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Economic Theory

Valeriy HEYETS

**MODERNIZATION IN THE SYSTEM
«SOCIELTY – STATE – ECONOMY»**

Abstract

All common and contradictory in society, state and economy on the way to modernization transformation is analyzed; concerning all mentioned above, the role of personal-human factor in its transformation is defined. The influence of globalization on county development in cooperation with world and national is revealed. The role of state in unity of society and personality, its capacity to organize and implement the process of recourses usage and knowledge accumulation in combination of moral and mind, what can't be avoid without effective state and public control over processes of modernization is grounded. The public mood towards some constituents of social system of Ukraine is analyzed.

Key words:

Modernization transformation, national states, postmodern model, public conciseness, knowledge, mind, moral, human capital, social state, degree of state presence, state and public control.

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Part 1.
Feedback on the Methodology
of Modernisational Transformation

Modernization as a phenomenal process of transformations in the society, state and economy, as follows from its name, has the basic meaning of making them modern. Formation of the present state of society, according to the founding fathers of the modernization theory, among who are W. Rostow and Sh. Ensenstadt, is characterized by ascension from its traditional order to the modern one having a capitalist system of economy. That system is functioning against a background of a considerable social differentiation of the society due to the blatant and constantly increasing inequality in the distribution of wealth, high communication, constant progress in science and education allowing, at the expense of technological and social innovations in all sectors of social, public and economic activities, overcoming the naturally existing in many countries traditionality with a simultaneous, though not always successful, aspiration to conserve and develop the cultural differences. Thereby a non-interrupted modernization is endured (from pre-modernity to post-modernity) whose main characteristics for the present time were justified by I. Wallerstein.

Modernization related transformations in the economy whose sense, in the classical interpretation of the modernization theory, corresponds to the activities of an economic system based on the domination of the globally triumphant (as more efficient in the long run) capitalist forms of economic management. The main feature of the latter are market relations, which have also become global and dominant not only in the economy and finances, but, very often, in the social sphere. At the same time, there are processes of the formation of global regional unions of states with restrictions of the authorities of the national states against the background of a stronger transcontinental influence of the corporations resulting in lower competition and strengthening of their influence on the policy of national governments. And, while the regional unions, on the one hand, restrict the powers of national states, on the other hand, the powers of national are restricted by the transcontinentalization. And the powers of the national governments, in the modern world, are also restricted «on the third hand» because of the higher communication in social and economic activities due to the emergence of a wide community involved in global networks, which make it possible to generate and exchange information and expand people's direct and indirect mobility. That changes the essence of the modernization projects in the modern society, state and economy, because the traditional cultural and behavioral values are affected by the increasingly active and aggressive exogenous influence. The traditional mechanisms of the propagation of values, in their turn, are being destroyed

by those very global nets due to «... sometimes even pathological combination of the real and virtual worlds in the mind of a network addict. The psychiatrists of the whole world realize this truly global invisible danger of «soft» mental and social degradation of hundreds million people, which is comparable to drug addiction...»¹.

Against the background of such transformations, implementing, under the influence of the electronic inventions, a post-modernization model of the development of a post-industrial society, «in the age of the global transition to a new civilization (characterized, among other things, by the appearance of synthesized forms of organic life without clear consequences for its natural forms, – V.H)», it is very important not to lose the intellectual and psychological potential accumulated during millions years of biological evolution and thousands years of human history. It will be very much needed in the large scale future changes...»², which, regardless their names, in their essence, will be very similar to the ongoing processes of the modernization of the life of society, state and economy, i.e., will be another modernization.

Presently, the modern society under modernization does not really control market and corporations, because «... in a market economy, organizations representing a certain interest act using rent-seeking methods, i.e. getting profit from its members from the society as a whole without offering anything for exchange... They will only abstain from such behavior only in case if, in the given society, their membership is so widespread... that they have to assume any negative externalities of their own actions»³. C. Crouch points out that success in the struggle for abstaining from getting additional profit at the expense of the infringement of the society's interests was ensured by the state on whose territory the corresponding organizations operated. In the modern transnationalized world «... the role that the giant firms are able to play (and they do – V. H.) in the global economy makes them extremely powerful lobbies threatening the equilibrium of both democracy and pluralism»⁴. That shows up especially strongly in the poor countries with weak and very often frustrated governments because «...representatives of the modern TNC are outside the lobbies..., they ... are inside the house where these decisions are made. They define standards, establish private regulating systems, work as government advisors, and they officers even occupy the positions of deputy ministers»⁵. The latter serves an example of how corporatism establishes control over the state, undermining its morale, while the society, agreeing with democratic election of the power, falls under the gov-

¹ Andreev I., Nazarova L. Electronic trap. Real pictures of the virtual world (Russian) // Svobodnaya Mysl. – 2014. – No 1. – P. 121.

² Ibid. – P. 126.

³ Colin Crouch. The Strange Non-Death of Neo-Liberalism» (Russian). – Moscow : Publishing House «Delo», 2012. – P. 194.

⁴ Ibid. – P. 198.

⁵ Ibid. – P. 198.

ernance of the corporately organized markets, which, as a matter of fact, are engaged in political activities. Such a situation is a serious failure of both market and state. Thereby the sense of modernization is changed in such a way that man's behavior in consumption society contradicts his positive evolution. Here, the most important is the fact that the social (none individualized) demands are satisfied secondarily. But satisfying such demands is one of the most important conditions of simultaneous modernization of society and economy, because the level of their satisfaction greatly affects the state of things in the society, state, and in economy, because, according to F. Bastia, the so called «abilities of collective improvement» are lost. In this context, F. Bastia pointed out that «...if the union of all individual improvements, especially with people who can transfer their increases in knowledge and experience to other people, did not guarantee the abilities of collective improvement, then people would have to refuse any philosophy and any science of morale and policy. Man improves thanks to his abilities to pass from mistake, that matter of evil, to truth, that accumulator of good»⁶. All that, in F. Bastia's opinion, is carried out thanks to science and experience.

It is very often considered that the state, as a whole institution or as a complex of institutionalized standards norms and organizations, in the end, is an incarnation of willpower, while such a state's property as «education» is a result of exogenous borrowings from people who act as «holders» and carriers of intellect, which can accumulate both in people and in the society as a whole, in so doing shaping the social conscience.

Thus the process of individual self-improvement and self-development is realized as «Man first passes, in his mind, from mistake to truth, and then, in his behavior, from evil to good, thanks to science and experience, and thanks to the discovery of previously unknown to him effects in certain phenomena and in his own actions»⁷. It is difficult not to agree with that statement, because any level of evil bringing about opposition, wars and victims, eventually ends with peace, during whose preparation and conclusion past mistakes are realized and the parties look for truth, which allows accumulating good. Thus righteousness and mind are combined and not only in the course of self-improvement, but also as a result of the government's efforts. «Growth of welfare state has led to the situation, when some professional services, especially in the sphere of education and health care were transferred the state sector, where they became accessible for most people and joined the rest of the public services»⁸. Thus, thanks to the state with its capacity to organization and promotion of knowledge accumulation, capital turns from the instrument of coercion and exploitation of labor into human capital, which, in many countries, has much greater accumulated value than the physical

⁶ Bastia F. Economic harmonies. (Russian). – Moscow : Eksmo, 2007. – P. 415.

⁷ Ibid. – P. 415.

⁸ Colin Crouch. The Strange Non-Death of Neo-Liberalism» (Russian). – Moscow : Publishing House «Delo», 2012. – P. 134.

capital. Besides, the latter, due to the crises, loses its value both over time and «over space».

In the process of the accumulation of human capital, on the individual level, the situation is quite possible, when, according to Schiller, an individual may have a propensity to prudent behavior, but, in the crowd, such behavior makes his or her stupid person unable to behave prudently. One can state that, to avoid the above situation, society and state should base their modernization on the interests of individuals living in the given society and functioning in the given state.

Thus an organic unity of social and individual interest is attained, because, according to P. Florensky, «if mind has nothing to do with being, then being has nothing to do with mind either, which is illogical. Then illusionism and all kinds of nihilism are inevitable ending up with slack. The only way out of that swamp of relativity and conventionality consists in recognizing that mind has to do with being and being have to do with mind.»⁹ And «whatever we think about human mind, we always have the possibility to state that it is a human organ, human's live activity and human's real power»¹⁰ And, thanks to mind, cognition is «live moral dialogue between personalities, each of who acts both as object and agent. As such, only personality is cognoscible and only by personality. In other words, essential cognition comprehended as an act by the cognizing agent, and essential truths comprehended as a cognoscible real object are the same in reality, though different in an abstractive mind»¹¹.

