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Review paper

ECONOMIC SYSTEM IN THE CONSTITUTIONAL STRUCTURE OF THE REPUBLIC OF SERBIA

UDC 34:330(497.11) 342.4(497.11)

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Abstract. *The problem of the relationship between law and economics represents one of the questions that draw the attention of researches from both economic and legal fields with the same intensity. Multidisciplinary nature of this relationship is reflected in the formal frame of legal and economic system, as well as in their academic fields. The strength of the mutual interaction of law and economics is particularly notable if this interaction is realized in primary legal document of a state. Of course, we are speaking about the constitution and as the authors of this work we will direct our research efforts towards the analysis of the current constitutional provisions of the Republic of Serbia, starting from the fact that it is a relatively new document, existing less than one decade. The title of this work reveals the focus of our research attention – the economic dimensions of the Republic of Serbia Constitution of 2006.*

Key Words: *economic system, law, constitutional matter, Republic of Serbia Constitution.*

INTRODUCTION

The relationship between law and economics is a continual conceptual issue that attempts to eliminate a one-sided and exclusive view when considering these social phenomena. The previous research endeavors have shown that there is an obvious methodological necessity that requires mutual interaction between law and economics related to the use of certain methodological instruments and exploring certain research themes. Such methodological pluralism has imposed itself as a necessary method for the realization of scientific needs of contemporary society and scientific community.

When considering these issues, special attention should be paid to the question of "what economics has to offer to law" (Barković, 2009:78). Such an approach is inspiring

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enough to incite us to undertake a set of research procedures in the direction of structural analysis of relevant legal texts that allow us to verify the position of economic fields within law. Among such legal acts, constitution represents a particular legal source that reflects the relationship between law and economics. The conclusions to which we have arrived based on the structural analysis of the nomotechnical form of constitutional provisions related to economics, serve as an incentive for conducting further research. Setting aside the structural form, there is a possibility to go deeper in our research efforts and explore whether law accepts or ignores the messages sent by economics, and if it accepts them, whether it understands them correctly which may result in its alienation from optimal models for the harmonization of social life in a community.

1. Economic System in Constitutional Matter

In the sense of an academic discipline, the issue of "*materiae constitutionis*" evidently belongs to the list of introductory or general issues of constitutional law as a science. Traditional and classical concept of theoretical analysis of this issue starts from assuming the historical motives for the appearance of constitution as the basis for understanding its subject matter. Thereto, it has almost become a common practice to consider constitution as a law which was created, before all, as an articulation of constituting a new political concept of state and society in their transition from absolute monarchies to their reshaping into modern states. American and French revolutions greatly motivated and strengthened the political awareness of people that constitutions are created to facilitate harmonized organization of social communities, to establish rules for setting up and functioning of state governments, as well as the rules for regulating the relationship between the government and citizens. Such a conceptual approach in theoretical understanding of constitution has created the starting point and opinion that the constitutional subject matter is something to be exclusively sought within the formal regulation of political acts of an organized social community. Therefore, it is probably why the politological approach to constitutional analysis is added to the list of basic constitutional problems presented in professional literature within the framework of legal theory.

The above given starting points related to the realistic position of constitutional law as a science and its subject matter are also supported by the insufficient presence of the economic dimension of mentioned problems. There is often an unjustified trend of "silent overlooking" of the necessity to underline the economic dimension of constitutional matter, which is the issue which deserves particular attention. On the other hand, "there are few economic articles in economic literature that speak of the presence of economy in law" (Weigel, 2003:16). Of course, it should be noted that economic issues are present in constitutional science to the extent they are present in constitutional texts, which may point to the significance of gaining the insight into the structural composition of constitutional text. If we sum up this composition, we get a general impression that classical political problems are dominant in regulating the organization and function of a state government and its relationship with citizens.

It is interesting to note that constitutional texts of the states that represent contemporary models of western democracy do not give much space to economic issues, while the situation is quite opposite in the states with single-party political systems. This opinion is expressed on the basis of the analysis of the structural composition of constitutions, while interesting results can also be observed in the practice – in applying these two basic types of constitutional texts. Contemporary democratic constitutional systems which treat economic issues in a narrow sense provide more fruitful, rich and free economic life within a state. Non-democratic constitutional systems have rich constitutional regulation of economic issues which entails the restriction of freedom of action of various economic subjects within a society. Thus, one might get a general impression that the state, as the most efficient constituent factor, acts according to the program-based vision of further development of society and, depending on the ideological concept of such orientation, the state can impose itself as more or less dominant factor in the economic sphere of society.

The above stated considerations are the result of the analysis based on the interpretation of the structural conception of constitutional texts that has developed throughout history in a quite expected, even intentional way. This is the occasion to let us remind you on the period of the development of Yugoslav state after the Second World War in order to grasp the meaning of the constitutional text that extensively spoke about the economic regulation of state and society. Thus, the Constitution of Federal Republic of Yugoslavia of 1974, structurally speaking, even in its introductory part abounded in economic issues since three out of ten given principles spoke about the social and economic order, the economic system and the goal of social, economic and political system. In the second part of the constitutional structure, the first section was dedicated to social and economic order embodied in the regulative opus that included 76 articles (from art. 10 to art. 86). The Constitution of Federal Republic of Yugoslavia was published in the Official Gazette of SFRY no. 9/1974.

Accordingly, we can conclude that the analysis of the space which is in a constitutional text dedicated to economic issues and problems leaves us to make certain assumptions. Thus, it can be expected, hypothetically, that the restricted regulation of the economic sphere of society is the result of the legislators' intention to let this sphere be regulated by economic subjects beyond the state influence. In other words, if a concrete constitutional text dedicates considerable space to economic sphere, this reveals the legislators' intention to assign a monopolistic position to the state in the most significant parts of society's economic structure. In order to draw such conclusions for each particular state it is necessary to analyze the realistic situation of its economic conditions which requires additional testing and checking of assumed opinions established on the basis of reviewing the structural composition of constitutional texts and the position of economic issues within them.

The justification of this approach is additionally supported by contemporary theoretical tendencies, especially present in the last decades of the 20th century when it seemed to be attractive and popular to research social problems related to law and economics using the advantage of resorting to the principles of both social sciences. Thus, for example, the movement *Law and Economics* was particularly dominant in the USA whose proponents were focused on the "application of the principles of marketing analysis for the purpose of resolving difficult social problems that affected the postindustrial society. Since there is a close link between legal and economic spheres of life, they insisted on law being based on economic principles, such as, rationality and efficacy" (Vukadinovic, 2006:26).

Another justification why we should dedicate a part of the constitutional matter to economic issues lays in the fact that a considerable number of sources of substantive law, including the constitutional law, comprise economic relations that should be regulated by basic constitutional rules. This fact also reflects the specific characteristics of economy and its basic principles which in modern democratic states are the subject to economic freedom and mechanisms beyond the state influence. On the other hand, we should bear in mind the well-known fact that scientific research of legal issues has been very much refreshed by the application of economic methods, categories and principles. "When performing a normative analysis, we should take into account that every society has its own assumption about the meaning of social welfare and the instruments of social protection." (Sakalaš, Lendak-Kabok, 2011:118).

2. THE REPUBLIC OF SERBIA CONSTITUTION OF 1990

In order to correctly comprehend the key issue, outlined in the very topic of this work, it is necessary to consider a few important factors which determine the essence of our understanding of the given problem. In one hand, it is a historical dimension embodied in the fact pointing to the radical distinction between the concept of economic order formally established by the Republic of Serbia Constitution and the concept of the economic order that was regulated by the previous Serbian Constitution of 1990 ("Official Gazette of RS no. 1/90). In addition, the context of economic ambient of Serbian society in the period of the adoption of the existing Constitution is a valid indicator which theoretically, logically and successively relies on the previously mentioned historical dimension. This creates the basis for further methodological analysis of the formal structure of the constitutional text and its content from the economic point of view. It would be probably also interesting to explore economic rationality of the constitutional text in the sense of its terminology, which would enable us to understand jurists' linguistics from the perspective of economic principles and categories. Yet, adhering to basic conceptual line that has formulated the headline topic of this work, the authors have decided to abandon this issue, at least for the time being.

This Constitution had a short preamble and 136 articles systematized within nine sections, while the individual units did not bear any particular title or headline. By establishing the Republic's rights and duties, this Constitution actually defined the jurisdiction of the state. Having split this jurisdiction between various state organs, the Constitution established that the rights given to the Republic and responsibilities, to which it was bound, were actually assumed and exercised by its organs, also defined by the Constitution, which constituted the organ-based functioning of the state government. As the basis and measure of the authority and responsibility of the state organs which take the Constitution as their source, the legislators foresaw three principal value-oriented legal and political categories: 1) human and citizens' rights and freedoms to which the Constitution dedicates special section, 2) equality before law, as the principal basis for establishing the state with the rule of law 3) autonomy and equal position of enterprises and other organizations. These three characteristics were seen by the legislators as three qualifying principal postulates embodied in the phrase "the basis and the measure of the authority and responsibility". While performing the assigned duties within their jurisdiction, the state organs should continually seek the purpose and sense of their existence, particularly exercising their duties in the field of human rights, equality before law and autonomy and equality of all economic subjects and other organizations. These three values represented the bottom line of the state authority and their violation would mean the violation of the constitutional sense of the state government and its organ-based function.

The Constitution also foresaw that the rights and duties of the Republic of Serbia also included the regulation of the following issues: legal position of enterprises and other organizations and their associations and chambers; financial system; the system regulating economic relations with other countries and markets, including planning and other economic relations of general interest; control over the distribution of the assets of economic subjects, financial revision of public expenditure and the method of unified organization of these activities; collecting statistical and other data of general interest; principal goals and guidelines of economic, rural and agricultural development; spatial organization and its economic use; policies and measures aimed at inciting the economic growth and development and finally, financing the implementation of the Republic of Serbia rights and duties.

It is interesting to note that in this Constitution the human rights corpus was not systematized through a specific classification that can be encountered in standard constitutional and political theory and practice and on the basis of commonly known criteria that can be found in constitutional and political theory and practice. They were rather dispersed throughout the entire section lacking any catalogized form and approach.

3. Contemporary Serbian Constitution

Unlike the previously mentioned monotechnical model, the structure of the contemporary Serbian Constitution (Official Gazette of RS no. 83/06) includes "three obvious basic systematic units: section, subsection and article. Each systematic unit has its own title. There are 10 sections, 16 subsections and 206 articles. The systematic structure of these units is not identical and majority of sections actually do nor have subsections – only four of them do. The third section has two subsections, the second and seventh have three subsections, while the fifth section is the largest and includes nine subsections" (Djordjevic: 2010:30). As for the number of articles, two sections comprise 60% of the total number – the section related to the organization of government (68 articles) and the section on human and minority rights and freedoms (64 articles). As for the organization of the economic system, the third section, comprising 15 articles "Economic system and public finances" regulates this area of social life. This section is subdivided into two systematic units that the authors, using the freedom of academic expression, named as subsections: "Economic system" and "Public finances". Reviewing the structural composition of the constitutional text, one can get the impression that the scope of constitutional norms that regulate economic system is not very wide.

These arguments referring to the restrictive position of economic themes in the structure of the constitutional text are further elaborated and explained by reading the first section of the Constitution related to constitutional principles. Modern Serbian legislators did not deem it important to define and present their principle normative position related to the economic sphere. Such legislators' attitude can be even considered to be "acquired habit" since they actually continued to rely on the same methodological and nomotechnical approach that had been used by the legislators back in 1990. Yet, the comparative analysis have shown that the legislators from neighboring countries have taken a different direction and introduced economic issues within the introductory part of constitutional principles. Thus, for example, the provision from Art. 2.4.1 of the Republic of Croatia Constitution prescribes that "the Croatian Parliament and people shall directly decide on the regulation of economic, legal and political relations in the Republic of Croatia" ("National Journal" no. 76/2010). Or, for example, the constitution of the Republic of Macedonia regulates the fundamental values of its constitutional order in its introductory provisions which, among other values, include "the legal protection of property" (Official Gazette of RM no. 52/91, 1/92, 31/98, 91/2001, 107/05).

Analyzing the legislators' stand towards society's economic problems, it is also interesting to note that the field of the organization of economic system and public finances is considered to be the part of the constitutional matter whose possible change is not the subject to be decided at a referendum. Probably the reasons for this assumption should be sought in the legislators' opinion that these issues are not considered to be suitable to be the subject of the populations' comprehension and direct vote. Or yet, such assumption can also lead us to conclude that this law is "too important to be left to lawyers to decide on, since it affects the destiny of all individuals, organizations and the state as a whole" (Popov, Stankovic, 2007:38).

Let's go back to the analysis of the part of the text of Serbian Constitution that regulates human rights and freedoms dividing them into individual, political, economic, social, cultural and ecological rights and freedoms. Once again, the legislators did not systematically classify them in the constitutional text, but they rather become obvious during the application of constitutional law. We can only discern just a trace of a partial systematization based on the order of the articles in this second section of the Constitution. Thus, at the beginning of this section there are the articles that regulate personal rights and freedoms, followed by the articles that include political rights and freedoms, then, economic and social rights and freedoms, and finally, at the very end, those that deal with cultural and environmental rights and freedoms.

Before presenting the normative analysis of the provisions of the Republic of Serbia Constitution that regulate economic rights and freedoms, we would like to point to an interesting fact from the global constitutional map. Thanks to updated Internet resources, we can easily and rapidly Google out the constitutional texts of almost all countries in the world, either in full, or their partial contents. In this way we can explore the structural composition of these texts and discover that 82 constitutions include separate normative sections that regulate economic rights and freedoms, which constitutes almost one half of all global constitutions (www.constitutteproject.org). Of course, we would like to underline that this fact is sourced out from the informative material which needs to be further elaborated and scientifically supported. It would be unprofessional to draw serious conclusions on the presence of economic issues in global constitutional texts on the basis of Internet data. However, the systematization presented on the above mentioned Internet site was made based on the availability of separate structural composition of constitutional sections, subsections and articles related to various rights and freedoms, and within these separate structural units there are those that include constitutional provisions regulating economic rights and freedoms.

If we get back to modern Serbian Constitution, it should be noted that the ownership rights are in the center of property rights and that this Constitution guarantees peaceful and unrestricted enjoyment of these rights, but only if they are obtained in accordance with law. This means that ownership and other property rights that were obtained in an illegal way are not the subject of constitutional protection. The Constitution also foresees the possibility of restricting, even confiscating property rights, but these situations may only occur if they are strictly in public interest, also defined by law, and accompanied by fair compensation, not below the market value. The purpose of such restriction or confiscation of property rights must be regulated by law, which is also the case with the public interest, which limits the state's executive authority. Of course, we are here discussing some of the exceptions from general constitutional norms guaranteeing property rights. One of the exceptions also refers to the restriction of models of utilization and management of property. Relativization of property rights is also encountered in exceptional cases related to forced payment of taxes and other debts or fines, but these restrictions can be only regulated by the principal law, and not some other subordinate laws and acts. Thus, for example, criminal law foresees restriction or termination of property rights as a result of illegal acts of the citizens who are the subject of certain criminal sanctions.

CONCLUSION

The analysis of the constitutional framework of economic system in Serbia was conducted out of purely theoretical reasons, but also based on the investigation of the existing situation in this field. In other words, can we say that the regime of existing Constitution satisfy the normative requirements in function of progressive development, or not? Therefore, the existing data related to public opinion on the way how this Constitution regulates these subjects are of particular importance. We believe that there is a rational justification for the view of the citizens and the elite that "the constitution does not fully guarantee social and economic rights of citizens", as well as that the constitution should better regulate "antimonopoly and free competition" (Jelinčić, Ilić, 2013:107,109). In this sense, it is necessary to continue the analysis of existing constitutional solutions where scientists and professionals will insist on redefining the existing constitutional rules of economic "game" whereas we are fully aware that constitution should not "impose itself as an obstacle but should allow… unobstructed economic and business transactions and efficient use of available resources" (Madžar, 2013:33). We believe that a part of the response to the issue related to the absence of constitutional rules that regulate economic matter lies in the specific historic background. We are here referring to turbulent and oscillatory changes of social order that have burdened Serbian society from its beginning as a modern state. The processes of intensive and radical changes of founding structure of social order adversely affected social and economic tissue of this state throughout the entire 20th century which has destabilized the efforts directed to the establishment of a consistent economic order. In the conditions of transitional turmoil, it is the constitution which is expected to contribute to the consolidation of regulatory mechanism which would secure a stable development. Therefore, our concluding remarks are directed towards the needs to start revising those constitutional solutions which inadequately regulated the problems of economic system. Here we are particularly underling those constitutional mechanisms which could provide additional depolitization of market economy in order to prevent further "tycoonization" of Serbian economic area. Such an approach would additionally provide a revision-oriented view directed towards upgrading of social and economic rights and liberties which is bound to happen since it is preconditioned by the needs for harmonizing social relations as a whole.

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EKONOMSKO UREDJENJE U STRUKTURI USTAVA REPUBLIKE SRBIJE

Problematika odnosa prava i ekonomije predstavlja jedno od onih pitanja, koje sličnim intenzitetom istraživačke pažnje privlači i pravnu i ekonomsku nauku. Multidisciplinarnost istaknutog odnosa prisutna je, kako u formalnim okvirima pravnog i ekonomskog poretka, tako i u akademskim oblastima njihovih proučavanja. Moć medjusobnih uticaja prava i ekonomije dostiže svoje uočljive domete naročito kada se realizuje kroz primarni pravni dokument državnog poretka. Naravno, reč je o ustavu, pa će autori nastojati da istraživački napor usmere u pravcu analize postojeće ustavne regulative u Republici Srbiji, polazeći od činjenice da je reč o relativno novom aktu, čija se egzistencija postepeno približava prvoj deceniji. Svakako da se već iz naslova rada osnovano može pretpostaviti da se akcenat te istraživačke pažnje pomera ka ekonomskim dimenzijama Ustava Republike Srbije iz 2006. godine.

Ključne reči: *ekonomsko uredjenje, pravo, ustavna materija, Ustav Republike Srbije..*

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Review paper

LIBERALIZATION OF FINANCIAL MARKETS: AN OPPORTUNITY OR RISK FOR DEVELOPING COUNTRIES

UDC 336.71:338.124.4

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Abstract. *The process of financial liberalization has created enormous opportunities for profit for banks and other financial institutions, but it has also led to an increased risk to their business and numerous banking and financial crises around the world. For decades, a considerable number of countries have isolated the economy and financial markets, resulting in greater protection from international financial shocks, but also reduced efficiency of local financial markets. In recent years more and more countries have chosen the liberalization of financial flows, reduction of government interference and have opened doors to foreign investors. These changes have led to increased opportunities for economic and financial subjects, but also to large exposures and frequent crisis. The paper considers different aspects of liberalization and analyzes positive and negative aspects of controlled and liberalized markets, as well as the consequences of institutional changes in the markets in the process of liberalization, with the aim to resolve the question of whether liberalization represents a chance or risk to financial markets of developing countries.*

Key Words: *liberalization, developing countries, banking crises, credit boom, institutions.*

INTRODUCTORY REMARKS

Due to political and economic changes that have swept the world in the late 80's, a large number of developing countries started the liberalization of its financial markets. This process in the world of finance was not new, since, a decade earlier, it affected the developed countries, which have thus begun the process of abandoning the Keynesian economic approach, which dominated the period of the Great Depression, and especially after World War II. The liberalization process has opened many opportunities for developing countries, enabling even more rapid development, creating more opportunities

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to make profit for all market participants, but at the same time, establishing an open market, despite numerous chances, and bringing significant risks, particularly in the form of rapid transmission of crises from one market to another. Since the late 80's communism, as one of the two dominant world political and economic ideologies, has suffered defeat and more and more countries are turning to capitalism, adjusting to its numerous demands. One of those requirements was the implementation of liberalization, above all, of financial markets, which was based on: 1) freely formed capital prices, 2) increased concurrence among various financial intermediaries, 3) the opening of financial markets to foreign actors. Some developing countries had already reached a considerable level of economic and financial development, while administering the state controlled their own version of capitalism and bank-centric financial system.

Liberalization, which was promoted by Western experts, who basically had the Washington Consensus, was to be conducted in the same way in all countries regardless of their specificity and the level of economic development. At first glance, the opening of alternative channels of financing and the creation of free-market stocks and bonds had to result in greater efficiency and more rapid economic development. However, in most countries, in response to the imposed changes, there were strong banking crisis, which left serious consequences on the economies of these countries. The question is, why did it happen, if it is a great part of diligently executing instructions proponents of financial liberalization? In this paper, through three interrelated parts, the attempt was made to answer this question on a deeper level. The first question was the lack of controlled financial system, then the quality of the process of liberalization and the end result, which is caused by liberalization in developing countries and their causes phenomenon.

1. Disorders of Repressed Financial Markets

In developing countries, channels of financial intermediation, banks and institutions to finance development are responsible for the emission of loans. Banks are responsible for short-term loans, while the development of financial sector institutions is in charge of long-term loans. Development financial institutions issued, often politically directed, preferential loans to some industries. The money for these purposes was mainly obtained from international funds through loans and grants. These financial institutions were used by the government to fund the selected sectors (in Europe after World War II) and for giving the so-called "soft loans" (in Central and Eastern Europe). Commercial banks have to abstain from long-term loans, the maximum credit limit, with branch restrictions (Pill, Pradhan 1997).

Foreign banks were prevented from operating on the market in these countries, so the major role in this markets was played by domestic banks, which are usually state-owned. In this way, there was a monopolized structure of financial markets, where only preferred domestic banks could operate. Their freedom in business was very limited by the simple fact that they had management imposed by the state. The effects of monopolization and state control over the financial markets were extremely negative. The nominal interest rate fell below the level of inflation, there was a chronic lack of capital, and balance of payments equilibrium constant was achieved by borrowing funds from international funds and foreign financial institutions.

A similar situation was with the securities markets, because it had the small length and width, with the greatest government in the trade. These markets have had little impact on savings due to a lot of similar financial substitutes, such as the short-term government bonds. There are many reasons to expect that the wider public participation in these markets will be limited. Most depositors are not properly informed and familiar with the financial market system, so they are very cautious and risk-averse when investing money. The division of property by individuals tends to be limited to those with high incomes who can allocate their risks through a variety of portfolios. The factor of uncertainty is further enhanced by the commitment to cash in respect of securities, whose value varies. In less developed markets the state is the major buyer of securities, mostly through its investment funds, state enterprises and public financial institutions. On the other hand, commercial banks are the most important actor in financial markets from the private sector, while other financial institutions, businesses and, ultimately, individuals are of less importance for the functioning of these markets (Drake 1977).

In recent decades, a number of developing countries have gradually opened to foreign investment, so that many crucial sectors have been left to foreign firms. What proved to be a rule of thumb is that foreign companies would rather not raise funds on the local market, except if required, due to the regulations of local authorities. However, in recent years, multinational companies operating in developing countries have striven towards the least engaging of funds from domestic sources, preferring international sources and combining them in order to protect themselves from the risk of external borrowing. On the other hand, protection against inflation and political instability in the country in which they operate, multinational companies have found in collecting money in domestic currency.

Securities transactions are typically small in underdeveloped countries. From time to time, there is a most unexpected sharp acceleration of trade, however, these changes are results of speculative operations, which lead to additional markets and price volatility (Umutlu, Akdeniz, Altay-Salih 2010). Thus potential serious investors get another reason to bypass these capital markets. Over time, several experts have pointed to the negative consequences of financial repression. They presented cases of increased efficiency of asset using due to deregulation and liberalization of financial flows. Special focus is placed on the important elements of financial intermediation, such as deregulation of interest rates, reduction of reserve requirements, directed credit programs issue and interest rate ceilings. According to the advocates of liberalization, high interest rates for lenders and borrowers to introduce dynamism that is desirable in the development, which attracts a net savings and divert investment from inferior use to encourage technical improvement. High interest rates encouraged mature borrowers to seek funding rather than bank loans. The liberalization of interest rates strengthen savings and encouraged new private investment (Demir 2009).

