on time, the yacht builder terminated the contract and simultaneously demanded payment of liquidated damages. Then the question was raised whether liquidated damages clause stood for a genuine pre-estimate of loss. After considering that both parties were of equal bargaining power and had the benefit of legal representation, the court upheld liquidated damages clause as it was negotiated.

Another similar case that reveals courts’ reluctance to qualify liquidated damages clauses as penalties when parties are sophisticated business entities and the damages are economic also concerns the dispute between the buyer and ship builder. The builder agreed to build up a vessel for $25 million and for each day that the vessel was not delivered agreed to pay $17,000 per day in liquidated damages. The builder did not complete the vessel on time and non-breaching party suffered $368,000 in actual damages, nevertheless, the breaching party was forced to pay approximately $3.3 million in liquidated damages in accordance to liquidated damages clause. The court upheld the clause, since both parties were of relatively equal bargaining power, comparable level of sophistication and had legal representation. After all, each party accepted the risk of its turning out in particular way, why should it be released from the contract, provided there were no misrepresentation or other deficiency of fair dealing?

Nevertheless, the circumspection that courts show before striking down the clause when parties are of equal bargaining power does not entirely displace the rule that the stipulated amount must be a genuine pre-estimate of loss. The common law courts generally will enforce contracts freely entered into by sophisticated parties, but they will still draw the line where liquidated damages are unreasonable given the nature of the harm. Courts will closely consider any major difference between the amount payable and the loss that might be suffered and where this difference is “out of all proportion”, the court is likely to intervene.

We may conclude that the deterrence of the breach is considered to be the dominant purpose of the clause when the agreed sum is “out of all proportion” to the likely loss. The court may also focus on the nature of the relationship between the parties in order to determine whether that relationship was oppressive and the dealing was unfair. The High Court of Australia observed that a mere difference in amount is not enough, let alone the suspicion of that difference; the comparison calls for a degree of disproportion sufficient to point to oppressiveness. Nevertheless, the oppression on a party to make a contract is not of itself a criterion in determining whether a contractual sum is a penalty.

The commercial justification test motivates common law courts to uphold the primacy of the parties’ agreement to the greatest extent possible. Nevertheless, the gap between the parties’ desire to legislate for their own remedial structure and the law’s

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3 Ringrow Pty Ltd v BP Australia Pty [2005] 224 CLR 656.
ability to achieve that goal inevitably remains because the compensatory model supports the doctrine of penalties, with its underpinnings in the prohibition upon deterrence (Bell, 2012). It seems unlikely that the commercial justification test will completely resolve the problem of uncertainty in determining the lines between a valid liquidated damages clause and an invalid penalty, unless the kind of notion that is supported by scholars, such as Coopersmith (1990), who focus on the unfairness of the contract process, prevails in the law of liquidated damages. It is worth noting that, historically, the doctrine of penalties looked namely to unfairness, rather than unreasonableness; and that unfairness was considered in relation to the contract process, rather than outcome. If unreasonableness of the agreed sum, even extreme one, was only relevant as an indication of oppression or unfairness in the contract process, then the main consideration for the courts would become the willingness of the parties as to the agreed sum. Whether the law of liquidated damages together with the commercial justification test will evolve in this way remains to be seen.

Penalties and Liquidated Damages under the Law of the Republic of Lithuania

In today’s commercial world contracts are being bargained and concluded between parties from different countries. Even when parties are from the same country, they are not restricted from the choice of law applicable to the contract. The chosen law may be applicable to the whole agreement or just part of it. But what if parties include a clause, which is not regulated by the chosen law? For instance, commercial parties intentionally include liquidated damages for the breach of contract but choose the law of Lithuanian Republic to be applied to the contract, which neither explicitly establish nor prohibit the application of liquidated damages.

Within the CC we cannot find any identical legal instrument to match liquidated damages. The Article 6.256(2) of the CC only provides for a liability to compensate damages and/or pay penalty (fine, interest). Precisely the latter (penalty) in a way may be viewed as a substitute for liquidated damages under the law of Lithuanian Republic, since it also fixes an exact amount payable upon the breach of contract and does not require any proof of loss. Both liquidated damages and penalties are of accessory nature and, in general, are only payable due to the liability for non-performance or defective performance of the contractual obligation. There are similar exceptions to liability, for instance, the breached obligation is void, or there is a sufficient defense for non-performance, such as force majeure or absence of fault, etc. The Article 6.258(2) of the CC provides that in cases where the penalty is payable for the delay in performance, the creditor is entitled to both penalty and performance. Similar rules concerning delayed performance apply under the common law in respect of liquidated damages.

Liquidated damages and penalties may be distinguished by comparing the liability limitation rules, models of control over agreed sums and purpose of the clauses.

Liquidated damages set a cap upon recoverable damages. In other words, a non-breaching party may only claim either agreed sum or damages determined by the court, but is not entitled to both, even if that ensures a full compensation. So liquidated damages function as the limitation of liability, whereas penalties under the law of Lithuanian Republic are regulated contrarily. The principle established in the Article 6.251 of the CC ensures the compensation of damages in full and entitles the non-breaching party to claim both penalty and compensation of damages at the same time (the Article 6.258(2) of the CC). In such cases courts grant the amount that is greater, since it is considered to include the smaller one as well\(^1\). Parties may, for instance, include exclusive penalty, as the only payable amount for the breach (Lazauskaitė, 2010), but certain exceptions, such as the debtor’s intentional fault or gross negligence, would still apply to that agreement (the Article 6.252 of the CC).