On the basis of the above statement, the act of cognition carried out by the cognizing agent based on his natural possession of his mind represents his cognitive activity, which is a real force identical to the productive force of man's labor, because, as was mentioned above «mind has to do with being and being has to do with mind». Due to such an interaction, in the society, social conscience emerges, which, in turn, develops under the influence of the cognitive activities performed by people, who live in the society (which is part of nature) and create states expressing the interests of the whole people by implementing their political will. In this case, the state is characterized by high moral values, education and well developed mind, because the latter, as stated above, «has to do with being and being has to do with mind» not only as human's organ, but also due to his or her live activities. In reality, such an interconnection is quite realistic, because state, as a rule, expresses the will and interests of the ruling class. In this context, it is important to consider, following the same methodological approach (and taking into account, that, beside society and state, there is the third by importance phenomenon, namely economy, which, together with society

⁹ Florenskiy P. Pillar and Affirmation of the Truth (Russian). – Moscow : Golden-Ship.ru, 2013. – P. 38–39.

¹⁰ Ibid. – P. 39.

¹¹ Ibid. – P. 39.

and state is in the process of phenomenological interaction and development¹²), the problem of mind and education and, correspondingly, the problem of the state's moral in the context of the interaction between capital (as market), state and knowledge (as a result of cognition). The process of the unification of all the three above mentioned phenomena (capital, state and knowledge as a product of human mind's activities, i.e. creative work) takes place in their non-contradictory interaction in case of the conversion of human creative capacities from the means of profit maximization into human capital raising the real production power of human labor.

Knowledge as labor's productive force is accumulated by the humanity and is most efficiently concentrated for the purposes of economic and social development, due to their badly organized and spontaneous character (according to Hayek) by the market forces competing against each other. At the same time, F. Hayek considers that both social activities and economic interaction of market forces do not exclude a «mental» origin of the interaction between the market agents¹³. However, F. Hayek himself always remained on Hume's positions of the secondary character of mind¹⁴, which allowed him to deny the «mental» origin of the interaction with all ensuing consequences to shape the managerial paradigm, first of all, in the economy. The erroneous character of the opinion of the limited creative power of mind was proven as early as in late XIX century by W. Jameson in his work devoted to the scientific foundations of psychology.¹⁵

F. Hayek's philosophy deals with the managerial aspect of the use of the knowledge resource for the purpose of modernization exclusively within the market and market relations. The knowledge resource, as is known, is multidimensional, and knowledge is, at the same time, a force, and a power, which may be both democratic and authoritarian, and in each case, it can both use knowledge and affect its formation as a development resource, which is impossible to use within Hume's interpretation of the power of mind, i.e. a mind that only can unite, move, increase or decrease the material. However, in the managerial context of modernization, J. Mill, a no less famous authority in justifying the dominant role of democracy and market forces (based on the individualization of the activities of market agents) proceeded from the following assumptions: «...the first element of good governance is the moral and intelligence of the people who form the society, the most important business where an outstanding skills would be manifested (which may be possesses by any form of governance) is the cooperation if

¹² Heyets V. Society, State, Economy: Phenomenology of Development, 2nd Edition, complemented and revised (Russian). – Moscow : Ekonomika, 2014. – 631 p.

¹³ Hayek F. The Fatal Conceit: The Errors of Socialism (Russian). – Moscow : Catallaxy, 1992. – P. 18.

¹⁴ Hume D. Enquiry Concerning Human Understanding (Russian). – Moscow : Progress, 1995. – 75 p.

¹⁵ Jameson W. Scientific Bases of Psychology. – Minsk : Harvest, 2008. – P. 387.

the development of moral and intelligence of the people themselves»¹⁶. Thus J. Mill, without denying the effect of market forces, but rather supporting it and without advocating the socialist system of management (opposed by F. Hayek) did not either advocate (as F. Hayek did) the efficient managerial system determined by market forces. In fact, he tended to a system dominated by people's mental activities and their moral values as opposed to selfish behavior based on individually organized cooperation which, as is well known, under market conditions, has both rational and irrational dimensions. During crises, which are usual in a market economy, the irrationality on the behavior of market agents sharply increases, which leads to the increase in the state's role. That is especially important taking into account the fact that A. Smith's state is a result of a social contract hence it should protect public morals, for which purpose it should promote the development of science, education and culture (which is often the case in reality).

As we can see, the founders of liberal democracy too consider the knowledge as a substance whose accumulation and assimilation raise the capacities of the productive force of human labor regardless the current form of governance, provided the society is guided by moral values (as pointed out by J. Mill), and not only by market selfishness. Thus, if, according to F. Hayek, the human activities are primarily guided by mental interaction (cooperation), which is the most efficient thanks to market forces, then, according to J. Mill, the first element of good management is the cooperation of human minds in organic combination with their ethic. As a result, a simultaneous unification and manifestation, in the form of governance, of both human moral and mind, in modern interpretation, are possible on the condition of the «enlighten» character of the predominant form of governance.

In sum, it follows from the above, that, while, for F. Hayek, the key role in the governance is performed by market forces, then, for J. Mill, any form of governance may be efficient, provided there takes place a cooperation based on moral values and intelligence, which should be characteristic for any form of governance, where they are present. Moral values and mind shape the ethic based foundations of the form of governance, which, unfortunately, have not properly developed in real practice that is dominated by selfish relations often leading to a variety of crises (which is testified by the recent global systemic crisis). The latter statement, in our opinion, is more expressive and exact, as the market forces, which presently dominate, are very often driven to absurd, that is, are completely irrational, that is why, «...capital is obtained through replacement and destruction of real economy ...enrichment leads to failures of the financial system of the real sector of the economy, which, in turn, leads to an intensive accumulation of property, ... because the main political measures in the sphere of economy (and also in the sphere of economic management, as mentioned below. – V. H.). Ef-

¹⁶ Mill J. S. Consideration on Representative Government. – London : Parker, Son, and Bourn, 1861. – P. 12.

fectively support that process»¹⁷. That means that it is exactly the form of governance that should be, first of all, characterized by co-existence and cooperation based on the morale and intelligence of the people, who, strictly speaking, are engaged in managerial activities in their predominant form. That form should be chosen due to intellectual activities of people united in a society as a result of their escape from the natural environment and unification in the institution of state as a result of their conscious choice based on their knowledge. That is, if we speak about modernization of a state, such a state first of all, should be characterized by «educatedness», which unites morale and intelligence in the people exercising the powers. At the same time, «educatedness» is not inherent for the state as such, because it is in the state's hierarchy, and state's hierarchy is will and power, so the state «consumes» «educatedness» not from inside itself, but from outside. That is why the state does not ensure «educatedness» automatically by uniting ethics and intelligence. The process is different because ethics as such is related to the sensitively conscious and non-verbal genetic layer of human intelligence and hence with the system of non-formal institutions, while morale is related to the verbal-and-theoretical layer and, correspondingly, to the doctrinal institutions. Obviously, one of the main guidelines of the state's modernization is exactly the adequate formalization of the non-formal institutions, i.e. bringing the state legislation, law, and morale into accordance with the society's basic imperatives, as well as subduing the upper class morale to the standards of the majority of the citizens. Actually, in this context, it is important to be based on the principle that the bulk of the responsibility for morale lays on the state as the institute acting from the position of the power of law on the whole and power of authority in particular (as well as the power of knowledge). So the state bears that responsibility both before the individuals who have chosen it and before the economic agents, because the economic activities take place within certain institutional and legal standards, which are institutionally conditioned and socially recognized in each concrete period in accordance with the moral imperatives of the society, where the state has been created, being that state the reality of a certain moral concept and its moral spirit¹⁸. Protecting the public morale, the state promotes the revival of and directly participates in the creation and support of people's intellectual activities through science and education. In so doing, it ensures the performance of the functions determining its economic and public institutional identity, including as regards modernization. In this context, it is not occasional that the cognition is based on the combination of the sensuous (moral) and natural ways of getting the knowledge about the outward material and spiritual worlds and about technological achievements of the material world and social innovations, which, as a rule, combine to raise the productive power of labor.

¹⁷ Derivatives are Destroying the Real Economy / Mixednews. – 14.11.2013. – <http://mixednews.ru/archives/44097>

¹⁸ Hegel G. W. F. Elements of the Philosophy of Right (Russian). – Moscow : Mysl, 1990. – 526 p.

State activities and the restriction of the state's contrariness representing the interests of the ruling class, and, in earlier periods, of the absolute power of a monarch or ruling class, including the despotic forms, has been one of the most important tasks in any time. It is exactly because of that reason, that A. Smith's moral philosophy¹⁹ (deepened by J. Mill with his conclusion on the necessity to combine morale and intelligence for any system of governance, in parallel with the market environment) is a result, first of all, of the state activities directed, among other things, to ensure the satisfaction of social needs whose extent serves as a measure of morale and intelligence of the system of governance.

An individual, relying on the accumulated knowledge, on the one hand, constructs his rational behavior aimed at attaining his objectives, but, on the other hand, should not cross a certain moral line, beyond which the aspiration to get profit and accumulate wealth maximizes, because «...the possibility to overcome the strongest aspiration of self-affection: a more powerful force and more stimulating motive act in this case. That force is intelligence, our conscience, our own observer in our soul, a man inside us, a big judge and valuer of our behavior»²⁰.