To accelerate the development of financial markets and raise efficiency in trading securities, the state must take a stimulative policy. First of all, companies should be encouraged to collect funds through the issuance of securities, offering them legal and any other logistics until they enter the financial market, and a variety of tax relief of funds collected in this way. Moreover, the incentive must be given to potential investors, primarily through favorable tax treatment of the profit.

Demand for the securities will increase liquidity, which will, on the other hand, improve the readiness of the central bank to rediscount, and the willingness of commercial banks to accept securities as collateral for the overdraft. Finally, official surveillance of trading in the securities market is imperative if one wants stocks and bonds to become more attractive assets. The aim of the official regulation should provide full disclosure and dissemination of accurate information on companies, whose securities are traded. The ultimate effect of successful regulation should be to prevent various forms of market fraud and protect the interests of minority shareholders, as well as to encourage the development of specialized services and technology. These measures should be taken in the spirit of promoting capital markets, because regulations, which do not achieve these objectives, can actually prevent the development of capital markets.

2. PROCESS OF FINANCIAL LIBERALIZATION

In the previous section we have shown the shortcomings of the completely controlled financial system and emphasized the arguments in favor of liberalization of financial flows. Recent years in the world were marked by intense process of liberalization in the business world, which strongly affected financial transactions. Clear boundaries between the local financial markets are increasingly disappearing and the world is slowly evolved into a single global financial market. Restrictive policies that have been led by governments of developing countries, gave way to liberalization of financial market operations, which opened the way for privatization of existing banks and the creation of new domestic banks and entering of foreign financial institutions to the local markets, making the competition in this field significantly heightened.

Financial liberalization is a process, not a single event. It has two distinct dimensions: internal and external liberalization. The following table presents the elements of these two dimensions of liberalization and their specific effects on the functioning of the banking and stock market (Ameer 2003).

Table 1 The dimensions of the liberalization

DIMENSIONS		Banks	Stock Exchange
	INTERNAL	The entry of foreign banks in domestic banking market Removing ceiling interest rates ▪ Deposit interest rates ▪ Lending interest rates Reduction in reserve requirements ▪ Cash-reserve ▪ Legal requirements liquidity Reduction policy directed loans Privatization of state banks Prudential regulations for banks The scope of financial services	Opening the market to foreigners Trading systems Incentives for foreign investors Investment banks / non-bank financial institutions (NBFI) in securities Issuance of shares
	EXTER	Off-shore loans from international banks Currency convertibility	Cross listing, investment funds Mergers and acquisitions Portfolio investment Foreign direct investment

Source: Bandiera et al. (2000)

Internal liberalization is implemented due to local deregulation and reduced state involvement in direct financial operations and control of the financial flows. External liberalization is largely conditioned by the just implementation of the measures of internal liberalization and creating the conditions for entry of foreign companies on the domestic market. In addition, major measures of liberalization are: 1) macroeconomic variables, measured by trading volume of shares or cash flow, and 2) the date of liberalization. The first approach is more objective because it does not rely on the custom scheduling. Another approach relies on country reports, which provide updated information on the status of the reform program, either voluntarily or because of the demands of international financial institutions Time methodology is often used to identify when a component of liberalization adopted, then the frequency components in one year is added and is defined as an index of liberalization for the year. The table below gives the introduction of certain components of financial liberalization in the six countries (Ameer 2003).

Table 2 The dynamics of liberalization in some countries

Component liberalization	India	Indonesia	Malaysia	Pakistan	Thailand	South Korea
Deregulation of interest rates	1996	1983	1991	1995	1990	1991–93
Reduction in reserve requirements	1993	1988	1994	1993	1992	1996
The abolition of priority loans	1994	1990	1991	1995	1980	1992
Bank Privatization	–	1992	–	1991	–	1981–83
The entry of foreign banks	1993	1988	1994	1991	1995	1987
Range of banking	–	1988	–	1991	1995	1989–91
Prudential regulation	1996	1997	1989	1994	1997	1991
Opening the market shares	1986	1989	1987	1991	1988	1987
The incentives for foreigners	1992	–	–	1997	–	1992
Trading System	1992	1992	–	1997	-	–
Investing in NBFI	1992	1996	–	1997	1995	–
Issuance of capital	1992	1996	–	1996	–	–
Liberalization of exchange activity	1988	1970	1994	1994	1991	1989

Source: Laeven (2003)

It is very clear from the table that there are earlier and later liberalized countries in the sample. Indonesia, Korea and Thailand liberalized early, while Pakistan, Malaysia and India carried out liberalization later. Government intervention in the process of financial intermediation in many developing countries has been reduced, after the phase of reform, starting with the liberalization of interest rates in many countries in the sample. These measures followed a reduction in reserve requirements and opened the banking sector to foreign competition. These measures had to revive the offer of loans and ensure a better allocation in these countries. Similarly, the stock market was opened to foreigners in most countries, but incentives to increase foreign investment, as well as the installation of modern financial technology, were launched quite late in many countries in the sample (Ameer 2003).

3. Effects of Financial Liberalization by Developing Countries

The process of liberalization is often met with very diverse opinions, because there are different views and observations on successes and failures of internal and external liberalization. The concept of financial liberalization has also been targeted by critics neostructuralists (Morisset 1993), as well as modern economists, because many of the initial premises of the liberalization process, such as perfect information and perfect markets, were taken lightly by the advocates of liberalization, without further study of their reality. None of these assumptions existed in developing countries at the time of liberalization. Neostructuralists argue that the limited market has information advantage over the institution in a liberalized market, while borrowing funds and the monitoring of loans. On the other hand, supporters of the liberalization point out that the strictly controlled market is burdened with numerous restrictions and occasional shocks in the operation, so it is unable to effectively respond to requests for funds, necessary for individuals and businesses. Whose arguments are real can at best be seen through practical experience. According to the position of many prominent economists, liberalization is the cause of the recent disturbances in the money and banking crises. Liberalization has made the local economy threatened by a global infectious shock. Modern financial transactions, such as bank loans securitization, have led to credit and other risks, incurred in the business of a bank, it can easily be transferred to the buyer and the newly created securities, and thus undermine the market in which it operates. This kind of financial transactions has largely contributed to the consequences of wrong policies and credit risk of U.S. banks be felt fundamentally by the global market (Radević, Lekpek 2010). Therefore, many experts who have studied this issue say that financial liberalization has a cost in terms of increasing financial exposure. Do these attitudes and experiences of individual countries suggest that policy makers should abandon in favor of increasing liberalization of direct intervention in financial markets? Of course, the answer depends on whether the costs exceed the financial fragility of the social benefits of liberalization, as well as on whether the government can expect to design and implement regulations to correct market failures, rather than enhancing them. The answer to this question is complex and it is very difficult in a work or study to completely eliminate this dilemma. However, it is possible, using the results of some experiments, to analyze one aspect of this problem. This is primarily the question of whether financial liberalization and frequent banking crises affect economic growth through their impact on financial development. One of the most important sectors, which is directly touched by the process of liberalization is the banking sector. Many scientific studies that dealt with banking crises have become aware that there are channels of influence, through which the implementation process of liberalization may affect banking stability. This occurs for several reasons.

First, deregulation of interest rates in the initial period which leads to their significant increase. Because of the maturity gap, which is due to the process of maturity transformation, later performance can be worse, because deregulation led to an increase in funding costs of banks. At the same time, because of their long life, interest rates on loans do not adjust to that speed to market changes, which altogether leads to a significant reduction in grain yields in the bank.

Second, financial liberalization is associated with the opening of financial markets. For banks, the opening of the financial system has meant access to significant sources of funding, which could be obtained in foreign markets (Allegret et al. 2003). However, lending in foreign currencies are stable in the short term, and then placing the funds in the long run and often in a domestic, not so stable currency were the main cause embrittlement of the domestic financial system to capital outflows. Liberalisation provides great mobility of capital and elimination of obstacles to investment and withdrawal of funds. For economies that have just adapted to new rules of the game and are becoming increasingly dependent on foreign investors, changing the mood of investors has meant major upheaval and caused serious crisis. Such crises have afflicted Chile in 1981, Mexico in 1995, Southeast Asia in 1997, Turkey in 1994. The following chart clarifies the scope of the currency gap in some developing countries, considering the development of foreign activities of banks. Decline in the economy of some Asian countries on the eve of 1997, could be predicted by looking at increasing share of foreign liabilities in total liabilities.

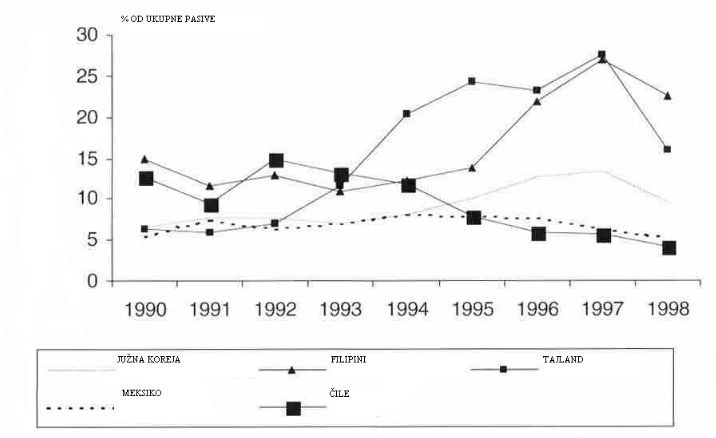

Chart 1 Ratio foreign banking liabilities to total banking liabilities
Source: IMF, International financial statistics

Third, lending process released of strict regulations and control significantly increases the number of commercial bank loans to the private sector. Chart 2 shows the increase in borrowing, that is. increasing the ratio of domestic credit to GDP.

Such an enormous increase in lending was seen by Mexican economy, with increasing ratio domestic credit to GDP by 21 percentage points between 1990 and 1994. Similar trends have appeared in many other countries, which started liberalization of financial markets, and are thus eliminated the political restrictions on commercial bank loans. This explosion of lending is only a short term solve problems that have arisen in the markets of these countries. In the long term, this phenomenon has led to increased credit risk, which banks took on themselves, which has reinforced the possibility of erosion of banking income.

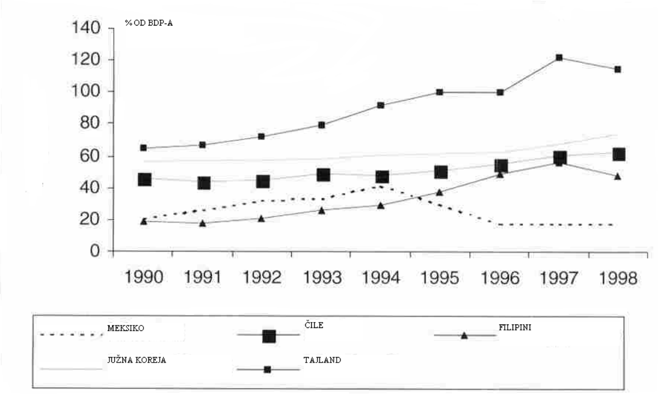

Chart 2 Lending boom
Source: IMF, International financial statistics

However, the occurrence of an explosion of credit, which many experts are often called "over-borrowing syndrome" in large part the result of the initial euphoria, the financial markets due to the transition from controlled to completely liberalized (Pill, Pradhan 1997). This phenomenon calls into question the efficiency and stability of the banking system. More specifically, the existence of government guarantees for bank deposits, causing counterproductive effect of bank stability, due to the presence of moral hazard (Allegret et al. 2003).

Any analysis of banking crises without considering the role of institutional factors would be incomplete. But, starting from the Washington Consensus, as a fundamental doctrine of global financial institutions, we come to different conclusions. Specifically, the Washington Consensus, which emphasizes liberalization as a necessary condition for global growth, has proven very often as completely inadequate for the simple reason as his agents claim that the very process of liberalization makes it unnecessary investment in the institution, which would be champions of change of the existing financial system before implementing radical reforms. It was precisely this approach that the market gives divine infallibility feature has led to the fact that the institutional vaakum created, because the former market institutions destroyed, while still not been made new, that would be replaced.

One of the main partner of developing countries in the process of liberalization has been the IMF, offering a sequential approach in the process of financial liberalization. This approach involves financial liberalization in a general program of macro-and microeconomic reforms. Accordingly, it is emphasized that macroeconomic stability is a precondition for financial liberalization. Some experts go further and argue that there are five prerequisites which must be met in order to be successful financial liberalization. These are (Allegret et al. 2003): 1) adequate prudential supervision and regulation of commercial banks, 2) a reasonable level of price stability, 3) budget discipline, which limits the negative effects of inflation tax, 4) behavior of commercial banks, in order to maximize profit, 5) the fiscal system, which is neutral on the issue of intermediary activities.

The major limitation of the sequential approach is the omission of an essential aspect of change that concerns of developing countries, and to institutional change, which underlies the process of financial liberalization. In this respect, Allegret et al. (2003) point out that financial liberalization in Asia led to destructive competition and excessive investment in some companies, because of the removal of coordination methods used by the government in economic decision-making. The financial crisis has occurred because of neglect of traditional coordination mechanisms, which existed in part planned and bank-based system of Asian capitalism, rather than because of inefficient financial supervision and regulatory capacity.

The causes of financial instability and perceptions of institutional infrastructure, which formed the basis of financial liberalization, shows how difficult it through (which exist in developing countries) and liberalization make coherent. Dominating the financial systems in most countries that joined the process of financial liberalization have been dominated by banks, ie. major role in the functioning of financial intermediation and banks have had. Thus, a centralized system would allow authorities facilitated control over economic and financial developments in the country. For this reason, many advocates of a radical approach to liberalization, they argued that the eminent role of banks is one of the major constraints in the process of liberalization of financial markets. They felt that the role of banks should be reduced so that they become just one of a wide range of stakeholders in the financial market. However, later confirmed that it was a completely wrong assumption. Blinded by the idea of a uniform approach to the development of financial flows in the country, they went from being the only copy the experience of most developed Western countries, whose market-based financial system, may be right for developing countries.

True, we have already emphasized the central role of banks, which are at the same time were under firm government control, often had a negative impact on the efficiency in the financial system and economy, because many times the economic motive remained on the sidelines when making investment decisions. These experiences, however, should not be viewed unilaterally. Many years of experience bank-centric system, which was used for decades in these countries and has become the engine of their development can not be completely dismissed as a failure. Change course need to be, but these changes should flow the other way, primarily to the abandonment of the banking system administered under strong government control, and implementation of marketization banks. it is necessary to transition from the model limited to the model bank, which is fully oriented to providing services and meeting the needs of its clients. In other words, it is strengthening the role of markets by enhancing market access to banks.

Regardless of these facts, the IMF, which largely represents the doctrine of free markets, while giving advice to developing countries, have remained completely blind to these facts, seeking abandonment of the practice, which so often has been successful and what were the needs of only some changes in order to be more successful. They still stubbornly offer, even countries that have reached a significant level of economic development, the Western form of governance, which even in economically and financially powerful and mature states, often showing their instability and lack of immunity to the crisis. Rational solution experts as a successful example rather point out Japan, which has developed a market-based bank-based system in which banks play a major role in the stabilization of financial companies, because as soon as the company sank into a crisis, the right management company switches from enterprise management to the bank, with which company work directly, and therefore emphasizes the central role of banks in the business discipline companies.

CONCLUSION

Expectations of countries that have entered the process of liberalization were to have a liberalized market, with increased competition participants and additional capabilities for collecting and placing the funds, give great impetus to economic development, most countries that have embarked on this process are directly faced with financial crisis primarily in the banking sector. There are more reasons for this phenomenon. The previous system, which was considered ineffective, based on the established institutions, laws and experiences, represented a great support. Advisors in developing countries completely neglected the need to build new institutions that would start to track changes so that the so-called "wild capitalism" occurred which had no clear rules and regulations. As a result, regulation of financial flows was left to still immature market and foreign speculators, who saw this country as an outstanding opportunity for high profits. However, these facts should not be an argument that the impact of liberalization process and to reject the favors of the concept of state-controlled financial markets. Complete state control of financial markets was proved to lead to inefficient investment, political and not economic to favor projects, as well as reduce the chances of a successful business. Liberalization that would primarily have a role to overcome the shortcomings and establish a stronger market orientation of banks, a concept that has been successfully used for decades in Japan. Liberalization is necessary but there must be a significant dose of caution regarding the pace and patterns of its implementation, not losing sight of specific countries and regions where they are committed.

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LIBERALIZACIJA FINANSIJSKIH TRŽIŠTA: ŠANSA ILI OPASNOST ZA ZEMLJE U RAZVOJU

Proces finansijske liberalizacije je stvorio ogromne profitne mogućnosti bankama i drugim finansijskim institucijama, ali i doveo do povećane rizičnosti njihovog poslovanja i brojnih bankarskih i finansijskih kriza širom sveta. Znatan broj zemalja je decenijama imao izolovanu privredu i finansijska tržišta, što je rezultiralo većom zaštićenošću od međunarodnih finansijskih potresa, ali i smanjenom efikasnošću lokalnih finansijskih tržišta. Poslednjih godina sve veći broj zemalja odlučuje se za liberalizaciju finansijskih tokova, smanjenje državnog uplitanja i otvaranje vrata stranim investitorima. Te promene su dovele do povećanih mogućnosti za privredne i finansijske subjekte, ali i do velike izloženosti riziku i učestalim pojavama kriza. U ovom radu razmatrani su različiti aspekti liberalizacije, analizirane su pozitivne i negativne strane kontrolisanog i liberalizovanog tržišta, kao i posledice institucionalnih promena na tržištima u procesu liberlizacije, a sve u cilju razrešavanja pitanja da li je liberalizacija šansa ili opasnost po finansijska tržišta zemalja u razvoju.

Ključne reči: *liberalizacija, zemlje u razvoju, bankarska kriza, kreditni bum, institutucije*.

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Review paper

AN OVERVIEW OF EARNINGS MANAGEMENT MEASUREMENT APPROACHES: DEVELOPMENT AND EVALUATION*

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Abstract. *Earnings management practice has received much consideration and interest from regulators and practitioners as well as academics, with literature in the accounting field providing three key approaches for the identification of the various practice levels and techniques, including aggregate accruals, specific accruals and statistical distribution approach. Despite the fact that many studies have been directed towards enhancing the overall power and specification of each approach, there are nevertheless pros and cons linked with the application of each model. This paper provides and reviews the literature available on the development and assessment of such frameworks in an attempt to emphasis the various points studies should be considering when identifying earnings management.*

Key Words: *earnings management, measurement of earnings management, aggregate accruals approach, specific accruals approach statistical, distribution approach.*

INTRODUCTION

The concept of earnings management has received much consideration and interest from regulators and practitioners in the field, with the literature referring to this practice through the use of various terms, including accounting manipulation, aggressive accounting, creative accounting, earnings management, and income smoothing (Stlowy and Breton, 2004; Atik 2009). Earnings management occurs when management direct their judgment and utilize estimated permitted by accounting standards or structure transactions in order to amend financial reports with the aim of misleading stakeholders in regard to

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the firm's economic performance, or otherwise to impact contractual outcomes that rest on the accounting figures reported (Healy and Wahlen, 1999). Such a practice does not commonly go against any accounting standards (Marai and Pavlović, 2013).

Despite the commonly held view that earnings management is prevalence practice within the companies, it remains that it has been remarkably difficult for researchers to document such a practice (Healy and Wahlen, 1999). Such a difficulty arises mainly owing to the fact that earnings management is unobservable, meaning its magnitude cannot be measured directly. Accordingly, for researchers to establish whether or not earnings have undergone management there is a need for earnings to be estimated prior to earnings management effects being seen.

The second issue is the fact that earnings management may be carried out through a number of different techniques, which causes difficulties in terms of establishing precisely which techniques have been utilized in order to amend the earnings reported. Since earnings are the sum of cash flow and accruals, earning can be manipulated through the use of accruals and/or operating cash flow, as highlighted by (Xu, Taylor and Dugan, 2007). The use of accruals for earnings management is referred to as accounting-based earnings management, which encompasses the use of judgments or estimates permitted by accounting standards, namely through salvaging values of long-term assets and expected lives, deferred taxes, losses from asset impairments and bad debt, obligations for pension benefits and other post-employment benefits; the management of through operating cash flow is referred to as real earnings management, which encompasses changes in production, debt–equity swaps, discretionary expenditures and the reduction of prices (Xu, Taylor and Dugan, 2007) .

When reviewing the accounting literature, three different study designs are recognized as widely used in identifying earnings management, namely aggregate accruals, specific accruals and the statistic distribution of earnings, as recognized by McNichols (2000). Despite the fact that all of these methods are centered on various ideas and assumptions to provide a solution to the previously highlighted problems, there is no sole technique with the ability to completely answer the mean questions in relation to magnitude, and the techniques of earnings management. This paper has the aim of presenting and discussing the estimating methods and the assumptions developed by each of the approach in regard to dealing with previous problems. Moreover, it also seeks to emphasize some of the points needing to be taken into account by researches when selecting the most suitable amongst the research designs available. This discussion is centered on introducing and reviewing the literature in terms of how each approach has developed and is assessed.

1. AGGREGATE ACCRUALS APPROACH

This method is essentially centered on two assumptions, the first of which is concerned with overcoming the problem that arises from techniques that managers can use to alter reported earnings. In this way, the assumption is made that accruals give management the ability and resources to manage reported earnings in comparison with cash earnings, which are less likely to be managed owing to the difficulties associated with their manipulation. As has been mentioned by Paul M. Healy (1985), managers exercise discretion over discretionary accrual only. The second assumption underpinning this method is that total accruals are elements of non-discretionary and discretionary, the former of which represents the choices made by the management to alter reported earnings. Accordingly, the common starting point for the measurement of earnings management is the calculation of total accruals. Subsequently, a certain framework is utilised for the estimation of the non-discretionary element of total accruals, facilitating total accruals to be decomposed into a non-discretionary and discretionary component (Dechow, Sloan and Sweeney, 1995).

In an attempt to break down total accruals into discretionary accrual and non-discretionary accrual elements, a number of different models have been devised by researchers, ranging from the more simple ones in which total accruals are utilized as an alternative for discretionary accruals, and subsequently spanning to the more complex, where regression analysis is utilized in order to do so. The literature review of the models adopted most commonly will be discussed in this subsection.

Healy (1985)

The study of Healy (1985) is the first to have presented total accruals as a measure for earnings management. Through this study, he suggests that total accruals encompass non-discretionary and discretionary accrual aspects, but ultimately does not provide a distinction between discretionary accruals and non-discretionary accruals; rather, the assumption is made that total accruals are equal to non-discretionary accruals when there is no presence of earnings management. This suggests that total accruals are equal to non-discretionary accruals, with both representing earnings prior to the impact of earnings management during the period of estimation, which may be presented symbolically as highlighted below:

$$\mathrm{NDA}_{\tau} = \frac{\sum_{t} \mathrm{TA}}{\mathrm{T}}$$

NDA: estimating discretionary accruals for the firm I in a given time t.
TA: total accruals, defined as the difference between reported earnings and operating cash flows.
T= 1, 2…. T is a year subscript for the years included in the estimation period; and
τ = a year subscript indicating a year in the event period.