Both legal systems establish a particular model of control over agreed sums payable upon the breach. If a penalty is unreasonably excessive, courts of Lithuanian Republic are allowed to intervene and reduce it in accordance with the Article 6.258(3) of the CC and case law that establishes certain criteria to justify the reduction\(^2\), whereas common law courts are not granted with the power to reduce the amount of liquidated damages but may render the clause unenforceable. Neither model of control permits to increase the agreed amount, even if ludicrously small.

The comparative analysis of penalties and liquidated damages show mutual incompatibility. The distinct purposes may persuade of this assertion even more, e.g. liquidated damages are aimed at facilitating the compensation of damages, whereas penalties besides that, also secure the performance of contractual obligations. At first sight, the purpose of penalties alone is contrary to liquidated damages. Nevertheless, the Supreme Court of Lithuania\(^3\) referred to the term of liquidated damages and, as Meškys (2012) observes, established liquidated damages as a separate form of security of obligations that falls under the Article 6.70(1) of the CC. Other scholars disagree with such position, mainly since securing performance and deterring the breach is against the traditional purpose of liquidated damages (Bublienė and Trukskaitė-Paskevičienė, 2013). However, from the modern point of view liquidated damages are integral with the commercial justification test. This means, as it was stated in the second chapter, liquidated damages agreed by commercial parties are enforceable, even when exceed genuinely pre-estimated loss, provided that deterrence of the breach is not the dominant purpose. So to this extent liquidated damages may function as the kind of security of obligations under the Article 6.70(1) of the CC. Let’s assume this proposition is correct,
but then the question is to which form of liability liquidated damages should be attributed. According to the Article 6.256(2) of the CC, only penalty and compensation of damages are established as two possible forms of contractual liability. Undoubtedly, liquidated damages have more common hallmarks with penalties, rather than compensation of damages. So if parties intentionally include liquidated damages for the breach of contract but choose the law of Lithuanian Republic to be applied to the contract, based on the analogy of statute, rules that govern penalties would also govern liquidated damages (the Article 1.8(1) of the CC). This way the model of control applicable to liquidated damages would shift from voidance to reduction of agreed amounts, unless the legislative process separating liquidated damages from penalties as a separate form of liability and incorporating additional grounds for voiding agreed amounts takes place. Otherwise, there will be no other judicial tool available for courts of Lithuanian Republic to control unreasonably excessive amounts, rather than reducing them. The problem of accommodating rules of liability limitation applicable to liquidated damages would also have to be dealt with. Under the current regulation liquidated damages would not escape the application of Articles 6.251 and 6.252 of the CC, so they would only limit the liability to the extent same as, for instance, exclusive penalty.

Although the issue of accommodating the liability limitation rules applicable to liquidated damages requires a thorough analysis, especially in respect of protection of weaker parties, nevertheless, the focus of this article is on agreed amounts set by commercial parties that exceed anticipated or actual harm. As the recent case law indicate, common law courts become more and more reluctant in rendering liquidated damages unenforceable, however, commercial justification, based on the reasonableness of the agreed amount, rather than fairness of the contract process, seems unlikely to completely resolve the problem of legal uncertainty in contractual relationships. On the other hand, in Lithuanian Republic the stability of contractual relationships is damaged when courts reduce the sums of penalties defined in the commercial contracts without explaining why it has been decided not to take into consideration the commercial type of relationship or even without mentioning the fact that the parties are businessmen¹. So it has to be further analyzed whether adopting a similar test to commercial justification applicable to penalties would enhance legal certainty and parties’ autonomy in contractual relationships in Lithuanian Republic, or perhaps a more radical solution is required, such as establishing liquidated damages as a separate form of liability, with additional grounds for voiding the clause, based on the unreasonableness of the agreed amount and/or unfairness of the contract process.

Conclusions

Within the common law the traditional approach, in accordance of which the enforceability of liquidated damages rests upon the difficulty of proof of loss and

¹ The Supreme Court of Lithuania, Civil Division, 19 June 2006 ruling in the civil case No. 3K-3-409/2006; the Court of Appeal of Lithuania, 28 June 2012 ruling in the civil case No. 2A-1314.
disproportion of the agreed sum, compared to the anticipated or actual harm, is relatively rigid from the point of view of commercial contractors that seek for a legal instrument enabling to convey information about a party’s intent or capability to perform under the contract. Recently adopted commercial justification test applicable to liquidated damages that exceed genuine pre-estimate of loss seems to resolve this problem to some extent, nevertheless, legal uncertainty in determining the lines between a valid liquidated damages clause and an invalid penalty will remain, as long as the focus is on the unreasonableness of the agreed amount, rather than unfairness of the contract process.

If parties intentionally include liquidated damages for the breach of contract but choose the law of Lithuanian Republic to be applied to the contract, then, in accordance with the analogy of statute, rules that govern penalties would govern liquidated damages. This way the model of control applicable to liquidated damages would shift from voidance to reduction of agreed amounts, unless the legislative process separating liquidated damages from penalties as a separate form of liability and incorporating additional grounds for voiding agreed amounts takes place.

In Lithuanian Republic the stability of contractual relationships is damaged when courts reduce the sums of penalties defined in the commercial contracts without explaining why it has been decided not to take into consideration the commercial type of relationship or even without mentioning the fact that the parties are businessmen. So further analysis is necessary in order to determine whether adopting a similar test to commercial justification applicable to penalties would enhance legal certainty and parties’ autonomy in contractual relationships in Lithuanian Republic, or perhaps a more radical solution is required, such as establishing liquidated damages as a separate form of liability and incorporating additional grounds for voiding the clause, based on the unreasonableness of the agreed amount and/or unfairness of the contract process.

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