As we can see, A. Smith places intelligence in the basis of the statement on individual behavior determined by the fight against selfishness. In A. Smith's interpretation, intelligence is a result of «educatedness» transformed from «enlighten despotism» to «socially organized market economy» based on freedom and democracy with the recognition of the need to solve the problem of social inequity and provision of socially significant services and goods and with the government promotion of the development of science and education. As a result, both society, state and individual understand the benefit of the fact that knowledge is that social good, the responsibility for whose supply, in most cases, lies with the state, if not completely, then in the interaction with private initiatives and private expenditures on education and science. History knows a huge amount of examples when, due to the government's efforts, it was possible to attain breakthroughs in technology, while market could only use them, to get profit, much later. Here lies the deep contents of socialization (may be also interpreted as modernization) of modern social and economic life both in the state and in the individual sense, which is the basis of human morale and intelligence on the way to Mill's understanding of good governance, where, at a certain stage, «enlighten despotism» played a role, and, presently, it is an «enlighten state», which should solve the dilemma of modern socialization in all its manifestations, because «...the world is in the midst of several epic transitions. Economic growth patterns, the geopolitical landscape, the social contract that binds people together, and our planet's ecosystem are all undergoing radical, simultaneous transformations, generating anxiety and, in many places, turmoil... Ultimately, however, the path

¹⁹ Smith A. The Theory of Moral Sentiments (Russian). – Moscow : Respublika, 1997. – 352 p.

²⁰ Ibid. – P. 150.

to sustained growth requires not just new policies, but also a new mindset»²¹. Which means that, without Mill's morale and mind, successful future is doubtful, because the modern market deepening, on the global scale, its dominance exerting «...far reaching influence destroys democracy, very unequal societies have higher alcohol and drug addiction, higher crime, lower morale, higher teenage pregnancy and lower literacy than those with lesser inequality»²².

The context of the above formulated statement about the closeness of socialization to modernization may and should be doubted in the part that any socialization could be compared with modernization. For example, can the Stalinist industrialization be simultaneously considered socialization? Besides, if a state is to modernize in accordance with people's needs, then how does it fit with the statement about the insufficiency of social capital for carrying out modernization? An example may serve the fact that socialization in the modern transition society (in the process of the formation of a socially oriented market economy) led to the situation where the society incurred considerable social losses, and, in essence, the market oriented transformation itself appeared to be not only lacking any social orientation or at least neutral, but often a socially aggressive market model with a high degree of appropriation, and uneven distribution of profit and wealth. It was not accidental, that appropriation of the state took place not only in the form of primitive plundering of its resources, but also through the establishment of monopolistic control both over most of the country's resources and over the authorities in order to accumulate even more wealth. The consequence was a horrifying differentiation of people's living standards and lifestyle causing extreme popular displeasure, which testifies about irrational behavior of market agents in the society under transformation with threatening consequences for the country (which was discussed above).

At the same time, individual's rational behavior, in the presence of a social state, should rely on the laws, standards and traditions as well as habits again based on the intelligence. That is a consequence of the use of the accumulated knowledge about the past, the present and even forecasted future not only in terms of acquiring scientific knowledge about the material world, but also about possible change on the ontological model in the future as the latter is based «... on the aspiration to risk minimization and absolutisation of untouchability, before our eyes, is turning into its antithesis»²³. Correspondingly, the task consists in creating «...a new social ontology (based on social protest activities **V.H**)...», look-

²¹ Klaus Schwab (Founder, Executive Chairman, World economic Forum). The Global economy in 2014. Project Syndicate / 13.01.2014. <http://www.project-syndicate.org/commentary/klaus-schwab-warns-that-the-world-is-entering-an-era-of-diminished-expectations-and-increased-uncertainty>.

²² Graham Peebles. Inequality and the Inevitable Collapse: graham@thecreatetrust.org.

²³ Sergeev K. What Is Impossible to Speak About: the Phenomenon of «Unspoken Requirements» and Modern Risks in the Modern Society (Russian) // Polis. – 2013. – No 4. – P. 42.

ing at it from a distance as at a possible concept, and not as at an inevitable mental reality. One should not fear the clutter of the approaching events, but start thinking about it»²⁴. If we do not think (with our mind) about the future ontology, we may expect the absence of such a proper state at all or its individual elements, such as the standards shaped on the basis of traditions and habits, as well as the experience of past generations, which is part of the same process of the accumulation of knowledge producing good governance based on morale and intelligence. Otherwise there develops a despotic state constantly changing its character and even in its liberal form able to expand with the official support in the form of various kinds of directives, instructions, and standards etc., which are compulsory or even forcibly enacted. Such an expansion may have a modern form and be embodied in a single person or in a group of people or the state with its institutions, which hardly share the popular habits, morale, and traditions (despite the fact that the latter are usually more stable to changes, as they had been naturally shaped based on the accumulated knowledge and experience).

The state with its institutions, under the influence of the economic groups enriching themselves from the public funds, fail to exert a proper influence on the process of socialization, but only increase people's protest activities and aggressiveness, which may cause a change of the current ontological model, as was mentioned above.

The mechanisms of education, i.e. transfer of knowledge through a social system of the support of traditions via private and public educational institutions, are self-reproducible. Thus man socializes²⁵ in the modern sense thanks to the development of the system of institutions and institutional actions, traditions, habits, customs and laws. All that is a result of the accumulation of knowledge constantly turning from creative to everyday, which makes it possible for man to socialize. His behavior becomes a process of modernization, both economic and social, where the state can and should be active showing high moral standards in performing its functions based on knowledge and retaining and developing individual and collective national differences. Such differences serve as a guarantee of national identity in the constantly globalizing world by keeping national social traditions against the background of the general economization of most spheres of human life.

As regards the state, the morale in the activities of people and organizations that represent it is related not only to the protection of human rights and freedoms, but also to the fact that the liberal-and-democratic doctrine of the state and economic organization, with low morale, leads to a huge stratification. That is

²⁴ Sergeev K. What Is Impossible to Speak About: the Phenomenon of «Unspoken Requirements» and Modern Risks in the Modern Society (Russian) // Polis. – 2013. – No 4. – P. 42.

²⁵ Heyets V. Institutions of Socialization in Ukraine and CIS Countries: Tendencies and Key Differences (Ukrainian) // Ukrainskyi Socium. – 2011. – No 2. – P. 7–34; No 3. – P. 7–34.

on the one hand. On the other hand, as Vandana Shiva writes, economic growth, which is extremely wished by economists, businessmen and policy makers, destroys life²⁶. And that, as professor M. Chossudovsky from the Center of Globalistic Studies in Montreal argues, is not due to the development of the real economy, but due to the formalized thievery, manipulations and speculations making it possible for the rich to enrich even more.

On the way to solve the constantly reproducing contradiction between poverty and wealth is the doctrine of «social state», a notion, according to Lorenzo von Stein (mid-XIX century) related to the ideology that equality and freedom should be attained and the disadvantaged should be ascended to the level of the rich and strong, because the well know axiom about conscientious individual and market agents is quite limited because of the persistent propensities to getting privileges for raising incomes and wealth under massive imperfect competition on the markets and irrational behavior of the market agents (especially under the modern conditions, when transnationalization decreases the competition and promotes monopolism). In such a situation, individualization of the behavior of economic agents leads to the rupture of the ties between morale and intelligence, and, in case of the refusal from social state, it will be replaced by the concept of the survival of not only the stronger ones, but also the more clever one, which involves manipulation and direct theft and raises the social protest activities leading, as K. Sergeev argues in the above mentioned article, to the idea of non-judicial punishment of the guilty, which is often the case presently. All that together has caused the existing systemic crisis, the fight against which has not been very successful so far, because, as M. Faber and many others consider, the global economy is today worse than it was in 2008²⁷. And, as Christine Lagarde argued at the Davos Forum in 2014, now it is still early to speak about a revival of the world economy. It is not excluded, that the beginning of a stable and long recovery has been postponed until the 30th of XXI century, when the technologies of the VI and VII technological waves will be massively used. These technologies have still unclear consequences for the modern society, as they, according to modern assessments, may cause a lot of troubles threatening man's existence not only with unclear consequences and «achievements» of future social technologies, but also with radical changes in human mind. We will dwell upon these issues later. It is not excluded that «Karl Marx was right speaking that as long as capitalism flattens out, crises will be increasingly ruinous and the last eventual crisis will lead to the final collapse, whose consequences will be so destructive that the very foundations of our capitalist society will be undermined»²⁸. That is especially strongly manifested in selected

²⁶ Vandana Shiva. How economic growth has become anti-life // The Guardian. – 02.11.2013.

²⁷ Faber Mark. Global Economy Today is Worse than in 2008 (Russian). – <http://smart-ab.ru/company/aforex/blog/150141.php>.