DeAngelo (1986)

In much the same way as Healy (1985), DeAngelo (1986) implements total accruals as a proxy for earnings management, with a definition of total accruals as the difference between operating cash flows and net income. She further emphasizes that TA (total accruals) encompass both NDA (non-discretionary) and DA (discretionary) elements. In contrast, however, the model presented by Healy was criticized by DeAngelo in the sense that, if NDA is considered to be too large in comparison to TA, the latter measure would then be considered a poor alternative for the degree of earnings management in period t=1, and thus, for her research, NDA may be considered too significant and systematically negative for a large number of organizations—even those lacking in systematic manipulation. In this way, an empirical observation has been made that TA<0 has the ability to create an erroneous inference that management had intentionally understated earnings, when the more precise explanation is that total accruals commonly comprise a (material) negative non-discretionary elements. As a substitute, a non-zero benchmark was developed for the "normal" or expected total accrual in periods before the management buyout. For this reason, the total accrual in the immediately prior period is taken as a benchmark for what the current accrual would be without income manipulation.

More specifically, DeAngelo (1986) examined whether or not the 'abnormal' total accrual's average value is notably negative for the sample firms in periods before the buyout (Jones, 1991). This particular average is calculated as described as follows: $(TA_t - TA_{t-k}) = (DA_t - DA_{t-k}) + (NDA_t - NDA_{t-k})$. This model and the implications of such are interpreted by DeAngelo as proof of a systematic earnings understatement. Such a view relies on the assumption that the general change in non-discretionary accruals $(NDA_t - NDA_{t-k})$ is approximately zero, where a notable average decrease in total accruals $\left(TA_t\text{-}TA_{t\text{-}k}\right)$ mainly represents a notable average decrease in discretionary accruals $(DA_t - DA_{t-k})$.

Jones (1991)

The study by Jones is the first to have presented the model where total accrual changes may be predicted through the use of explanatory variables. It has been observed that total accrual changes are likely to arise in some way from the organization's economic position (non-discretionary accruals), meaning that total accrual changes may be the outcome stemming from earnings without manipulation. For instance, if non-discretionary accruals are a function of revenue, the negative changes witnessed through the accruals may be owing to the non-discretionary changes as opposed to the discretionary accruals.

In contrast, the researcher also takes into account the fact that total accrual changes may result from discretionary accrual changes; in this instance, this is earnings management. Accordingly, in an attempt to control the impacts of economic circumstances in regard to total accruals—otherwise stated the non-discretionary accrual changes in total accruals—the expectation model detailed below may be utilised.

$$\frac{TA_{it}}{A_{it-1}} = \propto_i \left[\frac{1}{A_{it-1}}\right] + b_{1i}\left[\frac{\Delta REV_{it}}{A_{it-1}}\right] + b_{2i}\left[\frac{PPE_{it}}{A_{it-1}}\right] + €_{it}$$

Total Accruals = Non-Discretionary Accruals + Discretionary Accruals
where:
TA_{it} = total accruals in year t for firm i;
ΔREV_{it}= revenues in year t less revenues in year t-1 for firm i;
PPE_{it} = Gross property, plant, and equipment in year t for firm i;
$€_{it}$ = error term in year t for firm i;
I =1…. N, firm index;
T= 1… Ti, year index for the years included in the estimation period for firm I (it ranges between 14-23 years).

As can be seen in above equation, the calculation of total accruals may be performed as following: The change in non-cash working capital before income taxes payable less total depreciation expense. Gross property, plant, and equipment and change in revenues are included in the expectations model to control for changes in nondiscretionary accruals induced by changing conditions. Revenues are utilised with the aim of controlling for the organisation's economic setting owing to the fact that they are an objective measure of the operations of the firm prior to the manipulations induced by management, although notably they are not entirely exogenous. All of the elements encompassed within the accruals expectations model are scaled by lagged assets in order to decrease heteroscedasticity. Through the utilisation of the longest time series of observations available before Year 1 for all firms and the ordinary least squares, the estimation was made by Jones of α1, b1, and b2; of αi, β1i, and β2i, respectively. Following the estimation of the parameters outlined in the equation above, these will be incorporated within the following model with the aim of assessing the prediction error in the event period, which represents earnings management in the prediction (event) period. In line with the assumption that the link between the explanatory and non-discretionary accruals is stationary, the following outlines the prediction error:

$$u_{ip} = \frac{TA_{ip}}{A_{ip-1}} - \left(\propto_i \left[\frac{1}{A_{ip-1}}\right] + b_{1i}\left[\frac{\Delta REV_{ip}}{A_{ip-1}}\right] + b_{2i}\left[\frac{PPE_{ip}}{A_{ip-1}}\right]\right)$$

Discretionary Accruals = Total Accruals - Non-Discretionary Accruals
where:
u_{ip} = The prediction error.
The P = year index for the years included in the prediction period.
The prediction error (µip) signifies the degree of discretionary accruals in firm I at time p (prediction period) and subsequently demonstrates the earnings management of the firm at time p.

Dechow et al. (1995)

The overall performance of previous accruals-based models, such as those by Healy (1995), DeAngelo (1986), Dechow and Sloan (1991) and Jones (1991), is assessed by Dechow et al. (1995) with the aim of drawing a comparison between these and the new amended version by Jones. Consideration is directed towards the As can be seen in above equation modified version, with the view held that the standard Jones specification may be taken as being unable to capture the effects of sales-based manipulation owing to the fact that sales changes are recognised as giving rise to non-discretionary accruals. Accordingly, the new version has been developed with the aim of eradicating the conjectured tendency of the Jones model so as to ensure the discretionary accruals with error can be measured when discretion is exercised over revenues. In the newer version, non-discretionary accruals are predicted throughout the period of the event, i.e. during the times for which there is the hypothesis of earnings management, as following (Dechow et al., 1995):

$$NDA_\tau = \alpha_1\left(\frac{1}{A_{\tau-1}}\right) + \alpha_2(\Delta REV_\tau - \Delta REC_\tau) + \alpha_3(PPE_\tau)$$

where:
ΔREC_τ = net receivables in year τ less net receivables in year τ-1 scaled by total assets at τ-1.

The estimates of α1, α2, α3 and non-discretionary accruals throughout the period of estimation (during which there is no systematic earnings management hypothesis) are those gathered through the original model presented by Jones. The only change relative to the first model of Jones is that revenue changes are amended in line with the change in receivables during the period of event. The preliminary model directly suggests that discretion is not adopted in regard to revenue through either the event or estimation period.

The modified version makes the direct assumption that all credit sales changes during the event period are an outcome of earnings management owing to the fact that earnings are managed more easily through exercising discretion over the acknowledgment of credit sales revenue than through exercising discretion over the cash sales revenue. If such changes are recognised as successful, the earnings management predictions should then be unbiased in the case of those samples where earnings management has been implemented through revenue management.

Peasnell, Pope and Young (2000)

Peasnell et al. (2000) have provided a different cross-sectional model centred on predicting unusual accruals, referred to as the margin model. Comparable to the original model presented by Jones, as well as the modified version, a two-stage approach is utilised in order to predict unusual accruals. The primary phase comprises the regression of accounting accruals on a course of explanatory variables aimed to capture those accruals that have not been managed. Unlike the two previous models, deferent explanatory variables are included within the first-phase regression, which are taken from a formal framework that provides a link between accruals, earnings and sales. A further deferent from other models is the application of WCA (working capital accruals) as opposed to TA (total accruals), as well as the exclusion of depreciation from the margin model. As has been discussed through the work of (Peasnell et al., 2000), the justification behind the exclusion of depreciation from accruals measure is the fact that such an item is an inadequate instrument in systematic earnings management. Furthermore, appropriate tool for such estimation is modelling change in working capital accruals through three key aspects, namely creditors (ΔCREDIT), debtors net of bad debt allowance (ΔDEBT) and stocks (ΔSTOCK), each of which may be further described below (Peasnell et al., 2000):

$$\Delta STOCK = PUR - COGS \tag{1}$$

$$\Delta DEBT = REVC - CRC - BDE \tag{2}$$

$$\Delta CREDIT = PUR - CPS \tag{3}$$

Where PUR is purchases of materials, COGS is cost of finished goods sold, REVC is revenue from credit sales, CRC is cash received from customers, BDE is the bad debt expense, and CPS is cash paid to suppliers. It should be acknowledged that, although Δ STOCK in (1) encompasses inventories of materials, works-in-progress and completed goods, all intermediate transfers between such inventory categories involve the cancelling of entries that can be ignored when inventories are aggregated.

The second aspect is a modeling WCA, as shown below:

$$\begin{gathered} WCA = (\Delta STOCK = \Delta DEBT) - \Delta CREDIT + OTHER = \\ (REVC - COGS - BDE) + (CPS - CRC) + OTHER \\ = sm.REVC - cm.CRC + OTHER \end{gathered} \tag{4}$$

where sm equals the gross margin on recorded sales, cm equals the gross cash contribution on cash collections from customers, and OTHER includes all non-cash current assets besides stocks and trade debtors, and all current liabilities besides creditors. The postulation is made that OTHER is orthogonal to REVC and CRC in equation (4). The aim is that equation (4) establishes accrual recognition prior to being impacted through earnings management. Working capital is communicated as the total of two contributory margins, namely the margin on cash received, referred to as the 'cash margin', and the gross margin on its cash flow analogue and sales.

Through the application of this method, working capital accruals that are not established through sales and cash collections throughout the specified time are recognised as 'abnormal', and therefore are recognised as being the most probable to manifest (discretionary accruals) earnings management.

Equation (4) is utilised on an empirical basis through the application of the OLS regression tool, with Peasnell et al. (2000) also examining the ability to identify accrual management by adopting a cross-sectional prediction approach; the academics suggest that a greater ability to identify systematic earnings management can be seen through a working capital accrual measure when compared with a total accruals measure. When drawing a comparison between the models by Jones and the modified Jones version, and their own margin model, it was established that the modified version of Jones is more capable of identifying revenue-based manipulation, whilst the margin model is more capable of highlighting non-bad debt expense manipulations.

Kothari et al. (2005)

Kothari, Leone and Wasley (2005) presented a new model centred on identifying earnings management, with the model referred to as Performance Matching. The scholars also drew a comparison between the model efficiency in contrast with the regression-based approach, more specifically the original and amended models of Jones. In much the same way as the Jones model, this model utilises residuals from the annual cross-sectional industry regression, although there are two main differences: the first is the fact that it comprises return on assets, which is used to control for organisational performance; the second involves the use of a constant, which provides a greater degree of control in terms of heteroskedasticity, and it further elementals the issues associated with an omitted scale variable and allows the discretionary measure to be more symmetric. The model is seen as follows (Kothari et al., 2005):

$$\mathrm{TA}_{\mathrm{it}} = \beta_0 + \beta_1 \left(\frac{1}{\mathrm{ASSETS}_{\mathrm{it}-1}}\right) + \beta_2 \Delta\mathrm{SALES}_{\mathrm{it}} + \beta_3\, \mathrm{PPE}_{\mathrm{it}} + \beta_4\, \mathrm{ROA}_{\mathrm{it(or\ it}-1)} + \epsilon_{\mathrm{it}}$$

where $\mathrm{TA}_{\mathrm{it}}$ = total accruals predicted as the change in non-cash current assets minus the change in current liabilities excluding the current portion of long-term debt, minus depreciation and amortization, scaled by lagged total assets.

$\Delta\mathrm{SALES}_{\mathrm{it}}$ = change in sales scaled by lagged total assets.

$\mathrm{ASSETS}_{\mathrm{it\text{-}1}}$ = total assets

$\mathrm{PPE}_{\mathrm{it}}$ = net property, plant and equipment scaled by ASSETSit-1.

$\mathrm{ROA}_{\mathrm{it(or\ it\text{-}1)}}$ = return on assets

Dechow et al., 2012

Dechow et al. (2012) introduce a new method for detecting accrual-based earnings management, with this method built on the assumption that, in any period, accrual-based earnings management would reverse during another period. Furthermore, the view is also claimed by the scholars that, if the academics have priors in regard to the reversal timing, encompassing such priors could ultimately enhance the ability and the criteria of tests in the context of earnings management. Their findings suggest that the involvement of reversals could enhance test power by as much as 40%, and may also deliver a sound approach to avoiding model misspecifications that stem from related omitted variables. In some regard, this approach depends on the previous models to decompose accruals into non-discretionary and discretionary elements; on the other hand, however, they also encompass earnings management reversals within these models and analyse improvements. Nevertheless, there has been some criticism directed towards this model in regard to its failure to highlight the way in which the investigator can establish or outline priors for the periods during which there has been the occurrence and reversal of accruals-based earnings management. Rather, their method adopts the view that the scholar recognises the periods during which there will be the occurrence and reversal of earnings management (Gerakos, 2012).

2. Specific Accruals Approach

In contrast with the total accruals models, one key element of this approach is modelling particular accruals' behaviours in an attempt to identify its non-discretionary and discretionary aspects. This method commonly directs attention towards a particular sector environment where an individual accrual is sizeable and demands significant judgement. It determines earnings management from examining management discretions through an individual accrual account, namely the claim loss reserve, for example, which is a very material accrual for the insurance sector. Moreover, loan provisions are a particular accrual requiring significant judgement within the banking arena, or bad debt provision and depreciation predictions in an alternative setting. In line with such elements, in addition to subjective proof, the investigators may consider that, through a specific accrual or set of accruals, management discretion may be reflected. The section following provides a prior literature linked with this method.

McNichols and Wilson (1988)

The research by McNichols and Wilson is the first to utilise the specific accruals model to analyse whether or not management manage earnings, with attention directed towards a single accrual, namely bad debts provision, as opposed to a number of accruals. Moreover, it also implements the GAAP framework in order to examine the way in which a specific accounting number, bad debts provision, would be seen when there is a lack of earnings management. In actuality, the research utilises the residual provision for bad debts as proxy for earnings management. In order to calculate this residual, the authors model the expected provision for bad debt as a linear function of the beginning balance in the allowance for bad debts and the magnitude of current and next year's write offs. Through ensuring the control of such elements, the view is made that their method removes the non-discretionary aspects of bad debts expense, and thus gathers a bad debt provision, which mainly highlights accounting discretion amongst management. Accordingly, the model is as follows (McNichols & Wilson, 1988):

$$\text{Prov } t = \alpha 0 + \alpha 1 \text{ BgBl } t + \alpha 2 \text{ Write-off } t + \alpha 3 \text{ Write-off } t{+}1 + \text{resprov } t$$

where:
Prov t: the provision for bad debts, deflated by period t sales
BgBl t: the beginning balance of allowance for bad debts in period t, deflated by period t sales.

Write-off t: write-offs for period t, deflated by period t sales.
Write-off t+1: write-offs for period t +1, deflated by period t sales.
resprov t: the projection error, which by design is orthogonal to the repressors.

It can be seen that this model is similar to total accruals models in terms of decomposing total accruals into managed and unmanaged components. To do so it uses regression model.

Beneish (1997)

Beneish (1997) introduces a model centred on identifying earnings management from organisations dealing with significant financial performance, and examines actual earnings management occurrences, contrasting the performance of the model to that of the aggregate accrual approaches, particularly the modified Jones by Dechow et al. (1995). The method establishes a distinction between GAAP violators and aggressive accruals, and is centred on the explanatory variables able to capture and differentiate between elements that establish incentives to violate, and the likelihood of identifying GAAP violation. Moreover, they utilise a number of different possible variables that establish incentives to violate GAPP, and further take into account another eight financial statement variables, which could impact the overall likelihood of being identified by the market participants, with such variables capturing misrepresentations in financial data, as derived through GAAP violation. This delivers a probability prediction of the potential for earnings management between organisations in which abnormal accruals are not correctly outlined. The model is detailed as follows:

$$Mi = Bxi + \Theta$$

where:
M: a dichotomous variable which takes a value of I for violators and 0 otherwise.
X: the matrix of explanatory variables.
Θ: a vector of mean zero independent and identically normally distributed residuals.

As such, Beneish (1997) highlights that the capacity of the modified Jones model to separate discretion among firms with significant performance may be improved through incorporating lagged total accruals and a tool for measuring past price performance as explanatory. Such additional variables are in line with the estimation made by Guay, Kothari and Watts (1996), who suggest that accruals models that consider the incentives of management and who acknowledge the reversals of discretionary accruals are more likely to detect discretionary accruals.

Cecchini, Jackson and Liu (2012)

The study of Cecchini et al. (2012) examines whether or not the IPO (initial public offering) organisations manage earnings through the application of an individual accrual account on the balance sheet and an individual accrual account on the income statement, notably the allowance for uncollectible accounts and bad debt expense, respectively. Comparable to the approach of Teoh, Wong and Rao (1998), the writers begin through drawing a comparison with the scaled allowance of non-IPO organisations to the scaled allowance of IPO organisations, where the scaled allowances receivables are introduced in terms of percentage form $\mathrm{ALL_{it}} / \mathrm{GAR_{it}}$.
Where: $\mathrm{ALL_{it}}$ is the allowance for uncollectible accounts.
$\mathrm{GAR_{it}}$ is a gross accounts receivable, i and t are firm and year subscript

The study of Cecchini et al. (2012) further develops such an analysis by placing emphasis on the ratio of the receivables allowance to leading write-offs. The ratio is expressed through the percentage ALL_{it}/WO_{it}
where: ALL_{it} the allowance for uncollectible accounts.
WO_{it} Write-offs of uncollectible accounts, i and t are firm and year subscript.

Making the assumption that leading write-offs is mainly linked with the receivables allowance in year t, the ratio of 1 should suggest that the allowance is precisely adequate. Ratios seen to be more than 1 would suggest that the organisation has exaggerated its allowance, whereas the organisation may have understated its allowance if the ratio is much below 1. In terms of the examinations of bad debt expense, the work of Cecchini et al. (2012) examined the differences in the scaled bad debt expense between IPO firms and matched non-IPO firms through the application of scales as a scaling variable. This can be illustrated in the following way: $BDE_{it}/SALE_{it}$.
where BDE_{it} is the bad debt expense $SALE_{it}$ is the net sales and i and t are firm and year subscript.

The findings suggest that there is no notable difference when comparing the non-IPO and the IPO organisations. This finding somewhat challenges the view those IPO businesses understate their receivables-related accrual accounts. Moreover, Cecchini et al. (2012) apply the model presented by McNichols and Wilson (1988) with the aim to examine whether or not bad debt expense is seen to be much different between non-IPO and matched IPO organisations following the controlling for economic determinants of bad debt expense. This model is detailed as shown below:

$$\frac{BDE_{it}}{SALE_{it}} = \beta_0 + \beta_1 \frac{ALL_{it-1}}{SALE_{it}} + \beta_2 \frac{WO_{it}}{SALE_{it}} + \beta_3 \frac{WO_{it+1}}{SALE_{it}} + \beta_4 IPO_{it} + \varepsilon_{it}$$

where: BDE_{it}, $SALE_{it}$, ALL_{it-1} and WO_{it}, are defined above; IPO_{it} is an indicator variable coded as 1 for IPO firms and 0 otherwise.

The coefficient on $\frac{ALL_{it-1}}{SALE_{it}}$ can be communicated as negative, where the coefficients on $\frac{WO_{it}}{SALE_{it}}$ and $\frac{WO_{it+1}}{SALE_{it}}$ are expected to be positive. Markedly, a positive coefficient on IPO_{it} suggests that IPO organisations detail greater bad debt expenses than matched non-IPO firms, whilst a negative coefficient on IPO_{it} suggests that IPO organisations detail more minor bad debt expense than matched non-IPO organisations.

3. Statistical Distribution Approach

This method is centred on the assumption that management commonly have incentives driving them to satisfy particular benchmarks and goals; thus, earnings distribution encompasses lesser observations than expected just below the threshold, with more observations than expected above the threshold. Upon the analysis of the frequency and dissemination of reported earnings surrounding such thresholds, distribution discontinuities may be observed. Importantly, if the distribution is balanced, no earnings management is adopted; on the other hand, however, if earnings are recognised at a particular benchmark or at 0, earnings management may have been implemented. Nevertheless, earnings distribution in itself is not adequate; there needs to be particular thresholds that seek out and establish the discontinuity apparent at such thresholds. The following section considers the most commonly cited researches linked with this method.

Burgstahler and Dichev (1997)

The study of Burgstahler and Dichev (1997) delivers the first cross-sectional distribution method in order to analyse whether, why and how organisations achieve earnings management. This study establishes three thresholds that drive the manipulation of earnings. These are: to avoid reporting earnings decreases, to maintain positive earnings and to avoid losses. This research centres on the view that earnings management with the aim of avoiding decreases in earnings is likely to be highlighted through cross-sectional distributions of earnings changes. Such distribution takes the form of uncommonly high frequencies of minor earnings increases and uncommonly low frequencies of minor earning decreases. In much the same way, earnings manipulation to avoid losses will be highlighted through the form of unusual high frequencies of minor positive earnings and unusual low frequencies of minor losses.

With the aim of examining this assumption, two different forms of evidence are utilised, the first of which is graphical through the adoption of histograms in order to epitomise the pooled cross-sectional earnings data gathered, and to further emphasise the changes in earnings around zero and the lack of continuity of earnings; the second test is statistical in nature, and adopts the assumption that, within the null hypothesis of no earnings management, it is considered that there would be a smooth cross-sectional dissemination of earnings changes and earnings levels. From an operational standpoint, smoothness, in this context, is described as being the number of observations expected during any distribution period. This expected number is collocated as the average of the numerous observations in the two intervals immediately closest.

Degeorge et al. (1999)

Degeorge, Patel and Zeckhauser (1999) presented a method centred on behavioural thresholds for earnings management; with this particular model demonstrating the way in which efforts to surpass thresholds create certain earnings management patterns. The process begins with the establishment of three thresholds, each of which is considered a probable earnings management driver. The first of these is centred on reporting profits, which stems from the psychological value recognised in terms of the distinction between negative and positive results. The second is maintaining recent performance; in other words, to earn at least the same as the previous year. The third is to meet the expectations of analysts, especially the consensus of analysts in their earnings predictions.

Such thresholds are recognised as fundamental for management owing to the fact that the parties in question, along with the organisation, also view them as valuable. The model assumes that executives perform earnings management with the aim of impacting the views of outsiders, including banks, investors and suppliers, with the aim of deriving personal satisfaction from making a target. At the same time, outsiders make use of thresholds as a way of rewards and assessing executives; in this regard, upon the response of executives to such thresholds, reported earnings distribution becomes unclear. Essentially, too many earnings fall above the threshold whilst too few fall below. The assumption is also made that, when earnings are recognised as being within an unacceptable range, upwards management incentives are notable. Furthermore, if bonus plans limits are exceeded by earnings, limits will be moved, thus meaning future limits will be easier to achieve.

Gore et al. (2007)

The study of Gore, Pope and Singh (2007) adds additional value to the literature in two key ways. Primarily, it examines a wide-ranging non-American dataset, which has not been done before, thus validating the belief that those discontinuities reported in the literature previously are not particular to the US environment. Secondly, it further presents innovative tests, providing further support to the idea that the discontinuities in the distribution of earnings are linked with accruals centred on earnings management within their particular sample. Moreover, it also examines the links and associations between working capital accrual discretionary components, earnings target achievement frequency and the discontinuity observed in the distribution of earnings alongside basic targets. The scholars also implemented an in-depth assessment of earnings management in regard to earnings thresholds with the use of a significant sample of organisations in the United Kingdom. Emphasis was placed on earnings management with the inclusion of working capital accruals manipulation. Evidence was detailed as being consistent with earnings management with the aim of achieving goals. More specifically, they highlight that earnings adjustment for discretionary accruals eradicates earnings target discontinuity.

4. Discussion of Developing and Evaluating the Different Approaches

Despite the fact that all discretionary accruals models share the common concept—utilising non-discretionary accruals as a measure for earnings management—it remains that there are fundamental differences between the models. Particularly in regard to separating the non-discretionary accruals aspect from the total accruals, and their capacity to deal with changes in organisations' economic circumstances, in addition to the power and specification of each model. The models provided by Healy (1985) and DeAngelo (1986) hold the assumption that there is stability amongst non-discretionary accruals, with such limits recognised as unrealistic owing to the fact that accounting accruals experience change in line with the economic environment (Kaplan, 1985, cited by Dechow et al., 2012). As a substitute to the model provided by Jones (1991), the amended version by Dechow et al. (1995), in addition to the performance-adjusted discretionary accruals presented by Kothari et al. (2005), the variations of non-discretionary accruals are controlled through consideration to the changes in total assets, receivables and revenues, in addition to the performance of the organization (e.g. return on assets).

In terms of the power and specification of all models, the original and modified version of the model of Jones are acknowledged throughout the literature as being the most capable tools in terms of identifying earnings management (Dechow et al., 1995; Young, 1999). A number of researches conducted recently provided a comparison of the performance of alternative total accruals models in identifying earnings management. For instance, Dechow et al. (1995) and Guay et al. (1996) assess the overall performance of five deferent models with the aim of measuring discretionary accruals, in particular those of Healy (1985), DeAngelo (1986), Jones (1991) and Dechow & Sloan (1991), as well as the model suggested in their research—the amended Jones model. The findings suggest that the amended Jones model displays the greatest ability in terms of testing earnings management. Moreover, literature published previously, such as the works of Subramanyam (1996) and Peasnell et al. (2000) all emphasise highlight the superiority associated with adopting the Jones model in regard to cross-sectional data over their time-series counterparts.

This is owing to the fact that the former decreases time effect issues and creates a larger sample, thus inducing a greater coefficients estimate.

The main benefit associated with this method is its capacity to capture the scale of earnings management; in contrast, however, it is not able to highlight the accounts utilised by management. One further matter for consideration is the aggregate accruals models, which utilises residuals in order to calculate the discretionary accruals. In the time-series scenario it is recognised that residuals use is suitable, measuring the difference between abnormal and normal accruals throughout the estimation and event periods, respectively; on cross-sectional settings, on the other hand, this is not the same case. In theory, residuals should average zero, thus meaning that the model's specifications are significantly queried when measuring discretionary accruals.

In relation to specific accruals methods, seeking to identify earnings management through the use of single accruals can be both beneficial and disadvantageous, with three pros and cons highlighted by McNichols (2000) as linked with this particular accruals approach. The main benefit is, firstly, the fact that intuition may be used by the researcher for the main elements impacting the accrual behaviour, with knowledge of generally accepted accounting principles exploited; secondly, a particular accrual method may be adopted across those sectors where business practices cause the accrual to be a likely object of discretion and judgment; and thirdly, the direct estimation of the link between the explanatory factors and single accrual factors.

In contrast, there are three key drawbacks: primarily, there may be the identification of earnings management within a single accrual approach, but only if the accruals under analysis are managed, thus meaning there are problems associated with establishing those accruals utilised for earnings management. Importantly, even if the most suitable accrual is analysed, the impacts of managing an accrual alone may not be significant enough to achieve statistical significance. It is claimed by McNichols and Wilson (1988) that, upon specific accruals representing a small aspect of the discretionary component, they may not be successful in highlighting earnings management in instances where other discretionary elements have been manipulated. In this way, the aggregate accruals models may introduce a more in-depth study design when capturing the discretionary elements. Secondly, it is reasonable to suggest that management utilises more than one accrual during the process of earnings management; therefore, although the single accrual approach is efficient in terms of identifying the management of earnings in some cases, earnings management in most situations cannot be identified (McNichols and Wilson, 1988). Thirdly, the numerous organisations for which a particular accrual is managed could have a small relative to the number of organizations with aggregate accruals, which could ultimately restrict the generality and understanding of the results concerning particular accruals researches.

Regarding the distribution approach, it is key feature is being relatively simple to use, and it is a graphical description of the earnings after the alteration of reported earnings has accrued. In addition, this approach detects earnings management while avoiding the issue of measurement error and misspecification resulting from accrual-based earnings management models (Sun and Rath, 2010). McNichols (2000) stats that the distribution models are powerful in earnings management investigations, because they provide the researchers with a strong prediction based in the frequency of earnings realizations rather than the estimation of the discretionary accrual. Moreover, it is considered a suitable powerful method for measuring earnings management when an enormous number of firms sceptic to be managing earnings. However, the results of empirical studies that question the shapes of earnings distributions as evidence for absence / presence of earnings management do not support the assumption that earnings management can be completely explained by the discontinuity of the earnings distribution. For example, Dechow, Richardson and Tuna (2003) do not find an association between discretionary operating accruals and the earnings discontinuity. Also Durtschi and Easton (2005) provide results that should be taken in consideration when using the shapes of the frequency distributions of earnings as indicator for earnings management practices. They show that these shapes can be affected by deflation, sample selection, and a difference between the characteristics of profit and loss observations (such as market pricing and analyst optimism/pessimism). The same findings established by Beaver, McNichols and Nelson (2007), Durtschi and Easton (2009) who emphasize that researchers should consider evidence beyond the shapes of distribution and should be caution when interpreting a discontinuity in the distribution of earnings as indicator for earnings management. In contrary to these studies which questioned distribution approach for earnings management measurement, Jacob and Jorgensen (2007) reexamine the findings of Burgstahler and Dichev (1997) and support the findings in Burgstahler and Dichev (1997) and indicate that these findings are not induced by scaling. Above of all, it can be seen that this approach can indicate earnings management practice existence but delivers no insight into the techniques or magnitude of earnings management.

Overall, the various methods available for identifying the management of earnings are numerous, with the benefits of all methods seemingly reliant on their overall capability in terms of measuring earnings management level and methods. Accordingly, establishing which method is most suitable ultimately rests on the aim of the study: if the study is concerned with analysing the degree of earnings management with lesser attention directed towards the approaches, the aggregate method would be viewed as most suitable. The specific accruals approach is more suitable if the objective is to test whether particular approaches have been adopted in order to manage earnings; however, the results of particular accruals can be problematic to generalise when particular accruals are not very sensitive. In contrast, the method of distribution frequency is valuable when testing for the present management of earnings, although it is not able to detect the degree or the instruments associated with the changes in the earnings reported.

CONCLUSION

The measurement of earnings management is a common consideration amongst professionals and academics in the field; however, owing to the fact that these practices cannot be observed directly, as well as the numerous methods management adopt in its application, identification is problematic. Accounting literature does provide a number of different approaches for the measurement of earnings management; however, their abilities remain questionable, with all methods comprising benefits and drawbacks in comparison to others, which need to be acknowledged by academics when identifying earnings management. In actuality, the pros and cons of all methods ultimately depend on their ability to measure the level and instruments of amending the earnings reported. Furthermore, aggregate accruals approach are recognised as being the most widely utilised and capable, particularly the original devised by Jones, the subsequent modified model of Jones, and the performance model. The ability is derived from its capacity to control organisational performance when separating total accruals into non-discretionary and discretionary accruals, and subsequently utilising the former as a proxy for earnings management. Researchers should consider such approaches, which are able to highlight the level of earnings management without detailing the approaches applied. The specific accruals method is not only able to measure the management of earnings in regard to the level, but also has the ability to identify the tools implemented. Nevertheless, the results of such a method are problematic in terms of generalisation when particular accruals are not adequately sensitive. In relation to the frequency distribution method, this can be adopted simply and avoids measurement error that can arise with the implementation of different methods. Nevertheless, it may be utilised with the aim of identifying whether or not there is the presence of earnings management, but delivers no insight into the instruments or magnitude of earnings management.

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PRIKAZ PRISTUPA IDENTIFIKOVANJA NIVOA UPRAVLJANJA DOBITKOM: RAZVOJ I EVALUACIJA

Praksa upravljanja dobitkom izazvala je značajnu pažnju te postala predmet interesovanja regulatornih tela, praktičara i naučne javnosti. U literaturi iz oblasti računovodstva, navode se tri ključna pristupa za identifikovanje nivoa i tehnika upravljanja dobitkom. U pitanju su pristup zasnovan na ukupnoj razlici između operativnog cash flow-a i dobitka, pristup zasnovan na specifičnim razlikama i statistički pristup zasnovan na distribuciji raspodela. Uprkos činjenici da su brojna istraživanja usmerena ka poboljšanju svakog od navedenih pristupa, ograničenja su i dalje prisutna, te svaki pristup ima svoje prednosti i slabosti. U radu je dat kritički osvrt metoda za ocenu nivoa upravljanja dobitkom prisutnih u literaturi, uključujući i prikaz razvoja ovih metoda, uz naglašavanje prednosti i ograničenja koje je u istraživanjima usmerenih ka identifikovanju upravljanja dobitkom potrebno uzeti u obzir.

Ključne reči: *upravljanje dobitkom, kvantifikovanje upravljanja dobitkom, pristup zasnovan na razlici između cash flow-a i dobitka, disruptivni pristup, pristup zasnovan na distribuciji raspodela*.

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Review paper

REPUTATION AND FINANCIAL PERFORMANCES OF A COMPANY*

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Abstract. *As a kind of intangible asset, reputation allows the company to manage the expectations and needs of its stakeholders. It is just another tool in the efforts of each company to survive and improve its competitive position. This asset is difficult to acquire, and its formation usually requires high quality products over several years, solid financial results, constant innovation activity, responsiveness to the stakeholder demands, permanent technological advancement, high business success, etc. Reputation is a resource which cannot be imitated, and its strategic relevance in the resource portfolio is growing, because it can create differentiation and barriers in relation to competitors. The purpose of this paper is to examine the interdependence of reputation, as intangible resource of the company, and its financial performances. Two research questions are highlighted in this paper: whether actual financial performances affect the company's reputation and whether created reputation affects the financial performances of the company. The answers to these questions are given on the basis of empirical evidences of many studies realized in the previous period. The results of this paper will inevitably reveal significant interdependence, more precisely, the interplay of reputation and financial performances of the company. The contributions of the study are useful to managers in order not to forget the importance of a good reputation for superior financial performances, and also to direct more resources, time and efforts to the process of making a good reputation of their companies.*

Key Words: *reputation, intangible resources, financial performances, company.*

INTRODUCTION

Contemporary business environment shows that a company has to be part of the society and play an active role in it. The reputation of the company is built over time and

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it is the result of complex interactions and relationships between the company and its stakeholders. This means that the reputation is based on past actions, experiences, and reactions of stakeholders. In other words, reputation is based on the overall perception of the stakeholders associated with the company. Reputation means the development of these complex relationships over time, and it is hard to imitate in a short period of time (Grant, 1991). Reputation is built on the fundamental values of the company as a business system. For key stakeholders these values are: reliability, credibility, trust and responsibility. In recent years, companies have built and maintained their reputation by developing practices that integrate economic and social role in their corporate and/or business strategy. However, it should be noted that the reputation of the company is a very complex category (Dierick, Cool, 1989).

The reputation of a company combines two essential dimensions of efficiency. The first one is the valuation of a company. The second dimension is, however, evaluating the success of a company in achieving a certain level of corporate social responsibility (Fombrun, Van Riel, 1997). The assessment of company reputation is determined by matching the behaviour and expectations/preferences of its stakeholders.

Good reputation has strategic significance for the company (Dierickx, Cool, 1989). According to the resource-based view, firms with resources that are valuable and rare, have a competitive advantage and can expect to make a profit in the future (Barney, 1991). Also, the companies which assets are difficult to imitate can maintain superior financial performances in relation to their competitors. Intangible assets, such as good reputation, are crucial not only for abilities to create value in a company, but also because their intangible nature makes imitation by the competitors much more difficult. A good reputation is a valuable tool that allows the company to achieve long-term profitability or sustainable superior financial performance in relation to market rivals.

1. Reputation and Financial Performances of Company: Theoretical Basis

Reputation is identified as a key intangible asset that adds value to a company (Clulow, Gerstman, Barry, 2003). However, it should be noted that intangible assets almost never create that value alone, but in combination with other company's resources (Hall, 1993). The correlation between reputation and financial performance of companies can be realized in several ways: Generating profitable sales in a saturated market; Successful response to the actions of competitors; Attracting capital and strategic partners; Capturing new markets without any difficulties; High levels of customer satisfaction and repeat purchases; Attracting, motivating and retaining talented employees; Successful strategic reaction of company's management, etc.

Because of its intangible nature, the reputation has been identified as a tool that helps a company to increase its intellectual capital. Intellectual resources are the basis of competitive advantage in the 21st century, because intellectual values can differ a company in relation to its competitors and provide better value creation for the customers. If a company wants to lead over the competition, a strong reputation must be its mandatory choice, and not an option.

Both internal and external factors affect the reputation. Internal factors include: the ability to communicate, openness, human resources treatment, innovation ability, manager reputation, adaptability to change, solving the social issues and environmental problems.

Company's management has a significant role in shaping the reputation. External factors and stakeholders which impact on reputation are the following: customers, media, financial analysts, and government legislation (Lines, 2004).

A good reputation helps launch new products and enter new markets, by influencing consumers when choosing the same product in offered pallet of different market players (Fombrun, Van Riel, 2003). Companies that are trying to keep up with the competition, invest significantly in product innovation. Ability to design and launch a new product is the core of business or market success. Reputation is very important for these companies because consumers want to buy products from companies they have confidence. Namely, it is a confidence in the ability of the company for successful development of new products that customers want. So, the confidence is a necessary part of corporate reputation. The importance of a good reputation is reflected in reduction of transaction and communication costs with the market, and attraction of new customer's confidence.

One of the main reputation objectives is the strategic positioning of a company and its products in the market in relation to competitors. This is possible because in the multitude of bidders similar products on the market, when there are no significant differences in their characteristics, the reputation is an essential element for better competitive differentiation.

Company reputation data come from managers, as well as from market analysts. These are two stakeholder groups whose estimations are extremely important. However, there are other groups of stakeholders (e.g., customers, employees, and suppliers) whose estimations also has implications to financial performances of the company.

Some studies (Davies, Chun, da Silva Vinhas, Roper, 2003) show that the attitudes of stakeholders in the enterprise are directly related to the key financial results, and that the image and identity of the company are relative. In addition, this research highlights that reputation management includes the harmonization of these two concepts, and this harmony affect financial results. The perception of the company as a 'good citizen' helps to build a reputation as an intangible value, and to make it contribute to its competitive advantage. Reputation deserves the most of the credit for the positive impact of business social dimensions on its financial performances (Orlitzky, 2005). Corporate social responsibility is a way and a form of investment, that creates opportunities for expansion and growth in the future (Husted, 2005).

Where does the good reputation come from? An interesting view is that reputation is determined by the value (quality) of the previous efforts and behaviours (Podolny, Phillips, 1996). In many cases, stakeholders in the enterprise can identify these efforts. Managers are involved in the activities of the so-called building the explicit reputation (e.g. advertising, sponsorship) to improve the reputation of their company (Fombrun, 1996). Managers also manage the associations which company exchanges with stakeholders to ensure the benefit from the reputation (Podolny, 1994). However, stakeholders do not evaluate directly a range of activities that lead to the formation of their impressions about reputation. They rely mainly on the financial performances achieved in the previous period, because they are a "sign" of the total respect of a company. A good reputation is the result of a construction process in the past, based on the actual financial performances. Also, good reputation is the result of current financial performances of the company. However, the reputation of the company in the present will reflect to financial performances in the future.

The variety of potential benefits, which are the result of a good reputation, point to the significant correlation between reputation and financial performance (Podolny, 1993). Reputation also serves as the basic product quality indicator of a company, and consumers are willing to pay more for products obtained from the company because of its high reputation, even though there is a high level of uncertainty in the market (Shapiro, 1983). A company with a good reputation may have an advantage because employees prefer to work in such firms. In addition, in the case of the company with high reputation, suppliers are less concerned about the contracted current and future transaction. A good reputation leads to lower costs of contracting and monitoring. Marketing literature also suggests that good reputation supports sales and its efficiency. It actually attracts potential customers and influences the retention of existing customers.

Srivastava, McInnish, Wood, Capraro (1997) prove in their research in 1997 that stakeholder groups consider a company with a good reputation, less risky in terms of investment, compared to the other companies with similar financial performances, but with a worse reputation. Reputation is particularly important in cases of realization of initial public offerings, takeovers, mergers, and strategic partnerships (McGregor, Slovic, Dreman, Berry, 2000). Reputation as an intangible asset, often valued implicitly, by the analysis and sometimes explicitly based on the market share price. Davies, Chun, Vinhas da Silva, Roper (2003) point out, however, that reputation contributes to the annual company income between 3 and 7.5%, so it can be considered as an investment, and not as a cost to the company.

2. Methodological Framework and Hypotheses

Many researchers have examined the relationship between corporate reputation and financial performances, and have found that there is a strong and a non-linear relationship between corporate reputation and financial performances (Inglis, Morley, Sammut 2006, Sanchez, Sotorrio 2007). Determining the relationship between reputation and financial performances means responding two questions: 1. Does company reputation have an impact on financial performance? 2. Do financial performances affect reputation? Reputation and financial performances may be interrelated categories. With this in mind, we define two starting positions and hypotheses:

H_1. Financial performances of a company affect its reputation.

H_2. The reputation of a company influences its financial performances.

It is necessary to stress the strategic benefits of a respectable reputation, which (at least in the short term period) can be difficult to imitate by competing firms. Also, it is important for the researchers to demonstrate that reputation has a financial impact on the company, because there is a need to prove economic viability, i.e. profitability of investment in communication programs to build the company image and reputation.

With the aim of analysing interdependence between reputation and financial performance, we use the previous results of relevant authors' research in this field. Management theorists agree with one thing – reputation, as a unique and integral part of a company, is difficult to empirically evaluate because its base contains relationships which are almost impossible to statistically test (Rose, Thomsen, 2004).

3. IMPACT OF REPUTATION ON COMPANY'S FINANCIAL PERFORMANCES: RESEARCH RESULTS

Successful corporation management directs a significant part of financial resources and its efforts towards maintaining and improving the corporate reputation. Essentially, a good reputation has characteristics of intangible asset that can provide a competitive advantages, and which is indicated by the value of market-to-book ratio. When an investor buys shares of a corporation with a respectable reputation, she or he does not pay only for its real corporation property, but also for its reputation. In addition, since the consumer of a corporation products, in many situations, cannot confirm the quality of the products before the actual purchase moment, the respectable reputation can serve them as a sign or a signal of product quality (Kreps, Wilson, 1982). The corporation can build a brand, and after the formal trademark registration in the authorized institution, corporation receives exclusive property rights and the protection of its intellectual property. Brand (trademark) helps to solve, so called, consumers' „lack of information" problem about the quality of the product, but also it can be used as a sign of product quality. In addition, brand (trademark) is important for the consumers which are looking for the products with special qualities to reduce costs.

Company's reputation affects the its relationship with other stakeholders, such as, for example, potential employees (Stuart, 2002). Thus, a company with a good reputation can attract competent people. In addition, a good reputation can reduce transaction costs, because it allows company to save on the cost of writing a complete contract (Willamson, 1985). On the other hand, the suppliers of a company will have lower costs of monitoring (Bromley, 2002).

Moreover, a strong corporate reputation can serve as a defense against market rivals, in a way that complicates their situation when competitors try to imitate the characteristics of companies with a superior reputation. Therefore, it does seem likely that the reputation of a company affects its financial performances. However, it should be noted that, when a company achieves outstanding financial performances, these performances can also have a positive impact on company's reputation (McGuire, Schneeweis, Branch, 1990).

Rose and Thomsen (2004) has examined the relationship between company's reputation and financial performances in Danish firms. They found that corporate reputation did not affect the value of market to book value ratio, and financial performances had a positive effect on reputation.

Data collected by Fombrun and Van Riel (2004) suggested that, for a period of five years, companies with a good reputation completely financially surpassed companies with a worse reputation.

Eberl and Schwaiger (2005) explore the relationship between corporate reputation of the company and future financial performances by using the data of German companies. They come to two important conclusions. The first one, financial performances in the past are only one component which affects reputation. The second one, the reputation is a "cognitive component" that has a positive impact on future financial performances, while there are strong evidences that "affective component" has a negative impact.

Vergin and Qoronfleh (1998) following the Fortune's list, highlighed an evidence of the positive role of corporate reputation in value creation. Jones, Jones and Little (2000) noted that, in the case of a sudden and unexpected drop in the share value, a company with a good reputation suffered less decline in the share price. They also noted that when the crisis is strong, investors were in panic how to overcome the crisis. Investors solved this situation by investment decisions, since corporate reputation could not mitigate the decline in share value on the stock exchange. Roberts and Dowling (1997) also confirmed that reputation allowed companies to keep better financial performances for a long period of time (so called, the transfer effect).

Several different studies confirmed the connection between reputation and revenue. Graham and Bansal (2007) found in their research that an airline company reputation grew for 1%, and its customers were willing to pay additional 18 dollars for a ticket.

Herremans et al. (1993) examined whether large U.S. manufacturing companies with a better reputation in corporate social responsibility could outperform companies with a worse reputation in the six-year period. They measured the following financial performances (Herremans, Akathaporn, McInnes, 1993): operating profit margin, net profit margin, return on total assets, and return on equity. This study featured 21 branches, based on Fortune's survey about the corporate reputation for the period 1982-1987. The results were consistent with the hypothesis that the company reputation was positively related to financial performances, which wass confirmed by profitability indicators.

Roberts and Dowling (2002) explored the relationship between corporate reputation and high financial performances. Their data set was based on a sample of most U.S. corporations during the period from 1984 to 1998 of the Fortune magazine report. This study examined whether a good reputation allowed the company to achieve profitability or sustain other superior financial performances. They used annual data about the company's profitability, the market to book value ratio, and company size. They discovered that firms with excellent reputation were more likely to maintain financial performances over time. In addition, Brown (1998) argued that a bad reputation could signal the investors about the possible catastrophe, and in the moment when it happened, the company would not have necessary public support to overcome the crisis.

The complexity of the relationship between corporate reputation and financial performances is also pointed out by Fryxell and Wang (1994). Reputation is essential for corporations in their intention to protect their image and survive in the marketplace. This is important for risk management in corporations when stock markets are volatile, and when the investors, instead of rational decisions, make the decisions driven by fear. Corporate management can enhance reputation and influence investors' decisions if it reports on financial and social responsibility performances in the proper way.

4. IMPACT OF FINANCIAL PERFORMANCES ON COMPANY'S REPUTATION: RESEARCH RESULTS

Sobol and Farrell (1988) revealed the potential impact of financial performance on reputation. They conducted study and introduced earnings per share ratio, price earnings ratio and dividend per share for the ten-year period of time. The results showed that the relevance of financial performance varies according to different attributes of Fortune survey and varies from company to company. During the second part of the study, the above mentioned authors presented possible crucial factors that affected the reputation.

Fombrun and Shanley (1990) represented a broader concept of reputation, that observed a reputation as an overall perception of company's performances by its stakeholders. The ultimate objective of their study was to illustrate the diversity of information sources stakeholders used to evaluate and determine reputation. They chose accounting performances, profitability, and risk in the past, and market value of the company as the most important variables. Fombrun and Shanley (1990) argued that companies with a higher share price and better reputation, and also had better rating which made reputation an important factor for investors.