²⁸ Faber Mark. Marx Was Probably Right (Russian). – <http://mixednews.ru/archives/44105>.

emerging markets, where economic agents operate in a non-equilibrium system of coordinates, which is the reason why the population is often against capitalism (see Table 1), though the ideology of the reforms in the former socialist countries was based on the concept that the capitalist system of economy is the best and «...at the same time, the most advanced type of social (economic, societal and, at the same time, political) development and type of society representing for the states and peoples of different civilization as a model and example of existence»²⁹ with a simultaneously shaping, under that influence, unrealized dream of attaining the living standards and social relations characteristic for the consumption society of the developed countries. In reality, the result appeared to be quite different from the desirable. But the main thing is that, no matter how successful the market reforms in transition societies may be, attaining the living standards of the developed countries is impossible because the planet's natural resources today and especially tomorrow are clearly insufficient for that purpose either with the current technological paradigm or even with the future one.

(To be continued in next issue)

The article was received on May 27, 2014.

²⁹ Гранин Ю. Меняем «бусы» на нефть // Свободная мысль. – 2014. – № 1. – С.190.

*Economic Theory*

Iryna MARKOVYCH

**ECONOMIC FREEDOM
AND ECONOMIC DEVELOPMENT:
THEORETICAL-EMPIRICAL RESEARCH
OF CONNECTION****Abstract**

The article analyzes the existing theoretical and empirical approaches to the concept of economic freedom and its importance in the evolution of the country. The results of the identification of dependencies between indicators of economic freedom of the countries and individual indicators of their economic development were discovered. It was found the typical direct links between the expansion of economic freedom and the welfare of the population for the majority of the countries.

Key words:

Economic freedom, economic development, economic growth.

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The establishing of the problem in general and its' links to important scientific and practical tasks. Given the current dynamics of change of configurations of exogenous factors in the development of national economy, the ambiguity of their impact on certain areas of economic activity, contradiction of connection between them globally, the growing importance goes to the research of the indicators of individual performance of the condition of the country and the search for the connection between them and the dynamics of the results of operation of the national economy.

One of the features of modern institutionalism and priorities of the society's development is freedom in all its forms, including economic freedom. The high level of economic freedom as the immanent quality of a liberalized society is formed by the combination of factors of macro and geo-levels that are very unstable over time. Due to this feature, tracking fluctuations of values of qualitative and quantitative indicators of the global economy is a task for researchers at all levels who are pursuing the goal of forming the efficiently functioning economic systems.

Due to the ambiguity of the findings from studies of effects of expanding economic liberties, the debates in this area of economic research are going on with all the greater enthusiasm, as finding the most suitable method for each country and vector management of national economy should be based on clear theoretical and empirical foundations.

The analysis of publications on these problems. Today there are many scientific researches, where the authors have directly linked the growth and prosperity of the country with a certain level of economic freedom or with strong influence of the state. For example, studies by J. Scully (Scully, 1988, Scully, 1992), R. Barro (Barro, Sala-i-Martin, 1991), K. Sala-i-Martin (Barro, Sala-i-Martin, 1991) show that well-defined property rights, state policy, which contributes to the protection of these rights and the rule of law, and economic freedom is the core of the state.

According to some Australian authors (Doucouliagos, Ulubasoglu, 2006), regardless of the sample countries, the level of economic freedom and the level of aggregation, it has founded persistent positive association between economic freedom and economic growth. Also, they have shown that economic freedom has a much greater impact on economic growth than political freedom, which accentuates scientific attention to trends and opportunities to expand economic freedom at all levels.

Important plane, which addresses the consequences of achieving a certain level of economic freedom of the state, is the enrichment of the population. N. Berggren (Berggren, 2003) showed that with high levels of economic freedom

in a society enriched by all groups equally. If the low level of economic freedom – it would benefit only a few layers and can be amplified uneven development. Also Grubel H. discovered links between the degree of economic freedom (calculated by the method of Fraser Institute) and the level of income, their growth, reduction of unemployment and human development (Grubel, 2008). The same result was reached by Henke, H., Walters S. (Hanke and Walters, 1997) and Leschke M. (Leschke, 2000).

A study of the nature of the impact of economic freedom on economic growth is also interesting, especially the justification that economic freedom (or changes in its values) directly and indirectly may affect the final outcome of the correlations. In particular, researchers validate that economic freedom can exert both direct impact on growth and, also, indirect – in countries where economic freedom is greater (or where its change is more noticeable) rates on investment are higher (Gwartney et.al., 2004, Dawson, 1998). Furthermore, economic freedom produces an indirect positive effect on economic growth through physical capital.

Some researchers (Bhagwati, 1998) believe that «... economic freedom has a favourable impact on economic development, as international experience of the past fifty years confirms the fact that the countries which have more developed market institutions formed more open policy on foreign trade and investments tend to thrive. Conversely, those that are focused solely on domestic markets, coupled with significant state regulation of the economic processes, exhibit poor growth rates».

However, for objectivity, it should mention those studies that showed no statistically significant relationship between indicators of economic freedom and growth. For example, J. Gwartney, R. Lawson and R. Holcombe (Gwartney et al., 1998) concluded that economic growth can not be precisely predicted from the available extensions of economic freedom. A similar opinion is shared by some other researchers (Wu and Otto, 1998, Heckelman, 2000).

Ambiguity of the nature and density of relations is partly explained by the presence of a huge number of interrelated variables that affect economic growth. This causes instability results – due to certain factors included in the model, the time frame and sample of the countries, weight rating of individual variables can vary significantly.

Among national researchers of the state of economic freedom we should name B. Heyets (Heyets, 2010), A. Chukhno (Chukhno, 2001), I. Bulyeyev (Bulyeyev, 2005) and others who indicate that limiting the economic freedom to only domestic level is illegitimate and emphasize the importance of its manifestation in all spheres of life of the individual – social, political, spiritual, etc.

Taking into account the growing tension of the global environment, the belief that economic methodology should take a central system characteristics of man as

the main subject of economic processes, is becoming more powerful. In this context, we should mention Erich Fromm (Fromm, 2003), who in his book «Escape from Freedom» pointed out that «...human history – is a history of increasing individualization and yet more and more individual freedom», the essence of individualism is to ensure that the development of individual freedom is the «...the ultimate goal, that can not be subordinated to other allegedly more worthy goals».

However, a large number of theoretical and practical studies are still not able to build unambiguous specification of factors influencing the growth of the country in a modern economic theory, so it requires further work in this field.

The wording of goals of this article. Given the controversy regarding the effectiveness of specific tools and instruments of macroeconomic policy, the existing theoretical and empirical researches should extend towards identifying patterns of change in the intensity and nature of the relationship between indicators of economic freedom and individual indicators of economic development.

The main material with full justification of obtained scientific results. In recent years the attention of scholars to the economic freedom of the individual, society and the country has increased significantly. The importance of economic freedom of the country as one of the determinants of modern progressive society comes from a number of theoretical and practical aspects of the implementation of public policy and also principles of functioning of the country in the system of the international economic relations.

Economic freedom is an indicator the economy's ability to market, which is a measure of availability of functioning on voluntary basis, at the same time it is a partial measure of the degree of efficiency of the legal system; it displays the results of the fiscal arm of government regulation, etc.

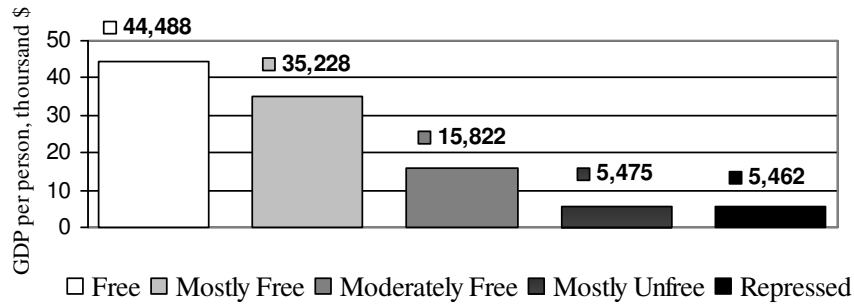
Today the question of determining the optimality of economic freedom acquires new aspects, given the strengthening of international relations and regionalization of world economy. Within the economic theory the researchers are developing concepts that take into account the ideological confrontation of approaches to public administration as the leading factor of economic growth and the free activity of the market participants, that is one of the research areas of the of economic freedom of the country.

The most commonly used gauges of economic freedom of the country, which are used in researches, are the two indexes – Index of Economic Freedom, which is calculated by the American Research Institute the Heritage Foundation, the other – the Index of Economic Freedom in the World, published by the Fraser Institute.

The Heritage Foundation shows patterns in the relation between the economic freedom and the well-being indicators, including GDP per capita (Figure 1), which are important in understanding of the relationships between the dynamics economic freedom and development of the country.

Figure 1

GDP per capita of the countries in terms of the size of the Index of Economic Freedom (according to the Heritage Foundation)



Source: author's calculations based on data of Heritage.orgio

Despite the differences in the calculation of the index of economic freedom between the Heritage Foundation and the Fraser Institute, the latter made similar findings: in countries with greater economic freedom GDP per capita is higher than in other states.