Brown and Perry (1994) confirmed the relationship between the return on assets (ROA) and reputation. Hammond and Slocum (1996) stressed that the delay period of the financial performances impact on reputation is from 5 to 10 years. Hammond and Slocum examined the impact of the past period financial performances on corporate reputation in the future (Hammond, Slocum, 1996). Based on research data of Fortune magazine for the period since 1981 to 1993, aforementioned authors pointed out that financial performance indicators, such as profitability and profit margin, affected the future reputation moderately.

Dunbar and Schwalbach (2000) also explored the relationship between reputation and financial performance, but based on the research in 63 German companies in the ten-year period. They found that the financial performances in the past had a strong impact on the future reputation. Many German companies have a relatively stable reputation, so reputation had a positive impact on the overall financial business in Germany. Financial performances of German companies had immediate and delayed effects on corporate reputation.

Sabate and Puente (2003) pointed out that the relationship between reputation and financial performances included the answers on two questions, whether the relationship was positive or negative and whether the reputation had an impact on financial performances, or vice versa. They pointed out that, in developed countries, the positive impact of financial performances on corporate reputation had always been confirmed. According to Neville et al. (2005), the financial performances of a company were in relation with its reputation. Moreover, they suggested that a positive relationship between corporate reputation and financial performances would contribute to increased competitiveness.

CONCLUSION

Reputation is the effect of the past commitments, efforts, behaviours of the company as a whole, and its managers and other employees, as well as the effect of current results, achievements, quality, and success. Managers should not consider the reputation as anything that simply happens spontaneously. Ignoring the role of intangible items in value creation for customers and increasing the market value of a company, the management takes the risk of poor management of the most important elements of intellectual capital, and it is the reputation. Good company reputation is a distinctive competitive ability, which inevitably leads to a better market position. High-quality intangible assets are associated with maintaining superior business performances. Previously mentioned elaborations point to the affirmative answers to both research questions or hypotheses in this paper. Namely, the results of many studies have shown there is an impact of the reputation on financial performance, and vice versa. The company has more chance to keep superior performances over time if it has a relatively good reputation. Company’s reputation has a strong impact on profit, rate of return and other financial performances. This emphasizes the importance of strengthening the reputation. Companies exert to improve profitability and other financial performances, and then, consequently, to maintain and strengthen the already build reputation. Good reputation, in turn, makes it easier for companies to maintain a good business (financial) performances over time. Good financial performances allow the company to sustain its reputation, and then contribute to the growth of its market value.

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REPUTACIJA I FINANSIJSKE PERFORMANSE PREDUZEĆA

Kao jedna vrsta nematerijalne imovine, reputacija omogućava preduzeću da upravlja očekivanjima i potrebama svojih stejkholdera. Ona je jedno od važnijih alata u naporima svakog preduzeća da se održi i unapredi svoju konkurentsku poziciju. Ova imovina se teško stiče, pa njeno kreiranje obično zahteva višegodišnje kvalitetne proizvode, dobre finansijske rezultate, stalne inovacije, responzivnost na zahteve stejkholdera, kontinuirano tehnološko usavršavanje, visok poslovni uspeh, itd. Reputacija se kao resurs ne može imitirati, pa njena strateški značaj u portfoliju resursa jednog preduzeća raste, jer ona može da stvara diferencijaciju i barijere u odnosu na konkurente. Svrha ovog rada je da istraži međuzavisnost reputacije kao nematerijalnog resursa preduzeća i njegovih finansijskih performansi. Dva istraživačka pitanja istaknuta su u ovom radu: da li ostvarene finansijske performanse utiču na reputaciju i da li izgrađena reputacija utiče na finansijske performanse preduzeća. Odgovori na ova pitanja mogu se *dobiti detaljnijom analizom dokaza koje pružaju mnogobrojne empirijske studije realizovane u prethodnom periodu. Rezultati ovog rada neminovno ukazuju na izraženu međuzavisnost, tačnije, međusobni uticaj reputacije i finansijskih performansi preduzeća. Doprinosi sprovedenog istraživanja su od koristi menadžerima kako bi bolje razumeli značaj dobre reputacija za superiorne finansijske performanse i kako bi više resursa, vremena i napora usmerili u proces izgradnje dobre reputacije svoje kompanije.*

Ključne reči: *reputacija, nematerijalni resurs, finansijske performanse.*

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Review paper

ROLE OF MARKETING EVENTS IN THE DEVELOPMENT OF TOURIST DESTINATIONS

UDC 658.8:338.48

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Abstract. *The aim of the research study is to analyze and highlight the basic guidelines and potential for development of events tourism in specific tourist destinations. A marketing event involves planning, segmentation of target groups, effective use of communications, work with sponsors and volunteer organizations, promoting events, analyzing the budget, and even providing logistics so that the whole event does not experience failure. The main objective of this paper is to highlight the role of marketing events in the animation and attraction of more visitors and its importance in the promotion of tourist destinations. It also highlights the importance of developing a permanent event as an extremely important component of the attractive factors of tourism in order to build Brand destinations. Research has shown that the organization of events can contribute to increasing investment, affect the development of the tourism industry, increase economic growth and valorization of natural and anthropogenic resources of tourist destinations.*

Key Words: *marketing events, tourist destinations, economic role, promotion.*

INTRODUCTION

An event as a deliberate and focused human activity occurred for the first time a long time ago, almost at the very beginning of ancient civilizations. Since the events in modern terms encompass a broad conceptual basis, the occurrence of various events not linked to the same period of time and their development walked in step with the general economic and social development. It is obvious that the economic emergence of events dates back to the society of organized human life, but the study of economic events and especially its management aspects are of a recent date (Andrejević, Grubor, p. 3).

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Finding out about an event promotion is the basic instrument of the communicative character of the marketing mix. Promotion of tourism is the process of mass communication between suppliers and users of tourism products/services, where the subject of communication is the exchange of information that can stimulate sales of the product/service. In fact, promotion is one of the planning instrument that is used to attract visitors and increase the total profits for the organizers of the event. Understanding and using the model combinations of forms of promotion is essential in order to meet the objectives of the marketing plan for the event. The main role in promoting event tourism is controlled coordination of all efforts by the seller to establish the flow of information and persuasion with the aim to sell the event. Profit for sellers and memorable experience for visitors are the two main objectives of markenting events (Finch, 2012, p. 146).

Marketing experts are often unable to see beyond the basic motivational factors of events, while visitors, as a rule, view them as products with a large number of uses. There are many potential benefits of events for visitors: a new experience, fun, a learning experience, an exciting result, an opportunity to meet other people, opportunities for shopping, drinks and food, the ability to see something unique and so on (Vagen Karlos, 2009, p. 68).

Therefore, the promotion of benefits can be used to inform and stimulate tourism demand to purchase, accelerate the decision-making process and indicate the usefulness of visits to a particular destination. Tasks promotion is directed towards creating awareness about the tourism product/service on the market, creating a positive image of the product/service and its better positioning.

To begin the research, parallel with the review of the literature, it is useful to define the role of event marketing, marketing mix instruments to identify the events, determine the basic marketing objectives, design and develop the product concept of event, choose a strategy of promoting tourist destinations, with the aim to establish a marketing mix and execute promotion events in the integrated marketing communications, and present the results of research marketing events in Serbia.

1. Literature Review

Social and economic development, raising living standards, altered requirements and consumer expectations of service offer, increasing leisure time, changes in lifestyles of modern consumers, etc., have resulted in the development and improvement of specific elements of the service economy, and economic defining of events. Most authors agree that an event in economic sense is a part of service economy, and since it is itself service economy in global terms, dynamically evolving approaches to certain events are characteristics of the environment in which the individual authors work.

With their diverse influences and application, events are now essential to the process of branding tourist places, cities, towns and regions. The brand is a name or a symbol which fully represents the product in the minds of consumers creates an overall impression of an event. That is why nowadays, there are special professional event planners who are engaged in elaborating the details of individual events in order to make them perfect.

In modern sense, marketing is oriented towards building relationships, both with consumers and with suppliers, stakeholders, factors selected environments, as well as the total public (Capon, Hulbert, 2001). Besides all the prominent characteristics of modern marketing, there is its consumer orientation. In strategic terms, the modern marketing event focuses on building beneficial relationships and partnerships in the selected environment management events.

In professional literature (Hall, 1997), the marketing event management function includes events, which are used to keep contact with the participants and visitors (event consumers), identifying their needs and motivations, developing products that meet these needs and building communication programs, which express intentions and goals of events.

The effectiveness of marketing events can be achieved by strengthening its consumer orientation, insisting on achieving satisfaction of visitors to the program of events, services provided and offer products associated with maintenance of events. The program of events is supposed to be full of examples of cultural, sports and other activities that take place in tourist destinations. In this way, an optimum marketing effectiveness is achieved by combining the marketing mix of events. The managers of the event deal with finding the optimal combination of marketing mix of events. The instruments of marketing mix events are under full control of the management, and enable the achievement of planned objectives of the event, but also a competitive advantage in the environment chosen event. To find the optimal combination of marketing mix, it is essential to understand the characteristics of the selected environmental events, i.e. the tourist destination. Over the past few years, an increasing number of authors have demonstrated the importance of understanding the marketing domain applied to events (Allen, 2004, Hoyle, 2002, Masterman, Wood, 2006, Supovitz, 2005) in addition to basic marketing body of knowledge (Brassington, Pettitt, 2003, Dibb et al. 2006, Jobber, 2004, Kotler et al. 2005).

2. ECONOMIC ROLE OF MARKETING EVENTS

Marketing is focused on identifying and meeting individual and social needs. Simply put, marketing means comfort while earning profits, but it is also the process by which a generation of ideas, goods and services are planned and implemented, their price determined, involves promotion and distribution, in order to realize the exchange that will meet the goals of individuals and organizations. In the technical sense, marketing is an organizational function and a set of processes of creating, communicating and delivering value to consumers, as well as customer relationship management, so as to obtain benefits for the organization and its stakeholders (*American Marketing Association*, 2004).

Product events should allow market supply of planning events, as well as to meet the needs, demands and expectations of visitors to the event. The ability of the product of events that represents the market offer of events includes the possibility of earning income.

Today's society tries to maintain the sequence of events in the light of the many recent tendencies of the economy. Of course, event organization has a number of its policies and activities, and makes a tangle of relationships in this regard. The set must include the event organization and coordination, leadership, planning, evaluating, controlling, human resources, finance and marketing. It is particularly important to organize the event, now in the time of economic crisis, which contributes to increasing domestic and foreign investment.

Successful marketing of the event management involves taking a large number of activities (Andrejević, Grubor, 2007), among which these are high in importance:

- Research the needs, demands and expectations of the target segment of the market events;
- Defining the concept of product events;
- Prediction of demand for a product, program or event;

- Decisions about the engagement of necessary intermediaries in setting up and execution of the event;
- Decisions about the amount of price (tickets) for an event that potential visitors are willing to pay;
- Planning and implementation of promotional activities in the selected environment events;
- Coordination of all activities of marketing events.

Increasing attention is paid to the marketing of events that bring together large numbers of people in one place in a short period of time. In the battle for customers' satisfaction, the most important is the economic role of an event and we are primarily talking about marketing of a tourist destination and an event as a tourist attraction.

The concept of product events may be associated with targeted marketing. Target marketing refers to a variety of segments of the market where the event will offer a particular product events, to meet the needs, requirements and expectations clearly defined by a group of visitors. Market segments of visitors to the event are chosen taking into account the criteria of effectiveness, measurable, affordability, feasibility and profitability (Jobber, Fahy, 2006).

Linking the concept of product events with target marketing allows appropriate selection of marketing strategies event, within four general strategies targeted marketing events:

- Undifferentiated marketing events;
- Differentiated marketing events;
- Focused marketing events;
- Customized marketing events.

Event managers who perform marketing experience can access with the aim of combining the different marketing mix of events, which leads to the differentiation of several basic types of event marketing programs. The management of events known as the following types of marketing programs events:

- Designed marketing, which is aimed at capturing the sensuality of experience to potential visitors of the event;
- Sensible marketing, focused on the emotions of potential visitors of the event, with the aim to offer affective experiences,
- Thought marketing, based on the intellectual characteristics of potential visitors of events, with the aim of offers cognitive experience;
- Action marketing, which encourages physical experience of potential visitors of the event, in accordance with their lifestyle;
- Bonding marketing, which combines the advantages of thought, attachment, thought and action in the original marketing event marketing program.

Marketing experts in a particular tourist destination should help event managers in designing various marketing activities, which will integrate and support the program of events, with the aim of creating and providing value to visitors of the event. Under the marketing activities are implied activities related instruments of marketing mix of events, whose combination of the impact on the achievement of defined objectives of a particular event, i.e. those combinations of instruments of market performance, which will ensure the ability of the destination to be competitive in the chosen market segment.

The economic role of marketing events affecting the development of the tourism industry, increase economic growth and creates an opportunity for the valorisation of natural and anthropogenic resources tourist destinations.

2.1. Marketing objectives of events

In the professional literature there is a widespread understanding of the marketing mix of events, which starts with the basic components of event and auxiliary components of a particular event. Given that we strive towards the production of those events that basically have to have a positive effect, the target event should be directed towards identifying and predicting the impact of all those who go in the direction of creating positive effects of the events themselves. Therefore, the main task of the event manager, in order to achieve positive balance of events, is to perform identification and forecasting, as well as an analysis of any particular influence.

It is about taking those preparatory actions that are directed towards the realization of the ultimate goal - achieving positive influence events.

The main aims of marketing events are to:

- Increase sales of products and services to customers;
- Increase interest and demand for products and services;
- Shorten product distribution channel.

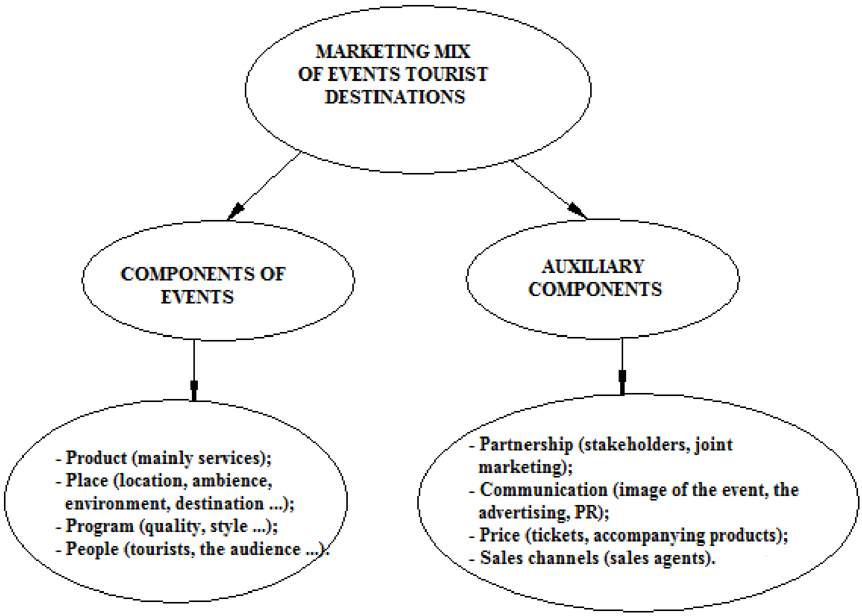

Fig. 1 Marketing mix of events for a tourism destination (Getz 1997)

In order for marketing managers to create certain preconditions for the realization of high-quality events, or prepare them in advance, they must take into account all the effects arising from the event.

2.2. The concept of product events

The concept of marketing product events must be viewed in a broader context, since it should contain a clearly stated value or benefit to the visitors of the event. Product of events is not limited to the visible and invisible elements, but it is the original product integrating the whole event. Therefore, the concept of product events can be decomposed into three basic elements:

- a key benefit, which refers to the experiences provided to visitors in overcoming the effects of leisure;
- a tangible benefit, which enables the achievement of key benefits, and refers to a regulated venue of the event, its functionality and aesthetic appeal;
- an augmented product, which includes additional features necessary for differentiation of events in relation to the competition, and refers to the quality of services provided to visitors (Morgan, 1996).

Product events should allow market supply planning events, as well as to meet the needs, demands and expectations of visitors to the event. The ability of the product of events that represents the market offer of events includes the possibility of earning income out of market exchange offers or events. Market exchange offers, products or events generate revenues in four basic ways:

- the sale of tickets for the event,
- subscription and membership of visitors to the event,
- sale of access to visitors of events, as various forms of marketing
- communication with visitors events,
- the sale of products and services that expand the range of events.

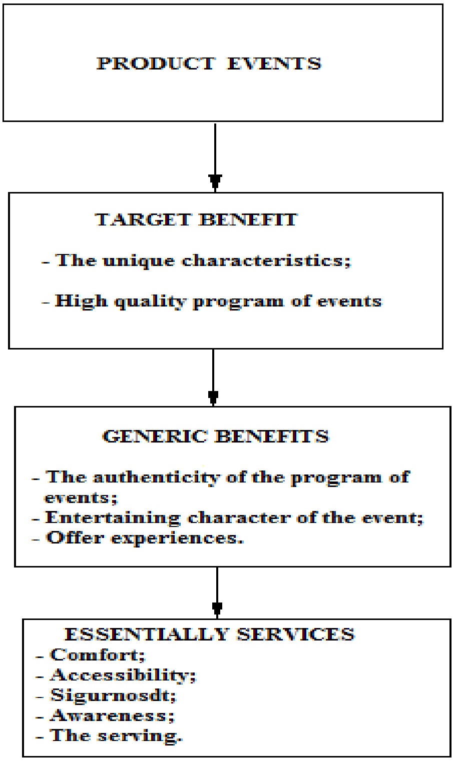

Fig. 2 Product events in target marketing (Getz, 1997)

Target uses are reflected in the unique characteristics of events, high quality programs, talking about matching the perceived and expected quality program of events, and also apply to services directly related to the maintenance program of a specific event.

Generic uses are covered by different experiences that visitors get from programs during certain events. In a sense, generic benefits reflect the "elements of style", because they are built, and confirm the authenticity of the program of events.

Essential services are related to the realization of the attractiveness of the program of events, and a direct effect on the satisfaction of needs, demands and expectations of visitors to the event. Essential services build on the specific benefits that represent the basis of events offers a target market segment events.

The system of marketing communications in the appointment and execution of events is dealt by event organizer with the product events. The price of the event and the venue of the event attract potential visitors of the event.

3. Importance of Promotions of Events of a Tourism Destination

Promotion of the event is aimed at pleasing the expectations and demands of visitors or consumers. In the modern management of events it increasingly needs to be the function of "creating" the visitor or customer events. The point is that it is desirable to devise such a promotion event which will create visitors or customers. Promotions events themselves cannot generate visitors, but the relationships that are established and built between the organizers and executors of promotion events, and the visitor, based on direct communication and presentation-quality programs allow you to create potential customers for each type of event.

Promotion shall mean all activities of events that aim to facilitate and accelerate the acceptance of a product or service on the market for customers and consumers. Promotion is a marketing instrument by which a provider realizes communicating with customers or consumers. It represents a method of continuous communication with consumers in the function of encouraging the sale of products and services. Promotional mix is a mass communication with consumers. Therefore, it is also called the communication mix. The communication mix is tasked to inform the consumer/customer of the product and its characteristics, conditions of purchase, the desire to develop and motivate them to purchase (Vračar, 1997).

Promotion of tourism also consists of activities (tourism advertising, sales promotion, public relations and connections with the media) to be taken to create awareness of tourism products, creating their image and better positioning.

Promotion of tourism is important for the following reasons (Delić, 2010):

- providing travel demand in the off season,
- purchasing a tourism product that the consumer/purchaser has not seen,
- creating customer loyalty,
- high competition in the tourism market,
- price elasticity of demand,
- possibility to substitute the tourism product.

The process of the promotional strategy starts from the choice of the market. Information about the event should be available in the market, in order to help the tourists make a decision to come to a tourist destination. As the tourist market is too wide and varies according to tourist needs, research and segmentation of the tourism market is a precondition for a successful promotional strategy.

The selected markets "are attacked" by the general tourist advertising, creating a positive idea of a tourist destination. Simultaneously, commercial advertising institutions from the tourism industry attack selected segments of consumers, as well as direct beneficiaries of their own products. In order for the influence of the market to have a real effect, there has to be harmony and coherence between the two mentioned activities.

The strategy of promoting tourist destinations implies a few basic tasks:

- creating a general image or performances of a tourist destination,
- building, maintaining and upgrading the image of a tourist destination,
- stimulating the loyalty and support of individual businesses in the promotion,
- providing information about tours destinations,
- stimulation of tourists with shopping, etc.

The process of promotional strategies in tourism includes the following stages (Mill, 1990):

First phase:	selection of markets to be "attacked" by the marketing mix,
Second phase:	establishing goals of the marketing mix,
3rd phase:	determining the appropriate messages,
4th phase:	selection and use of appropriate elements of the marketing mix (advertising, promotion, sales, connections with public relations, personal selling ...)
5th phase:	determining budgets,
6th phase:	control of promotional activities.

If we set out to promote certain tasks arising from selected targets to be achieved, then the way, means and methods to achieve the objectives are chosen and it is called *a promotional strategy*. The choice of the promotional strategies of service industries is affected by a number of factors, such as the nature of the service, phase in the lifecycle of services, the size of the budget, the objectives of communication, positioning services, positioning competitors. The strategy of promoting tourist destinations has a fundamental role to inform and stimulate tourism demand to stay in a given destination and on the basis of a given increased demand for the benefit of its products. The effect of promotion strategies are reflected in timely informing of consumers/tourists about the available attractive, communicative and receptive factors and events of tourism destinations that are involved in meeting the needs of the tourist demand.

3.1. The objectives of a marketing mix

The goals for communicating with consumers include developing awareness of different possibilities of a tourist destination, motivating tourists for additional information on the capabilities of the destination, developing the image of the tourism product, enabling to obtain permanent information about events in the tourist destination, accommodation facilities etc.

The objectives of a marketing (communication) mix with the media assume the provision of timely, accurate and complete information about the opportunities of destinations, development plans, tourism products, marketing events etc. The scope and structure and promotional activity tourism destination depends on its size, importance and role in the tourism and economy in general. The main instruments of marketing communications and a marketing mix in tourism are (Bakić, 2007): *Advertising, Public Relations - PR, Sales Promotion, Personal Selling, Publicity, Sponsorship, Direct Marketing, Merchandising.* The choice of instruments of a marketing mix is the most important phase of the building process of the promotional strategy. Promotional mix is made up of more instruments, out of which the most common are: tourist advertising, sales promotion, public relations, personal selling, etc. The most important role belongs to the mentioned tourist advertising.

Tourist advertising is one of the most important instruments of communication in tourism. The aim is to develop a tendency for products or services, as well as a reference to a specific purchase. Starting from the holders of tourist advertising, the same can be divided into general tourist agencies, and commercial and business advertising. Holders of general tourist advertising, i.e. advertising at the local, regional, national or multinational level, are the appropriate state or community organizations or bodies. Effects of general tourist advertising are expected in the longer term, in order to attract the attention of potential tourists in certain areas as a whole, and thus to provide an increase in tourist traffic and tourist spending in that area. Commercial tourist advertising is carried out by companies of the tourism industry with a particular orientation of the tourist facilities and types of tourist services. It is about advertising as an instrument of policy catering business, tourist, traffic, trade and other companies of the tourism industry, whose effects are short term. To show the performance of the tourism market, tourism advertising uses graphics, projection, personal and spatial resources.

3.2. The basic role of promotion events

Promotion of the event is the instrument of the marketing mix of events that builds positive public attitude towards the program specific event and its organizers, in a way that favors relative to competitors. Promotion of the event is part of the process of integrated marketing communications, including multiple modalities and communicating with visitors of the event, integrating the promotion of events and marketing communications.

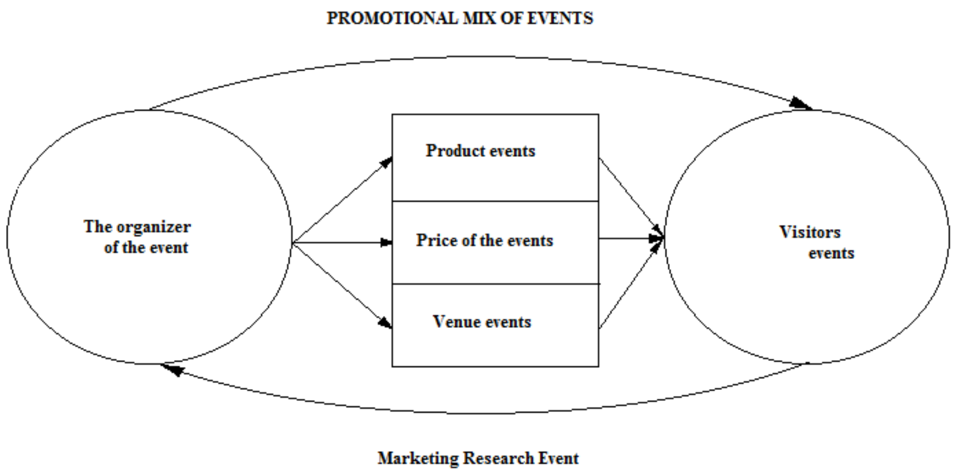

Fig. 3 The system of marketing communications in setting and executing events (Salai, Hegediš, 1994)

According to the American Association of Advertising Agencies (AAAA), integrated marketing communication is defined as a concept of marketing communication planning, based on the achievement of added value of integrating different communication activities such as PR, direct marketing, sales promotion and public relations, achieving more consistency and maximize communication activities. Promoting an event is realized depending on the characteristics of the event and the target audience. In promoting an event of great physical size and scope, such as mega sporting events, economic propaganda is most commonly applied. Promoting events of lesser physical size and scope, as well as local sports events, local festivals, local trade fairs or exhibitions is carried out by business publicity and direct marketing.

The system of marketing communications in the appointment and execution of events is dealt by event organizer with the product events, price of the events and the venue of the events attracts potential visitors of the events.

4. EVENT MARKETING RESEARCH IN SERBIA

Research has shown that most of the events/events (of all types) in Serbia are held in Belgrade.

"Most of those are traditional events, regional and local events, festivals, sports competitions, celebrations, religious ceremonies, etc." (Šušić, Djordjevic 2011, pp. 79-80). If we take the criterion for the number of visitors compared to the number of inhabitants, the most numerous is the trumpet festival in Guča. Certainly, Guča is a precedent; however, in Serbia there are still very well-visited festivals of all kinds. The most visited are those events that do not have admission fees (Guča, Beer Fest, Vrnjci Carnival, etc.) and which belong to entertainment (music festivals at first). Cultural, sports, gastronomy and folk events are of great importance. The number of visitors at events where admission is free is to be taken with a grain of salt.

Attendance is assessed by organizers themselves and they often do not give a true picture of the number of visitors. Including the best known, there are two dozen events of significant potential at the national level that have various facilities to attract large numbers of visitors. For instance, events such as the "Mowing on Rajac", "Homolj motives" and "Ljubic Horse Racing" are visited by about 50,000 people. Also very popular are the events that take place in almost all river flows in Serbia, and the most popular are the "Drina Regatta" and "Happy Run", which brought together about 35,000 rafters (*Statistics Department of Tourism*).

Food and drink festivals are recognizable, popular events held on the territory of Serbia. "The grapes ball" in Vršac has as many as 150,000 visitors, and most of the other wine festivals held in other places are well-visited. At the same time, gastronomic festivals attract a large number of visitors such as the "Leskovac Barbecue Week" which had over 500,000 visitors in 2013 as estimated by the organizers. Also, other events, such as "Bacon fest", "Prosciutto fest", "Sausage fest", etc., are visited by up to ten thousand people a day. Since food (agriculture and food industry) is a resource of great importance in Serbia, and the pub is one of the specific motives for every tourist to enjoy, such events should be given special attention. In Serbia, there are a number of events with a long tradition, such as: "Vuk's Parliament" in Tršić which was first held in 1933 and "Dragacevo Trumpet" (1961).

Since the mid-sixties of the last century, there has been a substantial increase in the number of domestic events. Organized events of various types have run in parallel with the period of stagnation in the last decade of the twentieth century. Since 2000, new events have emerged which have become massive and recognizable. Among them are: "EXIT Festival" (2000), "Vrnjci Carnival" (2002), "Belgrade Beer Fest" (2003) and "Kustendorf" Festival (2008) (www.turizam.merr.gov.rs).

Out of a large number of events in Serbia, only a few have the popularity that transcends borders and countries and attract a considerable number of foreign visitors. For many other events to become attractive for domestic and foreign tourists, what is necessary is further development of their organization and popularization. Professional teams and narrowly specialized institutions dealing with the improvement and promotion of events are needed for those kinds of activities. In addition, there are significant ongoing investigations of specific areas and constant monitoring of their impact on the overall economic development of tourism in Serbia. *Creating a database of events/manifestations in Serbia* is a basic step towards better organization and promotion. This way you can look at potential events/manifestations and create their development plans of national and international importance.

There is no doubt that making an Integrated Geographic Information System would significantly contribute to improving the exchange of information and better informing of the passengers from around the world on the tourism of Serbia and its possibilities of leisure and entertainment.

CONCLUSION

Events are an integral part of tourism. They have always existed as part of the tourism product, with greater or lesser importance and influence on the tourist destination, but their commercialization encourages an active interest of the participants and the entire tourism economy to study the area. As well as attracting visitors through the extension of their stay in the resort and the possibility to overcome the seasonal nature of the business, events represent an efficient way in which the community can direct its activities towards certain goals.

Events tourism is one of the youngest segments of tourism with the rapid development associated with the last decade of the twentieth century, when the events were perceived as a desirable product because of their unquestionable ability to bring economic benefits through tourism promotion, increased consumption by visitors and new business opportunities. Events tourism is a promising type of tourism, and as such has a large impact on complex developments in the tourism market. Events tourism, like any other sector, enters into the lives of a multitude of fine moments. It is a sector that is constantly growing and involves very large numbers of people, as service providers, and the tourists themselves.

As a phenomenon, events tourism has been recognized as one of the most influential phenomenon when it comes to forming the image, creating a profile of the destination and its positioning in the tourism market. The maximum positive impact that an event can have on the positioning of the destination market is achieved by designing and modernizing events that reflect the distinctiveness and uniqueness of a particular community. Studies by many authors who have studied events tourism have shown that the central factors which the successful integration of events in the destination brand depends on are: event differentiation, a tradition that binds them, joint planning of key stakeholders and media support.

Serbia is characterized by a large number of events that represent an inexhaustible source of significant potential for development of events tourism in this part of Europe. To allow for further, higher quality development of events tourism in Serbia, one of the main preconditions is the use of modern knowledge in this field, as well as recognizing the necessity of investment in research and continuous market research in order to timely recognize changes in the needs and demands of tourists and adequately react so as to attract their attention and retain their interests. Also, for further development of this segment of tourism, of great importance is the creation of a local marketing strategy for events tourism development, as part of the general strategy of long-term tourism development, based on experience, mentality of the population, the most advanced knowledge in this field and the unification of all stakeholders in the tourism industry.

In these times of crisis, where the financial situation is extremely unstable, the key role of event marketing is that its activities may lead to inflow of funds to a particular tourist destination and enable the protection and preservation of the natural environment, local culture, traditions, diversity and everything created.

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ULOGA MARKETING DOGAĐAJA U RAZVOJU TURISTIČKE DESTINACIJE

Zadatak istraživanja rada je da sagleda i istakne osnovne smernice i mogućnosti razvoja turizma događaja određene turističke destinacije. Marketing događaja podrazumeva planiranje, segmentaciju ciljnih grupa, efektno korišćenje komunikacija, rad sa sponzorima i volonterskim organizacijama, promociju događaja, analizu budžeta, pa čak i obezbeđivanje logistike da ceo događaj ne doživi neuspeh. Osnovni cilj rada je da ukaže na ulogu marketing događaja u animiranju i privlačenju većeg broja posetilaca i njen značaj u promociji turističke destinacije. Takođe, ukazuje na značaj permanentnog razvijanja događaja kao izuzetno važne komponente atraktivnih faktora turističke ponude u cilju izgrađivanja Brenda destinacije. Istraživanje je pokazalo da organizacija događaja može da doprinose povećanju investicija, utiče na razvoj turističke privrede, poveća ekonomski rast i valorizuje prirodne i antropogene resurse turističkih destinacija.

Ključne reči: *marketing događaja, turistička destinacija, ekonomska uloga, promocija.*

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Review paper

PROPERTY TAX BURDEN AND PROGRESSIVITY IN THE CASE OF SERBIA

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Abstract. *Property taxation has been in the focus of economic considerations in Serbia only in the last few years. In the absence of the alternative revenue sources, the property tax is designated by the state authorities in Serbia as a potential source of additional revenue. Legislative changes, particularly Property Taxes Law amendments in 2010, made the formal conditions for the increase of the property tax burden and progressivity. As the motive for increasing the property tax burden, the government has appointed more appropriate property valuation, while for increasing the tax progressivity achieving greater vertical equity argument has been selected, along with higher tax revenues that remain available to local authorities. This paper considers whether there has been an increase in the tax burden and progressivity of the property tax in Serbia, via the empirical measurement of theoretically funded indicators. The results show that, in general, property tax in the future may generate a greater burden, particularly for taxpayers who own valuable properties, which may be followed by moderate increase in tax progressivity.*

Key Words: *property taxation; tax burden; tax progressivity, Serbia.*

INTRODUCTION

Property taxation in Serbia is passed to the local government with the adoption of the Local Government Finance Law in 2006. The local authorities are responsible for the assessment of the tax base, tax collection and establishing tax rates within the limits set in the state legislative provisions. This direction of local authorities funding is also supported by changes of the Property Taxes Law, which defines the basic elements of the taxation object, tax base, tax rates and tax credits. In recent years, a large number of studies have considered property tax as one of the taxes that could increase tax revenue, while simultaneously achieving a more equitable income redistribution. The scope of

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property tax can be widened, through more efficient defining of the taxpayer's responsibilites and property tax base. This is the aspect of the property tax that mostly draws the attention of economic experts in Serbia. However, recently the focus of considerations is on increasing the tax burden to be borne by taxpayers, accompanied by increase in the tax progressivity. As the main impulse for the tax burden increase the government authorities have selected more adequate valuation of the property, while as the key motivation for progressivity increase greater vertical equity is pointed out. Regarding this, the amendments to the Property Taxes Law from 2010 altered certain elements of the final tax liability calculation. The main objective of this study is to determine whether the legislative changes from 2010 increased the burden and/or the progressivity of the taxation of property owned by individuals, and whether the increase has affected only individuals that own valuable properties or if it has affected the owners of the low value properties as well.

The hypothesis tested in this paper is that, after the legislative changes from 2010, an increase in the property tax burden has occured, as well as an increase in the property tax progressivity. To determine the characteristics of the property tax burden and progressivity, the range of real estate values is considered with the introduction of certain assumptions about real estate and taxpayer. By using legally prescribed parameters for tax liability calculation, tax is levied to pay for each of the real estate values within a defined value range, both before legislative changes in 2010 and after the legislative changes in 2010. Afterward, we introduce five fiscal indicators, of which the first three measure the tax burden, and the last two measure the tax progressivity. Comparing values before and after the legislative changes, conclusions are given regarding changes in the tax burden and progressivity.

The paper is arranged as follows. After the introduction, the second section provides the review of Property Taxes Law Amendment Act in 2010, which has introduced significant adjustments in all phases of tax liability calculation. The third part of the paper refers to the methodology of measuring the tax burden and progressivity. In the fourth part, the results of the analysis are given. The final part presents the conclusions.

1. PROPERTY TAXES LAW AMENDMENT ACT FROM 2010

Property taxation in Serbia is regulated by Property Taxes Law, which was changed in several occasions after the adoption in 2001. Over a number of years the property tax has been criticized, especially in terms of complexity and ambiguity in the tax base assessment. All rights on the property covered by the Property Taxes Law are subject to taxation. Property tax in Serbia is local tax - defined as a source of local governments revenue (Local Government Finance Law, article 6). However, the elements that constitute tax base and the maximum tax rate that local governments may apply are determined by the Property Taxes Law, while the tax rate decision is made by the local government within the limits established by the central government (Popović, D., p. 353).

Amendments to the Property Taxes Law were made repeatedly in Serbia, but in this paper we focus on the Property Taxes Law Amendment Act from 2010. This Law amendment introduced a number of changes in all phases of the tax liability calculation. At the real estate value assessment phase, value of real estate is accepted as a tax base. The value is calculated by applying the basic and corrective elements. The basic elements are usable area and the administrative average price per square meter of suitable real estate in the territory of a municipality, while the corrective elements are location and the quality of real estate (Property Taxes Law, article 6). Finally, the value calculated in this way is modified by the annual depreciation factor. The Law amendment lowered the amount of annual depreciation from 1.5% to 0.8%, while the maximum amount of depreciation that could be applied has been reduced from 70 % to 40 % (Property Taxes Law, article 5).

As for tax rates and tax brackets, some changes have also been made. Before the amendments, the tax structure looked as follows:

	Tax base	**Tax rates**
1	Up to 6,000,000 dinars	up to 0.40%
2	6,000,001 – 15,000,000 dinars	tax (1) + up to 0.80% on the amount above 6,000,000 dinars
3	15,000,001 – 30,000,000 dinars	tax (2) + up to 1.50% on the amount above 15,000,000 dinars
4	Above 30,000,000 dinars	tax (3) + up to 3% on the amount above 30,000,000 dinars

Source: Property Taxes Law, Official Gazette of RS, No. 26/01, 45/02, 42/02, 80/02, 135/04, 61/07, 5/09

If only marginal tax rates are considered, it might be concluded that the property taxation in Serbia was very progressive because the tax rates rise from 0.4 % up to 3%. However, it should be noted that, according to the Tax Administration data, in 99.7% of tax returns, the tax base calculated for real estates owned by individuals amounted to less than 6 million dinars in 2006, i.e., taxed at a rate which stood at 0.4 % or below that percent. However, this figure was significantly reduced in 2009, especially in larger towns where the most valuable properties owned by individuals are located, primarily because local governments have increased the average price per square meter of real estate by 10% to 30% (Levitas, T. et al., 2010, p. 109). With adequate real estate valuation and the gradual introduction of market values as a tax base, it can be expected that the number of taxpayers in the higher tax brackets increases.

After the Law amendment, composition of tax rates and tax brackets looks as in the table:

	Tax base	Tax rates
1	Up to 10,000,000 dinars	up to 0,40%
2	10,000,001 – 25,000,000 dinars	tax (1) + up to 0,60% on the amount above 10,000,000 dinars
3	25,000,001 – 50,000,000 dinars	tax (2) + up to 1,00% on the amount above 25,000,000 dinars
4	above 50,000,000 dinars	tax (3) + up to 2% on the amount above 50,000,000 dinars

Source: Property Taxes Law, Official Gazette of RS, No. 26/01, 45/02, 42/02, 80/02, 135/04, 61/07, 5/09, 101/10

If only changes in the composition of tax rates and brackets are observed and other changes are neglected, a premature conclusion that a mitigation of progressivity occured could be derived.

In the final phase of tax liability calculation, the total amount of the tax credit has been reduced. The tax credit, which amounted 40% of tax liability for the sole resident taxpayer and 10% for each household member (provided that the total amount of the tax credit could not exceed 70% of the tax liability) is corrected. For the sole taxpayer, providing the condition of residency in the taxable real estate is fulfilled, the tax credit has been raised to 50% of the tax liability, but it can not exceed the amount of 20,000 dinars (Property Taxes Law, article 13). In this way, this tax incentive can be fully utilized only for taxpayers whose tax liability before the application of the tax credit is less than or equal to the amount of 40,000 dinars, which significantly increases the progressivity of the property tax at the higher tax bases.

2. The Methodology of Measuring the Property Tax Burden and Progressivity

Measures of tax burden are indicators of how well tax policy meets one of its primary goals, equitably raising the revenues needed to run government. Equity has two aspects. The first, vertical equity, concerns the way taxes are distributed among taxpayers with different abilities to pay. The second, horizontal equity, concerns the way taxes are distributed among taxpayers with the same ability to pay. Tax burden measures thus answer broad economic and social questions about the effect of tax policy on the distribution of income and wealth (Atrostic, B.K. and Nunns, J.R., 1991, p. 343).

Over time, a number of different indicators of tax burden have appeared, which can be classified into four broad categories: 1) Tax rates (nominal, statutory), 2) Tax/GDP ratios, 3) Implicit/effective tax rates on consumption, labour or capital and 4) The effective ex-ante tax rates (Wolff, G., 2005, p. 2). Nominal rates and the tax/GDP ratios were originally used as indicators of tax burden, mainly because of the simplicity and accessibility of the necessary data. With the growing complexity of national tax systems, the methodology of calculating the tax burden has become more complicated. Effective tax rates eliminate some of the disadvantages of using nominal tax rates, and are used in many papers to measure the consumption, capital or labour tax burden. In the past, most of the papers were focused on the profit tax burden, and its impact on the investment process. As a reaction to this trend, methodologies of average effective (AETR) and marginal effective (METR) tax rates were developed. In recent years, an emphasis has been placed on the tax burden on labour as a factor of production, where the effective tax rates have been used to show the labour tax burden at different income levels for the representative individual with strictly defined characteristics.

There are only few papers that analytically approach the problem of determining the property tax burden. Papers dealing with the property taxation mainly studied other aspects of the property tax, while the tax burden has been ignored. In the United States, the property tax burden has always attracted the attention of economists, since it is the most important revenue to local authorities and the differences in the tax burden in various states are significant. The two most popular indicators of the property tax burden that American economists have used are the property taxes per capita and property taxes per $1,000 of total income. These indicators are the perfect tools for comparative analysis because they can show the differences in the tax burden in individual states, local communities and cities. In addition, the effective tax rate as the ratio of tax paid and the market value of the real estate is also a popular measure, because it indicates differences in the tax burden borne by taxpayers in different tax jurisdictions for real estate with the same characteristics. A large number of studies in the United States use just these indicators of the tax burden, while in European countries, there is hardly any significant research that deals with this aspect of property tax.

As far as progressivity, generally speaking, tax can be proportional, progressive or regressive. The tax is considered progressive if the average tax rate increases with income before tax, that is, if the marginal tax rate is higher than average tax rate along the entire income scale. The rate of progressivity is a term often used by economists and politicians, but with no clear meaning (Jakobson, U., 1976, p. 161). Generally, tax theory distinguishes local and global progressivity. Local (point, interval) progressivity measures the change of the average tax rate in one point or between two selected points in the income scale and it is closely linked to effective taxation. The outcomes of its analysis can help to specify the income intervals where the tax progressivity is the highest or the lowest, in what income intervals there are eventual turning points in tax progressivity, i.e. when tax changes from one form of progressivity (e.g. progressive) to the other form (proportional or regressive) (Široky, J., and Makova, K., 2007, p. 4). While local tax progressivity measures progressivity in a certain range of taxpayer's income, and can be used to determine the effects of partial tax legislation changes to the specific group of taxpayers, the macroeconomic analysis is necessary to determine the index that measures the progressivity along the entire income range. Musgrave and Thin (1948), in a very influential paper "Income Tax Progression from 1929 to 1948", introduced four local progressivity measures:

1) Progression of average tax rate;
2) Progression of marginal tax rate;
3) Progression of tax liabilities;
4) Progression of residual income.

Also, in order to arrive at a single measure of progression, Musgrave and Thin (I 948) compared the inequality of the before-tax and after-tax income distributions. A progressive tax system is associated with a decrease in income inequality, while regressive tax rates will be reflected by an increase in income inequality (Kakwani M., 1977, p. 72). Available literature regarding the tax progressivity can be divided into studies that focus either on the local or global measures of tax progressivity. The largest number of early researches has focused on two of the aforementioned four indicators of local progressivity, i.e. progressivity of the tax liabilities and progressivity of residual income. The former measures the elasticity of the tax liability compared to change in pre-tax income, while the latter measures the elasticity of after-tax income compared to change in pre-tax income (at a certain point of the income scale).

Very few papers deal with the calculation of property tax progressivity. Even researches that consider the progressivity focus more on the aspect of vertical in(equality) as an element of importance. A vertically inequitable tax system can be classified as "regressive" if higher value properties are taxed more favorably than lower value properties and "progressive" if higher value properties are taxed less favorably than lower value properties (Allen, M., and Dare, W., 2009, p. 82). On the other hand, in a number of works, global progressivity of national tax systems is measured with the inclusion of property tax in the observed taxes, so global indices of progressivity of different taxes are calculated (Suits's index, Kakwani index and others). These indices are mainly relying on Lorentz distribution of income and the Gini coefficient of inequality as tools to measure progressivity (Kakinaka, M., and Pereira, M., 2006, p. 1).

To assess the effects of property taxation in Serbia, a range of real estate value from 2.5 million dinars to 50 million dinars is established, with a fixed increase in the value of real estate of 2.5 million dinars, which gives 20 levels of real estate value. In order to determine the tax liability, it is necessary to introduce some assumptions:

1. real estate subject to taxation falls within the category of buildings and is located in the municipality of Kragujevac;
2. age of the building is 10 years;
3. location coefficient is 0.6 (the real estate in the suburban area);
4. quality coefficient of property is 560/695 (0.86);
5. taxpayer is an individual who resides in the taxable property with three household members.

These assumptions allow us to calculate the tax base, on which the tax rates are imposed in the municipality of Kragujevac, before and after the Property Taxes Law amendment from 2010 (Table 1). In this way tax liability is calculated, but it must be adjusted by applying the tax credit. The remaining amount represents the final tax liability. As it can be seen, only the taxation of real estate owned by individuals is considered, while taxation of enterprises is not the subject of this paper.

Table 1 Property tax structure in the municipality of Kragujevac (before and after the Property Taxes Law amendment in 2010)

Before amendment		After amendment	
Tax base	Tax rates	Tax base	Tax rates
Up to 6 milion dinars	0.30%	Up to 10 milion dinars	0.20%
6 – 15 milion dinars	18 thousand dinars + 0.80% on the amount above 6 mil. dinars	10 – 25 milion dinars	20 thousand dinars + 0.60% on the amount above 10 mil. dinars
15 – 30 milion dinars	90 thousand dinars + 1.50% on the amount above 15 mil. dinars	25 – 50 milion RSD	110 thousand dinars + 1% on the amount above 25 mil. dinars
Above 30 milion dinars	315 thousand dinars + 3% on the amount above 30 mil. dinars	Above 50 milion RSD	360 thousand dinars + 2% on the amount above 50 mil. dinars

Source: Property Taxes Law, Kragujevac Local Government Decision on the Property Tax Rate for 2009 and 2010

To analyze the property tax burden and progressivity five measures are used:
1) The total amount of tax liability;
2) Tax rate T_1, calculated as a ratio of the total tax paid and the tax base;
3) Tax rate T_2, calculated as a ratio of tax before the tax credit and the property value;
4) local index of progressivity of tax liability, which is obtained using the formula $v_1 = \frac{(T_1 - T_0)/T_0}{(Y_1 - Y_0)/Y_0}$, i.e., $v_1 = \frac{\Delta T / T_0}{\Delta Y / Y_0}$, where T is the amount of tax due, and Y is the value of property on which the tax is levied.
5) Local index of residual progressivity, obtained using the formula $\nu_2 = \frac{\Delta X / \Delta Y}{X / Y}$, where X is the value of the property after tax ($Y - T$), T is the amount of tax and Y is the pre-tax property value.