One of the problems identifying the link between the factorial and effective parameters is the correct choice of the parameters of the study model. As for the Index of Economic Freedom, from a certain point of view, they are quite strongly aggregated, which in some cases makes them not quite adequate for analysis and forecasting (De Haan and Sturm, 2007).

Some researchers propose to seek out dependencies not just between the absolute value of the index of economic freedom and individual indicators of the national economy, but also to conduct disaggregation of this indicator and to identify what impact makes each of the components of economic freedom separately.

In the investigation we have carried out the analysis of the direction and intensity of the effects of absolute and relative values of the Index of Economic Freedom of the country on the size of GDP, GDP per capita and changes in these standards. The main objective of the research was to identify the direct connection between the Index of economic freedom and individual indicators of the country's development. Versatile empirical analysis of the connection character makes it possible to justify a position that balances the theoretical discussion issues aspects.

For the calculation, the Index of economic freedom in the world was used (Economic freedom in the World) (EFW), published by the Fraser Institute in Canada. Integral index measures the degree of economic freedom in five major areas: the size of the state (EF1), legal system and security of property rights (EF2), sound money (EF3), freedom to trade internationally (EF4), regulation (EF5). These 5 areas are divided into 24 components, which in turn also consist of several indicators.

In general, to calculate the index data for 42 variables are used. Each variable is assigned a value from 0 to 10. Their average value determines the level of each component. Assessment area is calculated as the average of all components.

Gradation of the countries is carried out according to the scale:

- a high level of economic freedom ($EFW \geq 8$);
- above average level of economic freedom ($6 \leq EFW < 8$);
- below average level of economic freedom ($4 \leq EFW < 6$);
- low level of economic freedom ($EFW < 4$).

For this study we used panel data as cross-sectional, makes it impossible to draw conclusions about long-term trends and dependencies. In addition, using panel data, we can expand the sample of observations, allowing us to achieve a high level of adequacy of econometric models.

Evaluation of the relationships between the Index of Economic Freedom and GDP per capita was carried out according to the data of 112 countries over a 12-year period (2000–2011). Descriptive statistics of the input data is given in Table 1.

The equation between EFW and the level of GDP per capita is calculated (linear regression $y = 10144x - 55902$ ($R^2=0,3313$); exponential dependence $y=0,0083x^{6,9448}$ ($R^2=0,4449$) is an empirical confirmation of theoretical assumptions regarding large amounts of GDP per capita in countries with higher levels of economic freedom.

In order to detect differences in the type of relationships between economic freedom and the level of GDP per capita for countries with different levels of it, it's advisable to divide the entire set of data for the level of the index into 2 groups – the counties with an index of economic freedom in the range [2.5- 5, 5] and [5.5- 10.0] (according to gradation of Fraser Institute) and to construct the correlation field (Figure 2 and Figure 4).

For the countries with low and lower than average level of the Index of Economic Freedom, connection between this index and GDP per capita is nearly invisible, which can be explained, firstly, by the insufficient sample data to dem-

onstrate a clear trend dependency (285 surveys), secondly, by the insufficient correlation associated with the presence of provisional 3 zones, countries in which differ in the priorities of state policy (Fig. 2).

Zone I includes data for countries for which the low level of economic freedom is combined with an extremely low level of GDP per capita. This group includes Zimbabwe and Myanmar, which belong to the least developed countries in the world with serious economic, social and political problems.

Table 1

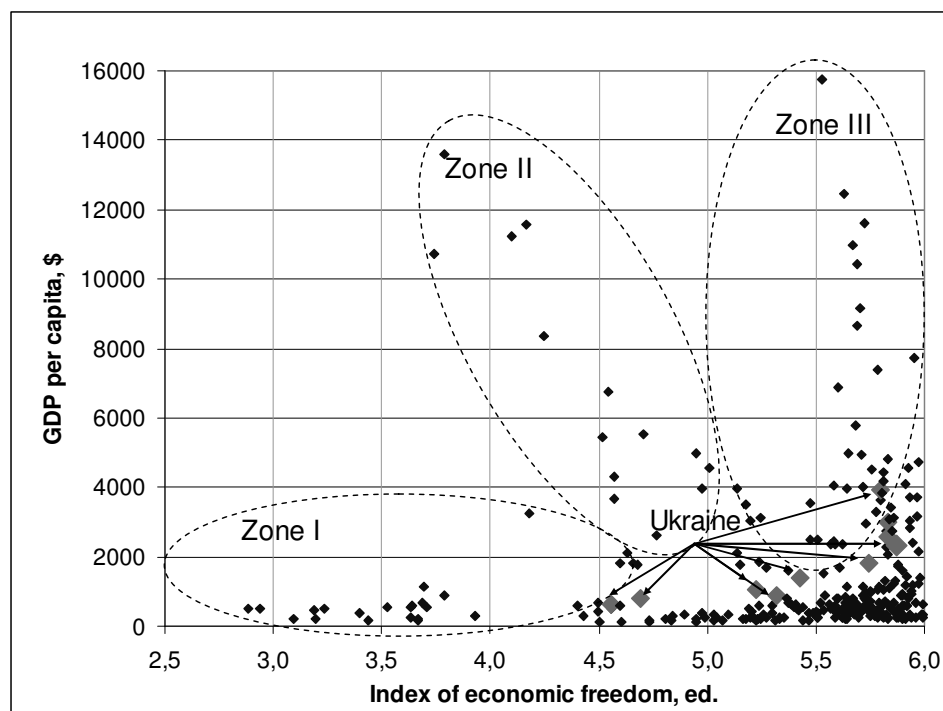
Descriptive statistics of the input data

Index	Maximum	Minimum	Average	The standard deviation	Number of studies
The Index of Economic Freedom, ed.	8.74	2.88	6.74	0.96	1344
Change in the index of economic freedom compared to the previous year, %	41.23	-20.87	0.37	3.42	1232
The Size of the State (component 1), ed.	9.93	2.36	6.31	1.44	1344
Legal System and Security of Property Rights (component 2), ed.	9.62	1.45	5.87	1.95	1344
Sound Money (component 3), ed.	9.89	0	7.96	1.61	1344
Freedom to Trade Internationally (component 4), ed.	9.57	0	6.98	1.50	1344
Regulation (component 5), ed.	9.36	3.31	6.59	0.94	1344
GDP per capita, \$	118550.5	122.18	12518	16980.44	1344
Change in the GDP per capita, %	29.14	-17.37	2.33	4	1344

Source: author's calculations based on data of Fraser Institute.

Figure 2

Relationship between Index of economic freedom and the level of GDP per capita for countries with low and below average level of the Index of Economic Freedom



Source: author's calculations based on data of Fraser Institute.

In zone are the countries, for which the size of GDP per capita is high, but the level of economic freedom is low (Venezuela, Algeria). These countries show high rates of economic development solely through commodity exports (90% of exports of oil goes to Venezuela, Algeria ranks 4th in the world in proven gas volumes, besides country has large deposits of phosphates, lead and iron ore), considering all these, changes in the expansion of economic freedom are invisible.

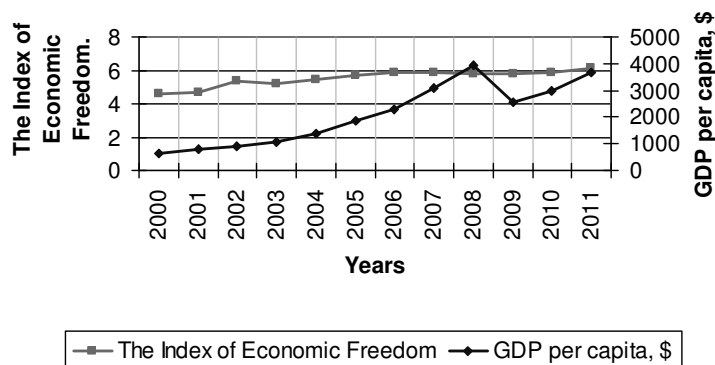
In zone III are the countries that have large volumes and a large proportion of state revenue is generated by exports of natural resources, however, measures of expanding of economic freedom limits are observed. (e. g. Argentina,

Gabon, Ecuador which is a major exporter of oil and wood). This approach to the state management is more favourable from the point of view of long-term growth in comparison to zone II, as the socio-economic climate of the country largely determines the possibility of expanding investment flows, more dynamic accumulation of financial resources, etc., which may eventually stimulate economic growth in general.

Using data on the value of the Index of Economic Freedom for Ukraine during the 11 year period, it should be noted that it has increased by 34% from 2000 to 2011. In 2000 Ukraine belonged to the countries with below average economic freedom, over the following years there was a positive trend and according to the most recent data for Ukraine the typical level of economic freedom was above average (Fig. 3).

Figure 3

Dynamics of Economic Freedom Index and GDP per capita in Ukraine, 2000–2011



Source: author's calculations based on data of Fraser Institute.

As for GDP per capita, this figure rose steadily until 2008, reaching its maximum at the point of U.S. \$ 3914, then there was a sharp decline from the gradual recovery in the coming years.