The first three indicators measure the burden that property tax creates for property owners. While the tax burden just shows what part of taxpayer's income is transfered in the form of taxes, the extent of progressivity shows changes in the tax burden of taxpayers in accordance with income changes. Local measure of progressivity of the tax liability shows that, if its value is greater than 1, a progressive tax is in place, while if value is smaller than 1, tax is considered to be regressive. Its value can show in what real estate value range an increase in the tax progressivity occurs. Also, if the value of the residual progressivity measure is smaller than 1 tax is considered progressive, otherwise, if its value is greater than 1, tax is regressive.

The analysis is carried out with respect to the previously defined assumptions concerning the characteristics of taxpayer and property. Respecting different sets of assumptions, we could get quite different results. Also, local tax progressivity measures are used, which do not provide a comprehensive measure of tax progressivity. Calculating a global index of progressivity, which requires a large set of specialized data on the income distribution and the tax burden, would generate more useful information about the nature of the property tax progressivity in Serbia.

3. The Results

After identifying all important elements, all the above mentioned tax indicators can be calculated. The values are shown in Table 2 and the graphs that follow. Table 2 shows the increase in tax liability that occured after legislative changes for the real estate value up to

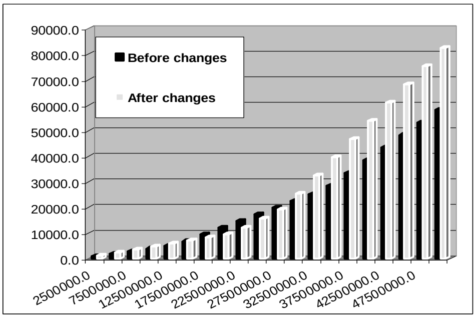
Table 2 Property tax burden and progressivity, before and after the Property Taxes Law amendment in 2010

	1) Tax liability		2) Tax rate T_1		3) Tax rate T_2		4) Indicator υ_1		5) Indicator υ_2	
Value	Before	After	Before	After	Before	After	Before	After	Before	After
2.5 mil.	986,9	1186,8	0,090	0,100	0,132	0,095	–	–	–	–
5 mil.	1973,7	2373,6	0,090	0,100	0,132	0,095	1	1	1,00000	1,00000
7.5 mil.	2960,6	3560,4	0,090	0,100	0,132	0,095	1	1	1,00000	1,00000
10 mil.	3947,4	4747,2	0,090	0,100	0,132	0,095	1	1	1,00000	1,00000
12.5 mil.	4934,3	5934,0	0,090	0,100	0,132	0,095	1	1	1,00000	1,00000
15 mil.	6789,6	7120,8	0,103	0,100	0,151	0,095	1,88	1	0,99971	1,00000
17.5 mil.	9421,2	8307,6	0,123	0,100	0,179	0,095	2,32	1	0,99949	1,00000
20 mil.	12052,8	9494,4	0,137	0,100	0,201	0,095	1,95	1	0,99955	1,00000
22.5 mil.	14684,4	12043,6	0,149	0,113	0,218	0,107	1,75	2,15	0,99960	0,99952
25 mil.	17316,0	15604,0	0,158	0,131	0,231	0,125	1,61	2,66	0,99964	0,99920
27.5 mil.	19947,6	19164,4	0,165	0,147	0,242	0,139	1,52	2,28	0,99967	0,99927
30 mil.	22579,2	25449,6	0,172	0,179	0,251	0,151	1,45	3,61	0,99970	0,99833
32.5 mil.	25210,8	32570,4	0,177	0,211	0,259	0,162	1,39	3,36	0,99972	0,99815
35 mil.	28579,5	39691,2	0,186	0,239	0,272	0,171	1,74	2,84	0,99947	0,99828
37.5 mil.	33513,8	46812,0	0,204	0,263	0,298	0,178	2,42	2,51	0,99892	0,99840
40 mil.	38448,0	53932,8	0,219	0,284	0,320	0,185	2,21	2,28	0,99899	0,99850
42.5 mil.	43382,3	61053,6	0,233	0,303	0,340	0,191	2,05	2,11	0,99905	0,99859
45 mil.	48316,5	68174,4	0,245	0,319	0,358	0,196	1,93	1,98	0,99910	0,99866
47.5 mil.	53250,8	75295,2	0,256	0,334	0,374	0,201	1,84	1,88	0,99915	0,99873
50 mil	58185,0	82416,0	0,265	0,347	0,388	0,205	1,76	1,79	0,99919	0,99880

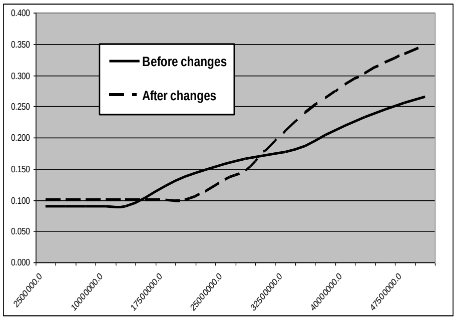
Source: Author's calculations

15 million dinars, and a decline in the range from 17.5 to 27.5 million dinars. For the higher values there is a continuous increase in the tax liabiliy, that can be seen in the Chart 1A. This trend can be confirmed by observing tax rate T_1, which keeps the pace with changes in tax liability. In the graph 1B three distinctive zones can be discerned. In the first zone, (real estate value ranging from 2.5 to 15 million dinars) tax rates before and after Property Taxes Law amendment are approximately equal. In the second zone, ranging from 17.5 to 27.5 million dinars, tax rate before is higher than the tax rate after the Law amendment.

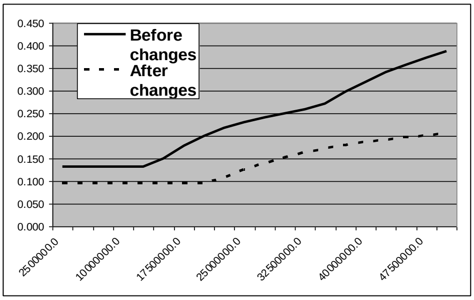
Only in the third zone, ranging from 30 to 50 mil. dinars, tax rate after the legislative changes becomes greater than the tax rate before the changes, and the difference rises with the increase in real estate value. As it will be shown later, the main factor influencing this behaviour of tax liability and indicator T_1 is tax credit.



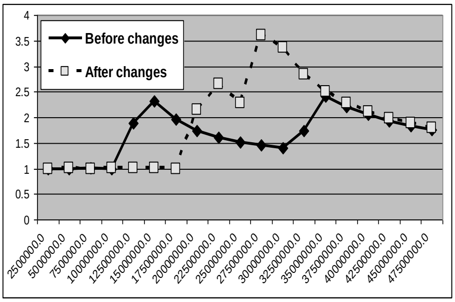
A: Tax liability



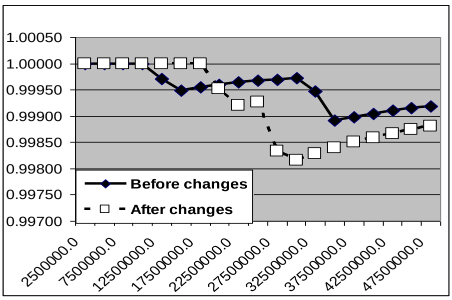
B: Tax rate T_1



C: Tax rate T_2



D: Indicator υ_1



E: Indicator υ_2

Fig. 1 The amount of tax liability, tax rate T_1, tax rate T_2 and indicators of local progressivity υ_1 and υ_2, before and after the legislative changes

Unlike T_1, indicator T_2 displays continuous increase compared to the values after the legislative changes. This can be explained by the fact that T_2 is the ratio of tax liability before applying tax credit, so tax credit change does not affect the T_2 value (Figure 1C).

Local progressivity of the tax liability is higher after legislative changes in the real estate value range from 22.5 to 50 million dinars (Figure 1D). However, this indicator shows that progressivity rises for the real estate values ranging from 22.5 to 35 million dinars, while the progressivity before and after tax changes are very close for values ranging from 37.5 to 50 million dinars. This trend is confirmed by the indicator of the residual progressivity (Figure 1E), whose value after legislative changes is continuously lower than the value before the legislative changes for the real estate values in the 22.5-50 million dinars range.

Having established the above mentioned indicators, the remainder of the paper deals with the question which of the taxation elements that were subject to legislative changes contribute to increase in the tax burden and/or progressivity, and which are acting in the opposite direction. The elements which were altered are the amount of depreciation, tax rates, tax brackets and the tax credit. To determine which elements have increased the tax burden and progressivity, it is necessary to recalculate the previously observed indicators, but in a way that only one of the elements changes, while keeping the other elements unchanged (ceteris paribus). In this way, only the element that is modified affects the tax burden and progressivity, so the direction of its isolated effect can be observed. This procedure is implemented for each of the elements.

3.1. The effects of tax credit change

Observing the isolated effect of change in the tax credit, we can notice that it is a factor that dramatically increases the value of the tax rate T_1, especially at higher real estate values, because starting from real estate value 17.5 mil. dinars, the tax credit "freezes" at 20,000 dinars, and just after this level there is a significant increase of difference between the tax rate before and after the legislative changes. The tax rate T_2 measures the ratio of tax liability before the tax credit and the value of the property, and since it is not affected by the value of tax credit, the tax rate before and after the legislative changes remains the same. We conclude that the tax credit is a factor that leads to a significant increase in the tax burden, especially for taxpayers with valuable real estates.

As for local progressivity of the tax liability, for the real estate value up to 20.0 mil. dinars, progressivity before and after legislative changes are approximately equal. For higher real estate values, progressivity after the legislative changes is constantly higher than the progressivity before the changes. Due to the occurrence of significant differences in the amount of tax credit before and after the legislative changes, at the level of real estate value of 22.5 million dinars a swift rise of υ_1 occurs, which at that point reaches its maximum. Indicator of residual progressivity υ_2 tracks changes of the progressivity of tax liability, because its values before and after the legislative changes up to the real estate value of 17.5 million RSD are approximately equal, but after that point a significant difference is noticeable. For easier interpretation, the indicators are graphically shown (Figure 2), where we can see all the above trends.

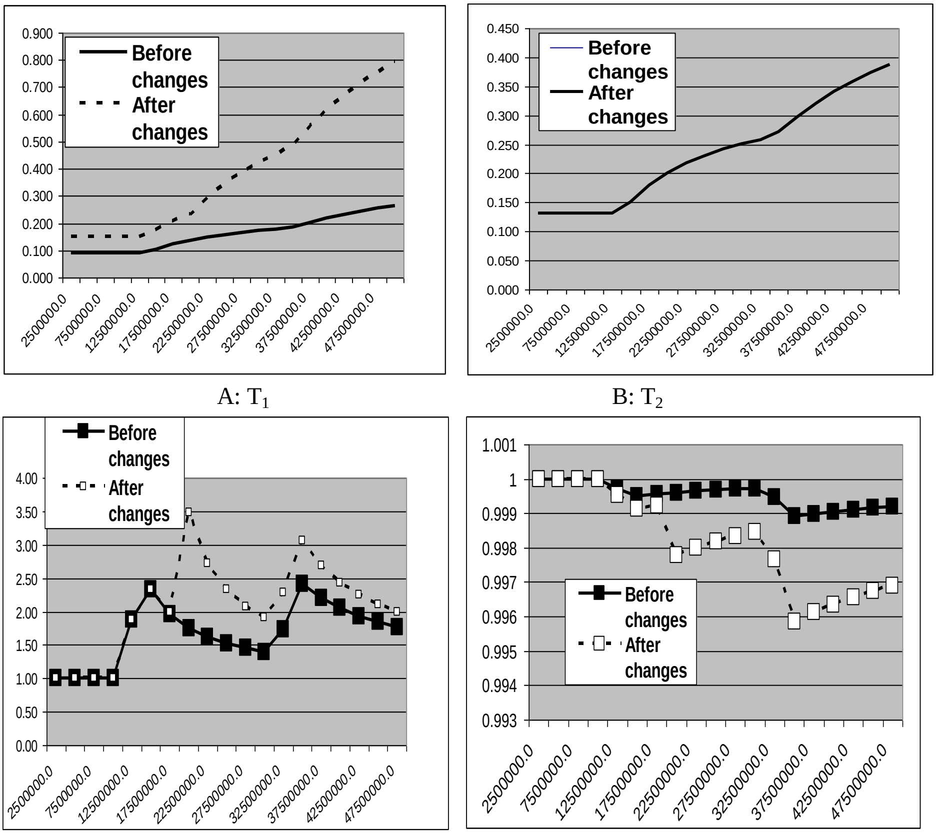
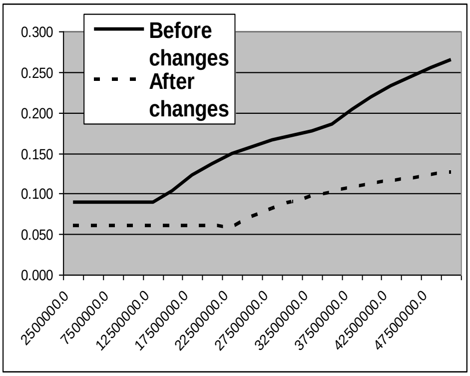


Fig. 2 Isolated effect of change in tax credit
Tax rates T_1, T_2 and local indicators of progressivity υ_1 and υ_2

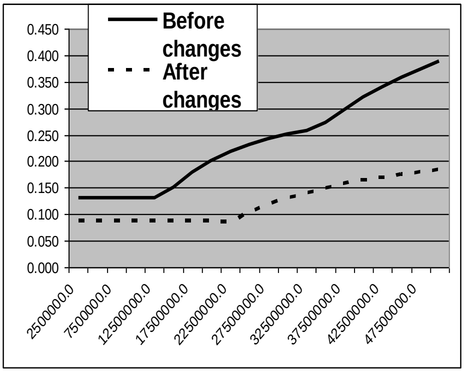
3.2. The effects of tax rates and tax brackets changes

Regarding changes in tax rates and tax brackets, in Fig. 3 a decrease in the value of tax rates T_1 and T_2 for all real estate values after legislative changes is apparent. The tax rate T_1, after legislative changes, remains continuously lower than the tax rate before the changes. With the increase in real estate value, the difference between tax rates increases. A similar trend can be observed for the tax rate T_2. Looking at these two indicators, we can state that the isolated changes in tax rates and brackets caused the reduction of the tax burden, which is intensifying as the real estate value rises.

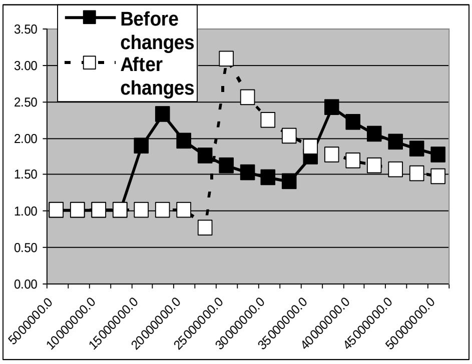
Considering the progressivity of the tax liability, there is no single trend. The reason for this lies in the fact that the progressivity of the tax liability represents the ratio of two relative values, the relative change of tax liability and the relative change in real estate value. Given that the relative change in real estate value is fixed before and after the legislative changes, the difference in the value of the indicator before and after legislative changes is only affected by the relative change in tax liability. Prior to legislative changes, indicator of progressivity of the tax liability had two peaks (one peak for the real estate value of 17.5 mil. dinars, and the other for the real estate value of 37.5 mil. dinars). This can be explained by transitions to higher tax brackets, because for a given range of the tax base, before the legislative changes three tax brackets were established, and the jump in the indicator value happens immediately after the point where the marginal tax rate rises. In the first case, for the real estate value of 15 million dinars the marginal tax rates rises from 0.3 % to 0.8 %, and in that point progressivity increases and reaches the first peak at the next real estate value. In the second case, for the real estate value of 35 mil. dinars, marginal tax rates rises from 0.8 % to 1.5 %, and in that point progressivity increases and reaches the second peak at the next real estate value. On the other hand, after legislative changes, tax brackets are set in a way that only one transition to the next bracket exists, at the real estate value of 25 mil. dinars, where progressivity indicator reaches its maximum (Fig. 3C). Similar jumps can be observed with indicator of residual progressivity (Fig. 3D), which also reports the existence of two points at which a decline in indicator value happens before legislative changes, while after changes there is only one point where a sharp decline occurs.



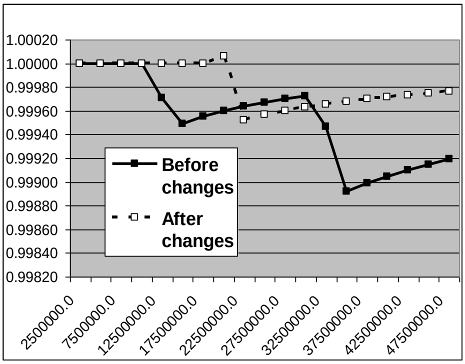
A: T_1



B: T_2



C: υ_1



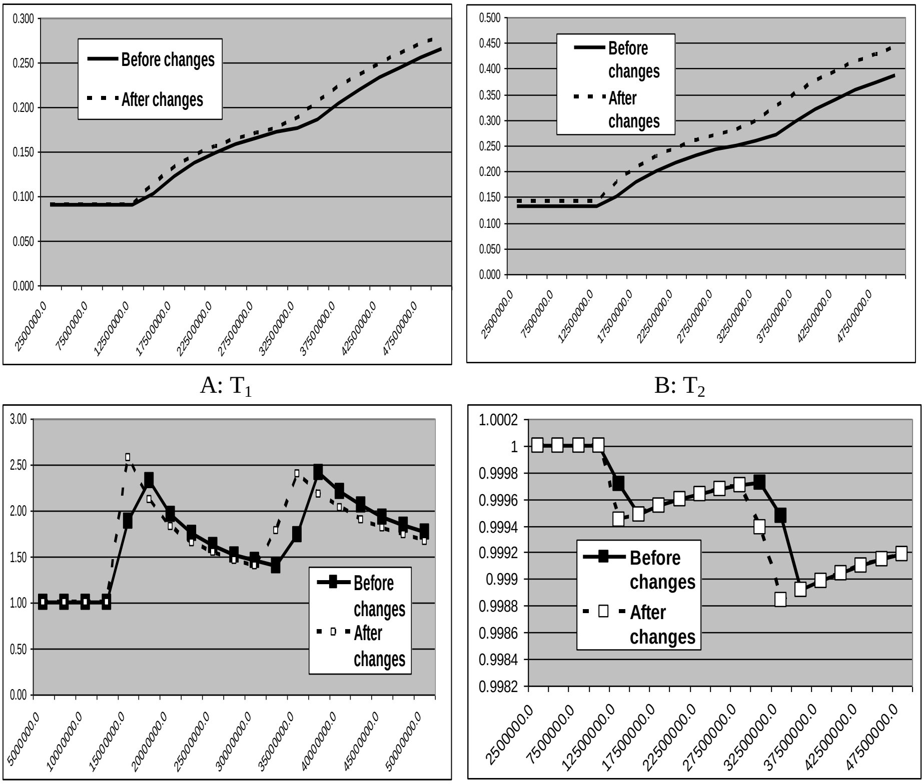
D: υ_2

Fig. 3 Isolated effect of changes in the composition of tax rates and tax brackets Tax rates T_1, T_2 and local indicators of progressivity υ_1 and υ_2

Based on all the foregoing, we conclude that the isolated change in the tax structure has led to a reduction in the progressivity of taxation, that is, a new tax structure is less progressive compared to the previous tax structure in the range of real estate value from 2.5 to 22.5 million dinars., but, for a range of values from 25 to 35 million dinars it becomes more progressive. Finally, for the range of values from 37.5 to 50 mil. dinars, again it is less progressive compared to the previous tax structure.

3.3. The effects of depreciation changes

Thanks to the reduction in depreciation percentage, after the legislative changes the amount of tax to pay is higher for all levels of real estate values. The increase in the tax burden can be seen both in the amount of tax payments, as well as with indicators T_1 and T_2, which are higher after legislative changes for all levels of real estate value (Fig. 4A and 4B).



A: T_1 B: T_2

C: υ_1 D: υ_2

Fig. 4 Isolated effect of change in depreciation
Tax rates T_1, T_2 and local indicators of progressivity υ_1 and υ_2

Regarding isolated effect of the depreciation reduction on progressivity, it is a change that affects all taxpayers across the entire range of real estate values in the same way. Accordingly, changes in the progressivity (Fig. 4C and 4D) can be attributed to transitions from one tax bracket to another tax bracket, but not to the reduction in depreciation rates. Depreciation decrease is a change that has led to the tax burden increase, but does not affect the progressivity.

FINAL REMARKS

Based on all the above, we can see that the changes of parameters in tax payment calculation introduced by 2010 Law amendment produced an increase of tax burden to be borne by taxpayers. Factors that have led to an increase in the tax burden are reduction of real estate depreciation, to a lesser extent, and, to a much greater extent, tax credit reduction, especially at higher levels of real estate value. On the other hand, isolated changes made in the composition of tax brackets and tax rates have generated the reduction in the tax burden at all real estate value levels, but this reduction is not enough to offset the impact of tax credit change. In the hypothetical example presented here, tax liability becomes constantly higher after legislative changes, but only at higher values that exceed 30 million dinars. For lower real estate values, the tax liability in the real estate value range from 2.5 to 15 million dinars becomes higher after legislative changes, but in the range from 17.5 to 27.5 mil. dinars it becomes lower. In this range the tax rate applied is lower after the Law amendments, but the tax credit percent also becomes lower along with the lower depreciation rate. The combined impact of the tax credit and depreciation prevails so tax liability increases. However, in the range from 17.5 to 27.5 million dinars, the tax liability after the legislative changes is lower, suggesting that the combined impact of tax rates and tax brackets is stronger than the combined impact of tax credit and depreciation. For the 30-50 million dinars range, a significant decrease of tax credit occurs, which increases the amount of tax liability, i.e., the impact of tax credit and depreciation prevails over the influence of tax rates/brackets changes.

Values of local tax progressivity indicators before and after legislative changes inform us that an increase in tax progressivity occurred, but not along the entire scale of real estate values. For a real estate value range from 2.5 to 10 million dinars, both progressivity indicators have a value of 1, which means that there is no progressivity in taxation (this is a proportional tax). Progressivity is more pronounced before the legislative changes in the 12.5-17.5 million dinars range, while at higher values, in the 20-50 million dinars range, property tax progressivity is more pronounced after the legislative changes. Using more detailed analysis, we have found that the tax credit change led to an increase in progressivity at higher real estate values, that is, the effect of changes in tax credit in the direction of increasing progressivity is more pronounced than the tax rates/brackets change in the direction of reducing progressivity. On the other hand, the impact of changes in the composition of tax rates and tax brackets led to reduction in the progressivity at lower real estate values.

State authorities in Serbia are oriented toward increasing property tax revenue. First of all, this will be achieved by introducing market values of the real estate as tax base. Currently, due to the tax base undervaluation, the analysis conducted in this paper has a theoretical character, because the share of taxpayers in the higher tax brackets is low. Also, the authorities for two years in a row limit the full implementation of the legal provisions through prevention of interannual rise of tax liabilities reported in the annual tax returns. With the introduction of market-valued tax base, it can be expected that the degree of undervaluation of the base will be significantly reduced. In this case, the burden of paying taxes will be higher, especially for taxpayers who own valuable properties, which will lead to an increase in property tax revenue. As far as progressivity, legislative changes have resulted in greater tax progressivity for valuable real estates, which, accompanied by an increase in average tax rates can lead to achieving greater redistributive effects and more equitable income redistribution. However, given the low property tax revenue, it can hardly be expected that this effect will be overly significant.