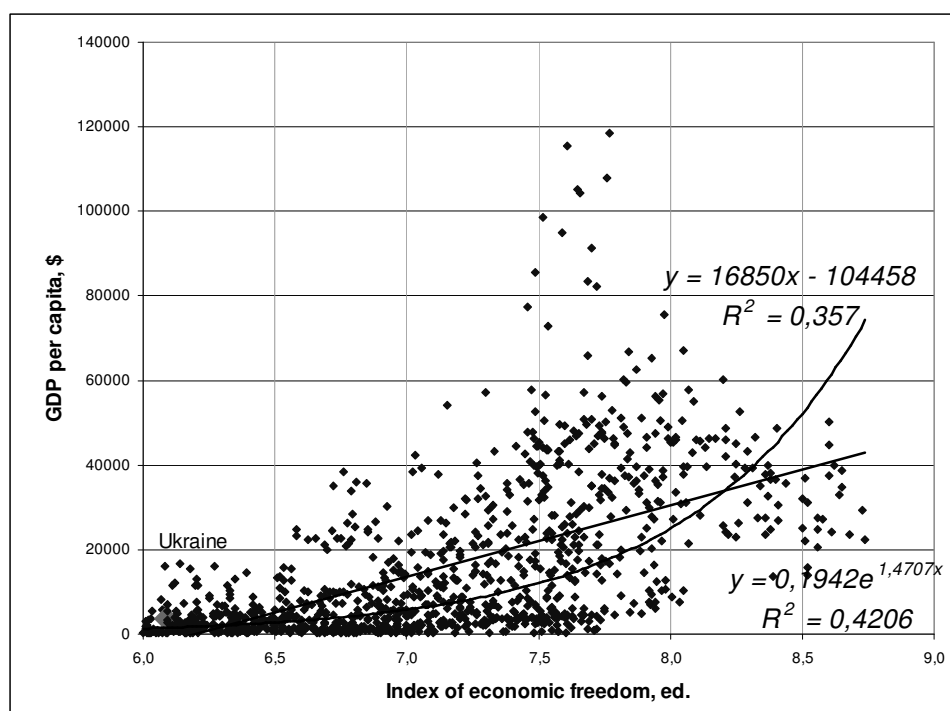
General dynamics Ukraine to the data is clear reflection of the empirical relation between the correlation index of economic freedom and GDP per capita.

When eliminating from the studies the countries, the success of which is due to the use of raw factor in international trade (among countries with low and lower than average level of economic freedom – Venezuela, Algeria, Argentina, Gabon, Ecuador), a linear relationship between the Index of Economic Freedom and GDP per capita is described by the following regression equation: $y = 327,2x - 922,04$ ($R^2 = 0,0624$), i. e. with increasing value of the Index of Economic Freedom, GDP per capita is also increasing.

Countries with the level of the Index of Economic Freedom high and above average show a closer relationship between the size of the index and GDP per capita for both linear relation and exponential (Figure 4).

Figure 4

Relationship between the Index of Economic Freedom and the level of GDP per capita for countries with high and above the average level of the Index of Economic Freedom



Source: author's calculations based on data of Fraser Institute.

Thus, we can conclude that the expansion of economic freedom is directly correlated with GDP per capita, and in countries which are characterized by large values of the Index, this dependence is more prominent.

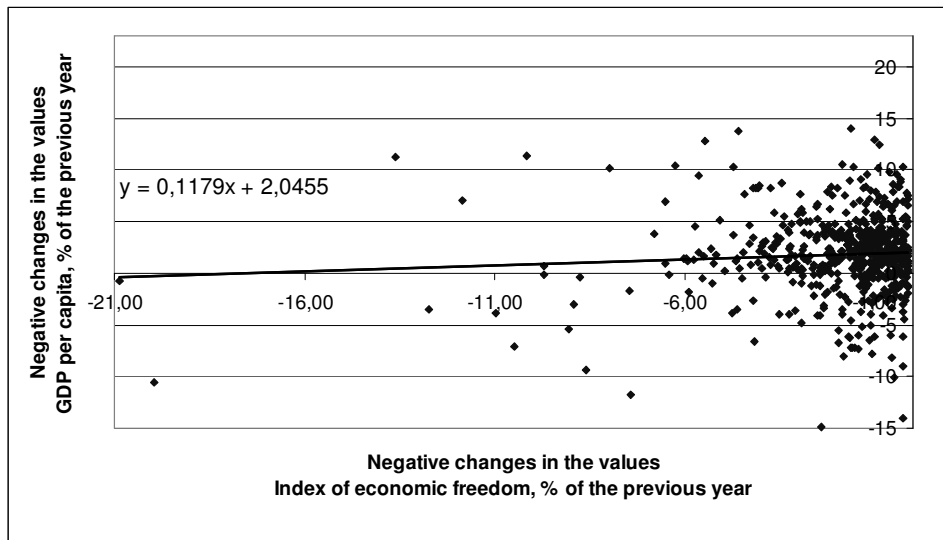
The analysis of a wide range of research on this subject, we can distinguish a difference in methodological approaches to identify the link between economic freedom index and some of the resulting performance development. The most significant point of dispute among scholars is ambiguous statements about the priority of application in models of dependence as a factor of variable absolute or relative Index of Economic Freedom.

Having conducted a study of the link between the change in the Index of Economic Freedom and the change in GDP per capita, it was found that in terms of the correlation fields are closely grouped around the range $[-5, 5]$ and the change in the index $[-10, 10]$ changes in GDP, which makes it harder to highlight any patterns in dependences.

In order to demonstrate the visual differences and empirical relations between the studied qualities, the range of change in the index of economic freedom was divided into two intervals: negative changes $[-21, 0]$ and improvements $[0, 42]$ and Corresponding Correlation field (Fig. 5 and Fig. 6).

Figure 5

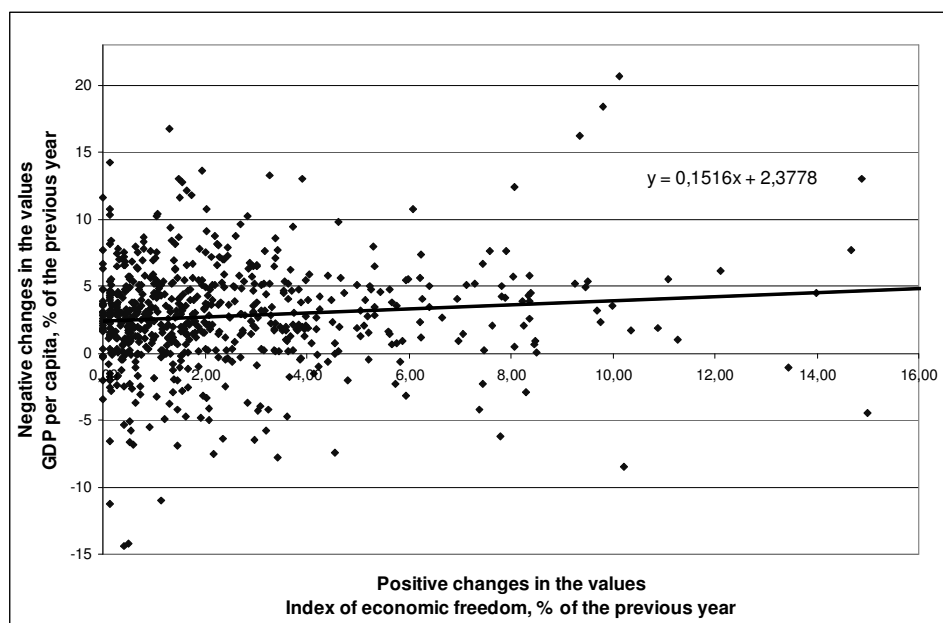
Relationship between negative changes in the values Index of economic freedom and the change in GDP per capita



Source: author's calculations based on data of Fraser Institute.

Figure 6

Connection between positive changes in the values of Index of economic freedom and the change in GDP per capita



Source: author's calculations based on data of Fraser Institute.

For a range of adverse changes in the index, one can identify certain patterns. In the leading countries in terms of commodity exports (Myanmar, Ecuador, Algeria, Nepal, Argentina, Mali, etc.) even the decrease of economic freedom does not stop the growth of GDP per capita. For the majority of countries, reducing the Index of Economic Freedom by 5–6% is combined with a lack of increase of GDP per capita by more than 5–7%.

Positive changes in the value of the Index of Economic Freedom correlate more noticeably with the change in GDP per capita (Figure 6), which is an empirical confirmation of the conclusion of some researchers obtained from the analysis of the sensitivity models of dependences, economic growth has a greater impact than an absolute value of economic freedom, especially, the positive changes in these values (Gwartney et al., 1998, Adkins and Andreas, 2002).

Calculations show that the relationship between the Index of Economic Freedom and the change in GDP per capita with a certain time lag (1 year, 2 years and 3 years) changes (Table 2).

Table 2

Relationship between the Index of Economic Freedom and the change in GDP per capita

Relationship	The regression equation	R^2
EFW and change in GDP per capita	$y = 0,1389x + 3,6909$	0,0137
EFW and change in GDP per capita (with a time lag 1 year)	$y = 0,2267x + 2,2762$	0,0388
EFW and change in GDP per capita (with a time lag 1 year)	$y = 0,1403x + 2,3828$	0,0163
EFW and change in GDP per capita (with a time lag 1 year)	$y = 0,1019x + 2,3695$	0,0092

Source: author's calculations based on data of Fraser Institute.

Arguably, the Index has a closer connection with the growth of GDP per capita with a time lag of 1 year than less than one year or a larger time gap. That means that the economic effect of the expansion of economic freedom in many cases can be observed not immediately, but at least after a year.

An important element of the research undertaken in the field of investigation and study of a causal relationship between economic freedom and economic growth indicators, are the conveyance of appropriate tests of sensitivity and causality. The most common calculation methodology is to conduct Granger tests, the result of which not only the direction of dependency, but also the presence of the reverse effect is detected.

Some researchers point to the exogenous index of economic freedom with respect to the parameters of growth (Adkins et al., 2002), although in contrast, there are other results of similar studies (Farr et al., 1998), indicating the existence of a causal relationship between economic freedom and development.

The main issues that arise in the analysis are the following: the correlation between economic freedom and economic growth due to the influence of freedom on the development of the state or the country's development, promotes the expansion of economic freedoms, or perhaps another third factor affects these

values. Obtained by the economist John Dawson (Dawson, 1998) results indicate that the increase in the overall level of economic freedom leads to growth, while changes in freedom go together with growth. Amongst the main elements of economic freedom that are capable of accelerating growth is a free implementation of market mechanisms and instruments of protection of property rights.

These results emphasize the importance of economic freedom in general and the role of free markets and property rights, particularly in the long-term economic prosperity.

Findings from this study and recommendations for further research in this area. Balancing the degree of state intervention in the development of the national economy with the effect of market regulators is a crucial problem in most countries. Tracing patterns in the relationships between trends in value of the index of economic freedom and individual indicators of countries' development allows us to identify possible sources of intensification of economic growth.

At present, a variety of studies formed the link between economic freedom and economic growth, but the results are far from conclusive. In spite of the existence of numerous gauges of vectors that measure the impact on economic growth, economic theory has not yet formed a comprehensive list of factor traits that conclusively affect the level of development.

With this in mind, the importance of theoretically grounded and empirically proven relationship of economic freedom of the country with its other characteristics was developing in recent decades, which led to carrying out numerous econometric calculations. As an extension, studies have been conducted to determine the links between the Index of Economic Freedom (its' variation) and GDP per capita (its' variation), which resulted in the findings that there is a direct link in the relationship between the absolute and the relative value of the index of economic freedom and absolute and relative GDP per capita. This should be considered as the basis of approaches to Ukraine's development.

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**European Economy**

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Sergey IVANOV

**TRANSACTION COSTS STRUCTURE
OF THE INVESTMENT CONSTRUCTION
CYCLE STAGES***

Abstract

In this article there have been examined the economic problems of the Russian investment construction sector. The economical growth directions of economic activity «Construction» have been determined. Comparative analysis of key economical institutional indicators has been performed. Research and practice problematic of the development of Russian ICC – high transaction costs of investment construction cycle – has been actualized.

Key words:

Entrepreneurship, construction, transaction costs, entrepreneurial costs, regulation costs, development indicators, investment construction cycle, contracting.

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JEL: D23, E22.

Some meso-economic studies, for example (Zotov et al., 2001), identify two primary issues: the current problems of the complex (industry) and its impact on the real sector of the economy. For investment construction complex (ICC)¹ this thesis is seen particularly clearly: it defines the state of development of all key aspects of the formation of the competitiveness of the Russian economy. Firstly, it creates a base for the development of productive forces, provides housing opportunities of migration and territorial consolidation of the effective workforce. Secondly, the development level of regional ICC defines quality and economic parameters of development of territories, their transportation and engineering infrastructure. Thirdly, the cost of construction product determines the efficiency of investment processes in the industry. (Asaul, 2005) 70% of the costs in a structure of industry investment capital (Russia in numbers 2012: short statistical review, 2012) are the capital construction, equipment and engineering services and real estate costs. That is why the development of regional ICC should be considered in qualitative and cost aspects. The quality aspect, by its nature, is technological, expressed in the current level of performance, innovation, technical and technological equipment of the complex and is the subject of study in engineering and technical-economic disciplines, and the economic aspect, which is the subject of this study, integrative determined by the valuation of the construction product. The cost of the product affects the effectiveness the participants' entrepreneurship during the investment construction cycle, and all related investment and social infrastructure fields.

It is theoretically correct to conduct a comparison of analysis of the state of economic and institutional position of economic activity «Construction» (F45) with the same activities in other countries. Inclusion in the comparison countries of the former Soviet Union and European Union is intrinsic in terms of the specifics of territorial features and evolutionary processes of ICC economic development. Modern scientific schools, which studied economy in construction, use this basis in their studies for comparative or criteria analysis (Asaul, 2004). International monitoring of investment and construction activities currently underway by a number of international research organizations: World Bank (WB), World Eco-

¹ Under conditions of national form of government the phenomenon of ICC finds specific and fully legitimate economical content only at the regional level [2, 3, 4]. The national ICC may be considered as the sum of regional ICCs.

conomic Forum (WEF), Organization for Economic Co-operation & Development (OECD), etc. But the most interesting reflection of economic and institutional aspects of the construction industry are provided by Global Property Guide a specialized in real estate research company, in their annual report «Residential property markets and investment» (Global property guide, 2011). Therefore, this article discusses the status and problems of the domestic industry «Construction» (F45) within the framework of indicators and report compares economic indicators of institutional development in the selected group of countries. Comparative indicators of construction industry development in 2012, are interpreted according to Global Property Guide, are given in Table 1.

Comparative analysis shows that the group with the high specific cost of the construction is formed by the most developed countries such as the United Kingdom, France, Switzerland and Russia (unit cost of product in the Russian construction industry (10,302 Euro per m²) (see Table 1) . But in European countries the high cost is determined by «... passivation factor – the territorial limitations of development of large European cities and activating factor – a high level of demanding advanced technologies in construction solutions» (Groak, 2013), the nature of the disproportionate cost of the Russian construction ICC is determined by the institutional factors. This (imbalance) are expressed by four indices (see Table 1), associated with the functional logic*.

Firstly, the Russian ICC has one of the lowest ratings (see COMP index value – 4.21 of 7) of competitiveness, which is expressed through the levels of capital liquidity, duration of construction investment contracts (projects) and investment attractiveness. The weakness of competitive position is determined by the high cost product with a relatively long construction cycle (22% higher than the EU average), which negatively affects the liquidity and efficiency of investment.

Secondly, the Russian «Construction» industry (F45) has two parallel depressing trends: the low level of legislative framework development (see indicator LOW value – 25 of 100) and an insufficient level of entrepreneurial freedom of market participants (see indicator EFREE value – 50.47 of 100). In this context, the position of the Belgian ICC (Jauhiainen and Moilanen, 2011) is very representative: on the one hand, a national regulation system, which possesses a lower level of the regulatory framework regulation (20) and no plans to expand it, and, on the other, a relatively high level of entrepreneurial freedom of the market participants (see Table 1). Of course, one could argue, appealing to the relatively high level of transaction costs in Belgium (TRANS – 17.88%), but one should understand that it is «... more business communications costs at this stage, reflecting the inherent principle of development, while maintaining low prices for construction products (2,753 Euro per m²)» (Global property guide, 2011). At a minimum, such a system has obvious potential and background evolution and institutional self-organizing of investment construction cycle participants.

Table 1

Comparative indicators of national construction industry development in 2012*

Country	PM2	COMP	LOW	EFREE	TRANS
Austria	5,109	5,14	90	71,88	11,82
Belgium	2,753	3,83	20	57,51	17,88
Bulgaria	1,305	4,16	30	64,91	24,88
Denmark	3,782	5,4	90	78,64	2,05
Estonia	2,153	4,62	80	75,2	3,81
Finland	6,184	5,47	90	74,04	10,15
France	13,380	5,14	80	64,59	16,30
Germany	3,094	5,41	90	71,79	11,46
Hungary	1,645	4,36	65	66,58	10,58
Italy	7,213	4,43	50	60,33	17,00
Latvia	2,657	4,24	50	65,83	5,16
Lithuania	2,189	4,41	60	71,26	2,35
Luxembourg	5,647	5,03	90	76,23	15,65
Netherlands	4,271	5,41	90	74,68	11,03
Poland	3,326	4,46	60	64,1	6,61
Portugal	2,213	4,4	70	64,01	13,65
Romania	2,043	4,08	40	64,71	7,58
Russia	10,302	4,21	25	50,47	25,00
Serbia	2,135	3,88	40	57,96	8,15
Slovenia	2,786	4,3	60	64,56	6,92
Spain	4,022	4,54	70	70,15	12,16
Sweden	6,991	5,61	90	71,87	6,54
Switzerland	11,397	5,74	90	81,95	5,74
Turkey	3,384	4,28	50	64,21	9,93
United Kingdom	15,187	5,39	85	74,53	5,03
Ukraine	2,807	4	30	45,76	12,50

* Interpreted according to Global Property Guide – Residential property markets and investment (Russia in numbers 2012: short statistical review, 2012). Legend: PM2 – unit cost of construction (m²/euro); COMP – comprehensive competitiveness ranking CSI (7 – maximum); LOW – legislative framework realization indicator of ICC (100 – the highest score); EFREE – entrepreneurial freedom indicator of ICC subjects (100 – maximum); TRANS – level of transaction costs (%).