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PORESKI TERET I PROGRESIVNOST POREZA NA IMOVINU U SRBIJI

Oporezivanje imovine u Srbiji je tek u poslednjih nekoliko godina u fokusu javnofinansijskih rasprava. U nedostatku drugih načina za ubiranje nedostajućih budžetskih sredstava, porez na imovinu je poreski oblik koji su državni organi u Srbiji odredili kao potencijalan izvor dodatnih prihoda. Zakonskim izmenama, a naročito izmenom Zakona o porezima na imovinu iz 2010. godine, stvoreni su formalni uslovi za povećanje poreskog opterećenja i progresivnosti u oporezivanju. Kao osnovni motiv za povećanje izdašnosti poreza na imovinu državni organi navode adekvatnije vrednovanje imovine, dok se kao osnovni motiv za povećanje progresivnosti navodi postizanje veće vertikalne pravičnosti, uz istovremeno povećanje poreskih prihoda koji ostaju na raspolaganju lokalnim vlastima. U ovom radu utvrđuje se da li je došlo do povećanja poreskog opterećenja i progresivnosti u oporezivanju imovine u Srbiji, empirijskim utvrđivanjem vrednosti teorijski definisanih pokazatelja. Rezultati analize pokazuju da će, generalno, porez na imovinu u budućnosti stvoriti veće opterećenje, i to naročito za poreske obveznike koji poseduju vrednije nepokretnosti, što će biti praćeno skromnim rastom progresivnosti u oporezivanju.

Ključne reči: *oporezivanje imovine; poreski teret; progresivnost u oporezivanju, Srbija.*

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Review paper

CONCENTRATION RISK FOR PLACED ASSETS BY THE LARGEST BANKS IN SERBIA

UDC 347.734(497.11)

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Abstract. *The fact that the U.S., in the recent past, faced a financial collapse which led to the global economic crisis, and the fact that the euro zone felt the financial collapse of Greece about five years ago has caused the public sector in Serbia, as well as all European countries to be seriously shaken. The significant decrease of transactions in the money market has resulted in the increase of exchange rates, the decline in interest rates, inflation and a decrease in the GDP. This has all been reflected on the economy, which has drastically reduced the number of employees, which has had a direct impact on the living standards of the population With the decrease in living standards, people are in a weaker position to pay back loans, which in turn can lead to some global crisis. The vicious circle is hard to break, and the European and world public is directing its forces, on one hand, to the recovery of the economy and on the other to bailing out banks. In this situation, it is not easy for banks to decide how to optimize the risk they are exposed to, i.e., which industrial branch, for what term and which region is the most optimal for investments. The authors have conducted a study, the results of which illustrate the current situation in Serbia and the trends in Serbia's largest banks.*

Key Words: *bank, loan, concentration, risk, activity, region.*

INTRODUCTION

The problems facing all economic entities in Serbia are mutually connected. The range of problems is broad - from global ones to those specific to one branch activity. The economic crisis is universal, the state has no funds, the industry is in ruins, the GDP is low, unemployment and inflation are high, living standards are low and so on in a circle. A way out of this situation cannot happen abruptly, solutions must be systemic. However, how to begin the fight and what to expect?

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The authors of this study started from the assumption that banks are business subjects who are the quickest at finding a solution. Namely, before banks there is the largest set of laws, those taken from developed countries which are slowly pulling themselves out of the global crisis. Additionally, banks have the strongest government oversight in terms of the practical application of these laws and respect for recommendations given by the Basel Committee and the OECD. In addition, primarily foreign banks operate on the Serbian market who are trying to break the vicious circle by implement solutions from their own countries. The National Bank of Serbia insists on constant improvements to the existing methods of risk management, control and management of the bank's processes. However, nothing comes of itself, and so banks too have had to adapt to the new conditions and circumstances and to invest considerable efforts in order to develop an adequate risk management system.

In terms of the banking industry, concentration of risk holds an important place in literature and represents a current topic discussed in international academic circles. There are a lot of models for measuring concentration of risk and they are constantly being developed. Banks have focused on this issue and, as already mentioned, are obliged to apply the minimum prescribed by the Basel Committee, which has been implemented in the national legislation of our country. Precisely for these reasons, the authors have not chosen to view concentration of risk from the perspective of the banking industry, but from the perspective of industry that uses banking services.

The authors, by using the methodology of bank audits of balance sheet items for loans given and investments, place the focus on the largest banks in Serbia, where the criterion for the size of the bank is the amount of total assets of the bank.

The database includes publicly disclosed audit reports for 9 of the largest banks in Serbia, that is the balance sheet positions for loans and investments in the largest banks in Serbia.

It is important to note that the analyzed position for loans and investments is comprised of:

- Cash and cash equivalents (with special attention to foreign currency accounts that the banks have with other banks);
- Revocable deposits and loans (in the vast majority of cases these are repo transactions[1]);
- Receivables from interest, fees and other;
- Loans and deposits given;
- Securities (held for trading, held to maturity and held for sale);
- Shares (equity participation in other entities);
- Other investments.

The aim of the research is to illustrate in which industries Serbian banks are investing assets in times of economic crisis, as well as the maturity of those investments and the geographic area which they prefer. The research will also predict the future trend of activities.

[1] Repo transactions (*Repurchase Agreement*) with securities means the purchase and sale of securities in which the contracting parties agree that at the date of purchase the seller sells the securities to the buyer, who pays the purchase price for the security, at the same time the buyer is obligated to on the contracted date resell the same securities to the seller, who is obligated to pay the agreed repurchase price.

1. A REVIEW OF THE LARGEST BANKS IN SERBIA

Serbian banks are ranked according to the criteria of the largest balance sheet sums (total assets measured in billion dinars).

The study covered 9 of the largest banks in Serbia as on December 31, 2012. Figure 1 illustrates the ranking of these banks by rating their participating in the total assets of the entire Serbian banking sector.

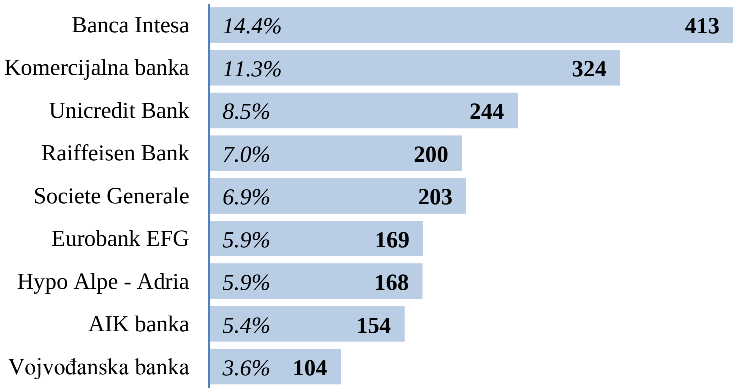

Fig. 1 Overview of the Top 9 banks in Serbia in 2012*

**Data source:* NBS (2013): Kontrola poslovanja banaka, izveštaj za IV tromesečje 2012. godine, http://www.nbs.rs/internet/english/55/55_4/index.html (15.06.2013)

The authors note that 68.7% of the total balance sheet assets of all Serbian banks have been covered by the research, or 68.7% of the Serbian banking market, which represents an adequate sample for making the relevant conclusion using the audit methodology.

2. CONCENTRATION OF RISK FOR INVESTMENTS OF THE LARGEST BANKS

Concentration risk is risk allocation according to some pre-defined criteria. The professional literature, under the term "concentration of risk" implies the direct or indirect exposure to the same or a similar source of risk occurrence. The criteria for concentration of risk presented in the study are industrial activities, regions and maturity of investments. This is important from the point of view of the bank, because the bank determines the objectives for future operations based on risk concentration. For example: low-risk regions will be attractive for banks to open up more branches in those cities, in order to spread its business network. Also, banks will have more concerns toward high-risk activities, as such they will apply more stringent measures for loans, as they will, depending on the liquidity, decide whether to invest assets for a short or long term.

2.1. Concentration of risk according to industrial activities

When investments by clients are in question, it is important to the bank which activities the client performs. Those more profitable activities will certainly carry less risk, because the likelihood of those clients paying back their loans is greater, given that they have a profitable business. On the other hand, there are industry branches which have been in a crisis in the past few years and banks will be cautious during loan disbursement to those clients.

On figure 2 (figures are in millions of dinars) we can see the analyses of risk concentration for loans and investments by sectors for the period from 2010 to 2012, which is scaled in a way to show in which industries banks invest the most:

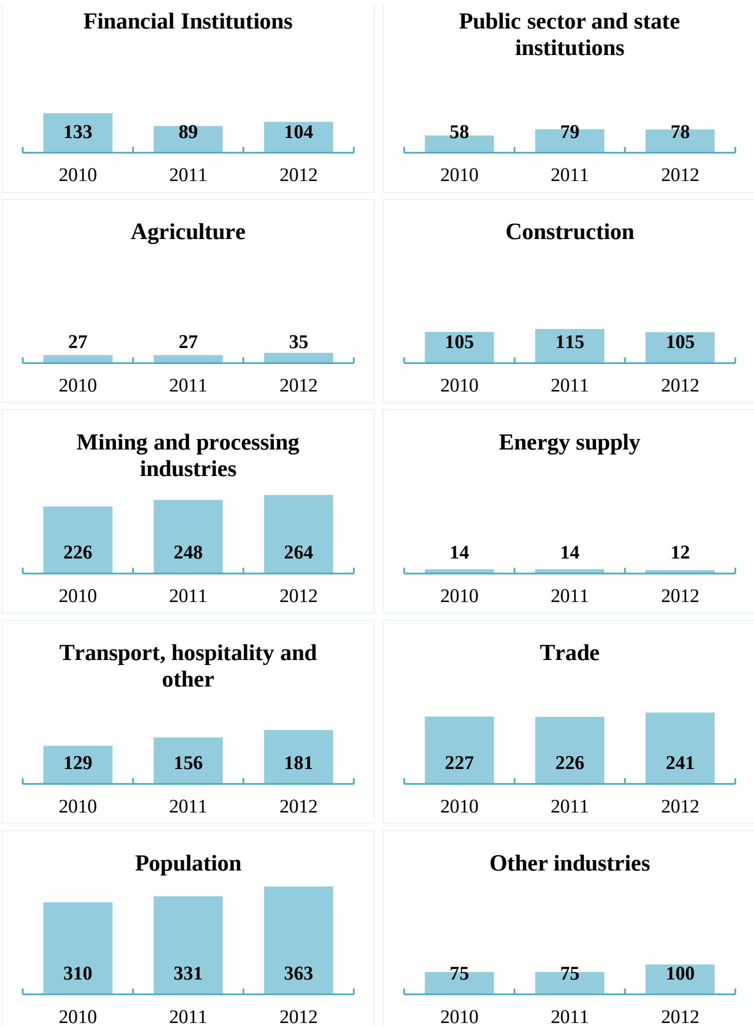

Fig. 2 Risk concentration by industries*

**Data source:* Official audited reports available on the bank's web presentations

From the results it is evident that there is no activity that can be singled out as the one most invested in, but it can be noted that loans to the population occupy a large share of total investments with all banks (on average[2] that is about 24% for all three years observed). Trade, as well as mining and the processing industry, are among the activities that make up about 17% of total investments, on average.

Viewing relative changes in 2011 compared to 2010, it can be seen that the largest increase in exposure was noted in the public sector and state institutions, as well as transport, tourism, hospitality and the service industry, 35% and 21%, respectively. Positive displacement, but in smaller percentages, was recorded in mining and processing industries (10%), construction (9%), energy supply (7%) and population (4%). Imperceptible changes have occurred in agriculture (1% growth), trade and other activities (almost unchanged state). The decrease was only noticeable in financial institutions (down 33%).

Noting again the relative changes, but now in 2012 compared to 2010, a reverse situation is noticeable. Investments in the public sector and state institutions, where we had the largest increase in exposure, now note the largest decrease in gross exposure in the amount of 24%. A decrease in 18% and 9% occurred in energy supply and construction, respectively. Mining and the processing industry, trade and loans to households rose by 6%, 7% and 10%, respectively. Traffic, hospitality, tourism and service industries have felt a higher growth of 16% and a similar increase (17%) was reported in the financial sector. Investments in agriculture (30%) and other activities (32%) have had the highest increase.

Only mining and processing industries, traffic, tourism, hospitality and service activities have had a constant growth over all of the three years

The interesting fact is that largest Serbian banks have been continuously increasing their investments in the entrepreneurs sector during the observed period, which we can see in Figure 3:

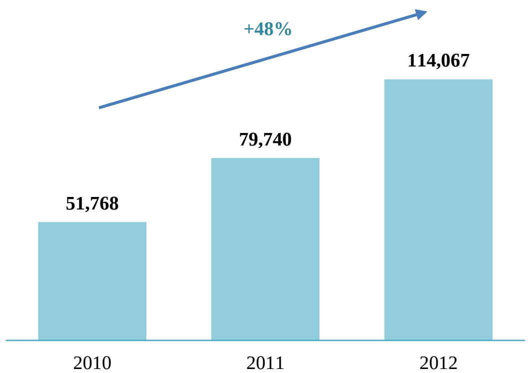

Fig. 3 Lending frowth entrepreneurs*

Data source: Association of Serbian Banks (2013):
Study about contribution of banking sector in the economy and society of Serbia

2.2. Concentration of risk according to maturity of investments

Maturity of investments is very important from the point of view of a banks liquidity. The bank must have enough of both short-and long-term assets. The first group is more liquid and those investments are more easily converted into cash to be able to cover some

[2] It is a weighted average, while the total gross exposure of banks was used as a weight.

unexpected expenses. Additionally, short-term investments (those that mature within one year) carry less risk than long-term (those that mature in more than one year), because it is easier to predict what will happen in the following year, rather than what will happen in five or more years. Long-term are riskier (the likelihood that the client will not return funds is greater), but that is also the reason that they are more profitable as they enable an inflow of money into the bank over the long run.

It is important to note that the study only included maturity of balance sheet items for loans and deposits given, as that is the most important item for credit risk, as well as the problem defined as the subject of research herein. The fact that other balance sheet items, whose maturity is usually up to a year, do not have as much importance on the balance sheet of the bank and its concentration of risk by maturity, represents an additional problem for Serbian banks - the problem of a lack of diversification of maturity which has led Serbian banks to the problem of reconciliation the maturity of funding sources with the maturity of obligations It was precisely this problem which confronted the Serbian economy with the fact that the banks were not their "allies".

Short-term investments consist mostly of loans per current accounts (*i.e.* Overdraft loans) for natural as well as legal entities. It also includes loans to industry and small and medium-sized companies which they use to fund some unexpected expenses. Investments with maturities of 1 to 5 years comprise the largest group of these investments (on average). This includes cash, consumer and auto loans, credit cards and other types of loans to natural persons, while for legal entities there are loans for working capital and investment loans. The group of loans with a maturity of over 5 years is mostly residential and mortgage loans with a maturity of up to 30 years.

Figure 4 illustrates the trend of allocating loans according to their residual maturity, looking at the weighed average for the largest banks in Serbia.

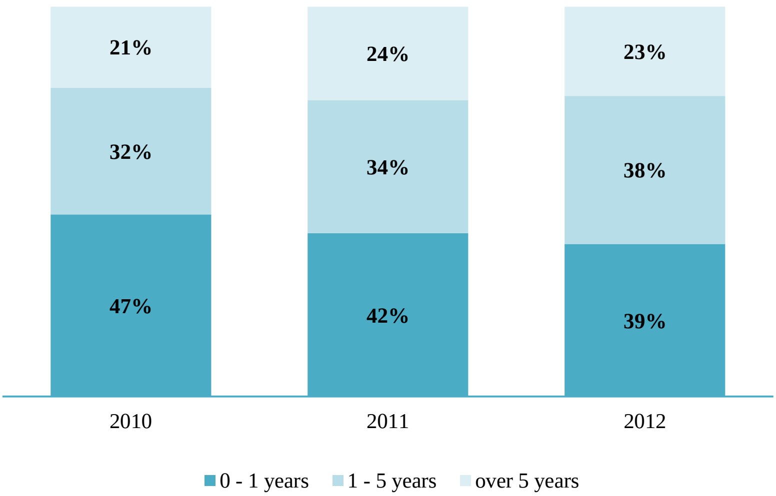

Fig. 4 Distribution of total gross loans according to remaining matury*
**Data source:* Official audited reports available on the bank's web presentations

What can be seen from the research is that the share of short-term investments decreases every year (in 2010 it was 47% while in 2012 it was 39%), while the share of loans with a maturity of over one year increases. This attests to the fact that the banks intend to do business on the territory of Serbia for a long time and that they are investing into our economy on the long run, which is certainly encouraging.

2.3. Concentration of risk by region

A bank, as an economic subject, never operates within one geographic area rather it operates through its network of branch offices which are geographically dispersed. Consequently there are those regions which are more profitable for banks and those that are less. Additionally, banks are active on the interbank market, both at home and abroad.

More developed regions carry less risk and therefore banks focus more on them. Looking at the operations of the 9 largest banks in Serbia the conclusion imposes itself that banks invest mainly in Belgrade and its surroundings, as well as in Vojvodina, with an emphasis on the South Bačka District. The Serbian economy cannot be satisfied with this policy because in this manner there isn't even a hidden hope that the situation in the economy of the less developed regions will improve.

The following chart (Figure 5) presents the geographical concentration of credit risk in the largest banks in Serbia (in billions of dinars):

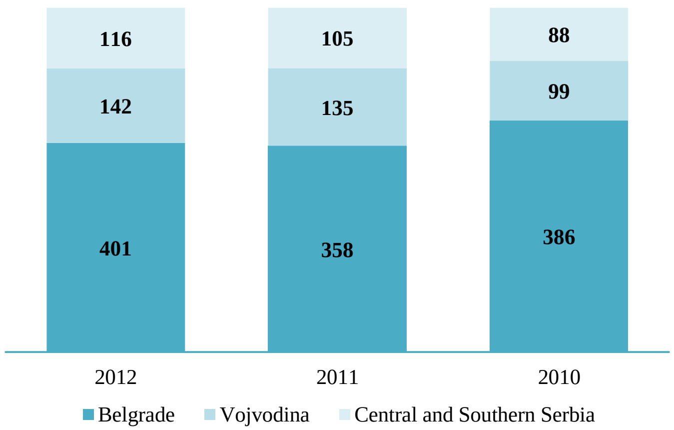

Fig. 5 Overview of the geographic concentration of the Serbian largest banks*
**Data source:* Official audited reports available on the bank's web presentations

As for investments into Serbia, leading are investments in and around Belgrade, as the largest and most developed region of Serbia. Investments in Vojvodina take a second place in the amount of investments by Serbian banks, while investments in other parts of Serbia (Central and Southern Serbia) are less represented.

Below (Figure 6) we present a summary of investments in Serbia, Europe and other countries, in billions of dinars.

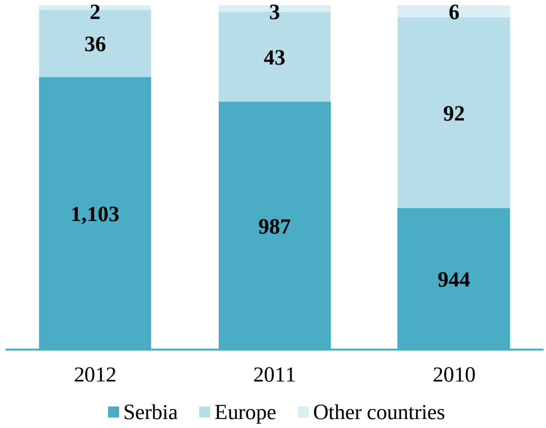

Fig. 6 Overview of the geographic concentration of the Serbian largest banks*

**Data source:* Official audited reports available on the bank's web presentations

As might be expected, banks in Serbia invest the most in Serbia. It is noticed that the investments in Serbia are increasing respectively, which again testifies to the fact that the banks are intent on staying and expanding their operations in this region. On the other hand, the fall in investment in European countries and other countries throughout the world is evident, which means that the Serbian banking industry lacks great power and still needs the help of foreign investors.

Conclusions

From the enclosed research we can conclude that in our country banks represent the main and almost only source of equity for industry, but those investments are insufficient due to the following facts:

- Serbian banks invest the most into the population.
- Out of all branches of industry the most is invested in mining and the processing industry.
- Traffic, catering and other service activities are also supported by Serbian banks.
- Serbian banks classify the construction industry and energy supply in the highest risk branches of industry.
- "There is hope" for the agricultural industry but the banks still hugely rely on state support.
- The banks feel the need of the industry for long-term investments, but as of yet have not made significant progress in terms of granting long term investments – although they have sense for the industry needs for restructuring/reprograming of the old loans.
- The industry can receive cash only in the short term.
- The banks will support you more often if you do business in Belgrade and Vojvodina than in Central and Southern Serbia.

All of the above stated facts indicate that the Serbian banks behave in a manner compliant with the macroeconomic conditions of the environment. They apply the safest investment scenario, *i.e.* take as few risks as possible. It is obvious that banks need support from their parent companies, as well as the support of the state. The crisis in the region has caused all of the above elements of a "vicious circle" to need financial help which is most difficult to receive. The only safe conclusion is that it is possible, even though you have lost several battles, to win the war.

The presented research clearly shows the trend that the largest banks in Serbia are increasing investments into the domestic economy. The amount of investment is not sufficient, just as the maturity of investments is not compatible with the real needs of industry. However, despite the fact that the diversification of the loan portfolio is insufficient and slow, the development of the region is not impossible. Respecting the fact that our economy and our country in general carry a great risk, the trend indicating that banks are willing to take a risk is encouraging, as evidenced by the presented investment growth both from the perspective of branches of industry and from the point of maturity of investments. The road is bumpy and slow but can bring expected progress.

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RIZIK KONCENTRACIJE PLASIRANIH SREDSTAVA NAJVEĆIH BANAKA SRBIJE

Činjenica da su se SAD u bliskoj prošlosti suočile sa finansijksim krahom što je dovelo do svetske ekonomske krize, kao i činjenica da je evrozona pre oko pet godina osetila finansijski krah Grčke, uzrokovale su da se stanje javnog sektora Srbije, kao i svih evrtopskih zemalja ozbiljno poljulja. Transakcije na novčanom tržištu su znatno opale, što je imalo za uticaj porast deviznih kurseva, opadanje kamatnih stopa, rast inflacije i pad BDP-a. To se sve reflektovalo i na privredu, u kojoj se drastično smanjio broj zaposlenih, što je imalo direktan uticaj na životni standard stanovništva. Sa smanjenjem životnog standarda, ljudi su u slabijoj mogućnosti da vraćaju uzete kredite, što opet može dovesti do neke globalne krize. Začarani krug je teško prekinuti, a evropska i svetska javnost usmeravaju svoje snage s jedne strane na oporavak privrede, a s druge strane na spašavanje banaka. U takvoj situaciji bankama nimalo nije lako odlučiti na koji način da optimizuju rizik kojem se izlažu tj. u koju industrijsku granu, na koji rok i u koju regiju je najoptimalnije plasirati sredstva. Autori su sproveli istraživanje čiji rezultati očitavaju trenutno stanje u Srbiji ali i trendove najvećih Srpskih banaka.

Ključne reči: *banka, kredit, koncentracija, rizik, delatnost, regija, ročnost*.

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