But institutional trend that has grown in the Russian Federation, on the one hand, due to excessive regulation of communications (including levels of control and coordination of investment and construction decisions), and on the other – this is not covered by an adequate level of the regulatory framework development. Ultimately, the Russian construction product by virtue of institutional contradictions prevailing in the lawsuit as regional economic systems has the highest level of transaction costs in Europe – 25%, and that this is the main problem of development in Russia.

Investment construction activity generates a significant amount of non-operating expenses, which substantially affect the price of construction products sold and/or the investment efficiency. The high cost of construction products is a factor that hinders the productive forces and productive relations development of within the national economy.

Primary. High transaction costs prevent the formation of an effective spatial distribution of labor resources; opportunities to reduce migration and consolidation in the industrial areas of potential breakthrough. Indeed, «... the housing space coverage of the country is 40% of the level of developed countries» (Groak, 2013), and prices in regions not just high, they are rising much faster than the annual rate of inflation and wage growth index. Thus, in Moscow only in the I quarter of 2012, an increase in the cost of housing space was 2.3% (Exhibited average price is 146.9 thousand Roubles per m²), and in St. Petersburg – 1.3% (average price is 77.3 thousand Roubles per m²). For comparison, in the same period the real wage fund in St. Petersburg increased by 0.6% (Asaul and Ivanov, 2013, p. 81).

Secondary. Objective understanding of the transaction costs of investment and construction cycle as an obstacle in the growth of the investment attractiveness of the industry, transport and engineering infrastructure. Deterrent factor which brakes the claimed government policy of modernization impersonally is the high cost of construction, as a consequence – a relatively long payback investment. Thus, 70% of the construction work's value in the investment industry budgets of the Russian Federation (Russia in numbers 2012: short statistical review, 2012) can be contrasted with 20-30% of the Eastern European countries (Global property guide, 2001) and 10-22% of the value of the Asia-Pacific region. Obviously, in terms of the global integration of portfolio investors consider, first of all, global territorial alternatives, and from this point the investment conditions of Russian regions do not look competitive (see COMP index value- 4.21 in Table 1).

The methodological basis for the inquiry on transaction costs in this article are publications of R. Coase, Y. Barzel, D. Bromley, X. Demsetz, D. North, K. Arrow, M. Jensen, R. Dzhoskou, William Meckling, K. Menard, O. Williamson, T. Eggertsson. Within the framework of the existing basis one formalized their definition: «the costs that accompany relationships of economic agents» (Dalman, 1979), and classification (see Table 2), are divided into 4 groups: research (search for information); contracting, provision of technological processes, the protection of property rights.

Table 2

Structure of the ICC transactional costs

Groups defined by R. Couse (<i>Oleynik, 1999</i>)	Costs classification within the group	NSA* (%)	Types of ICC transactional costs, which according to R. Couse [8], belong to academic group
R Research (searching for the information)	Acquisition costs, searching, processing, analysis of market information, providing decision making of marketing decisions by private and legal persons within ICC markets.	47	Data collection about the current status of ICC
C Contracting	Contractual activity costs of individuals and entities: negotiations, approvals and signing of contracts, monitoring of their execution, closing of contracts, conflict treaty process.	29	Planning of the interaction between the subjects. Negotiations about compliance of mutual interests and interaction plans. Making Decisions on the form, character, and timing of the cooperation. Securing agreements with application of the procedures for execution of contracts and conclusion of deals. Verification of compliance with the obligations by the subjects during cooperation.
T Engineering processes support	Non-production expenses to ensure the engineering process and conditions of its implementation	8	Participants co-operation in the course of shared use of material and immaterial resources
J Property rights protection	Costs of private persons and legal entities arising from the execution of laws and regulations aimed at the registration of property rights and its protection, payment of duties and taxes, licensing	16	Specification and property rights protection. Legal arrangement of the land lots and construction (reconstruction) objects

* Results of the research conducted within the main aspects of the scientific school «Methodological problems of the regional investment effectiveness and construction complexes as a self-organizing and self-governing system» at the St. Petersburg State University of Architecture and Civil Engineering (Asaul and Ivanov, 2008).

The key issues of the debates define the concepts, approaches and tools for reducing the level of transaction costs of regional ICC (Asaul et al., 2009).

Firstly, we rely on the consolidated point of view about the nature of transaction costs of investment construction cycle. They arise due to uncertainty in information and communication activities of the participants of the investment, construction and operational processes. Finding information and relation counterparts, planning and shaping construction and operational cycles, registration of legal documentation, approval and obtaining permission documentation actually don't create an added value of construction products, as these are non-productive costs of the company. The higher the levels of uncertainty in these processes, the more resources are expended by the regional ICC on their compensation. In fact, there are two types of costs in accordance with their nature: business (arisen as a response to the low level of organization of investment construction market, the lack of established practice among contractors) and regulatory (arise in the implementation of the subjects of legislation and rules of registration of contracts and property rights authorization documents).

Secondly, determinateness of the transaction costs nature in the regional ICC makes it possible to identify specific costs of regional economic activity of ICC attributed to classify groups according to methodology offered by R. Coase. The solution proposed in (Asaul, 2011), allows one to select specific operations and processes of the participants in the regional ICC (see Table 2), which are forming research, contractual, technological and legal costs that can be considered as an idea about the structure of the transaction costs of investment construction cycle.

As a third block in the theoretical basis of the study, we accept the results of the research (conducted in 2006–2009) about the quantitative relations in the structure of the transaction costs in investment construction activities. Deterministic relationship groups (see NSA column, Table 2) make it possible to identify the specifics of the distribution of transaction costs.

In furtherance of ideas about the point of transaction costs concentration a quantitative relationships were detailed both within academic groups by Ronald Coase, and in relation to the stages of investment construction cycle, which allowed to localize and stage and participants of the process, generating the bulk of transactional relationships. Quantitative values obtained during the study were standardized (expressed in percentage values) and distributed according to investment construction phases of the cycle. The results obtained are given in Table 3, which allows evaluating the distribution of ICC transaction costs throughout the phases of investment construction cycle.

Concentration of the costs studied is objectively detected during the development of business plans – 35.7% of the transaction cycle total cost. Biggest market uncertainty characteristic is typically occurring during pre-investment stage of the projects, where a choice of investment intentions and creation of appropriate communications is performed, as well as evaluation of risks and marketing environment research of areas and facilities.

Table 3

Structure of the transactional costs during the stages of investment construction cycle (%)

Investment construction cycle stages	Groups of transactional costs (as defined in Table 1)			
	<i>R</i>	<i>C</i>	<i>T</i>	<i>J</i>
Total	47.0	29.0	8.0	16.0
Stage A. Evaluation and selection of the investment intentions	6.2	0.7	0.0	0.0
Stage B. Business plan elaboration	35.7	0.5	0.0	0.0
Stage C. Legal implementation	0.0	11.5	0.0	7.3
Stage D. Front-end engineering design, project engineering design	2.3	6.3	3.7	0.0
Stage E. Construction (reconstruction), commissioning of facility	1.2	4.9	4.3	0.0
Stage F. Implementation of the project results, registration of rights	1.6	5.1		8.7
Stage G. Facility operation	0.0	0.0	0.0	0.0

According to this logic, one can predefine a connection between the value of transaction costs of subsequent cycle stages (C, D, E, F, G) and depth of the studies done during the stages A and B. Level of certainty, risks which triggered the investment construction cycle, are largely depend on the organization's readiness to bear the transaction costs exactly in the pre-investment phase. At the same time there is an understanding that the macro- and meso-level management of the ICC transaction costs should focus on creating conditions for information and communication security investment planning process.

Thus, as a result of the study revealed the practical aspect of improving the competitiveness of the Russian investment construction sector and key scientific problem – creation of approaches to the management of the transaction costs level. A theoretical ideas described in this article about the subject, nature and structure (quantitative relations) of the transaction costs, in part, which connected to the investment construction phases of the cycle are the scientific basis for further discussion of conceptual approaches to reduce them. In this article it was actualized scientific and practical problems of Russian ICC development – high transaction costs of investment construction cycle.

In the context of understanding of the research issues the following conclusions have been made:

1) the comparative analysis showed that the specific value of the product construction investment activities disproportionately high due to disharmonized factors such as institutional development of construction as an economic activity;

2) domestic construction product due to institutional contradictions in the investment construction industry (considered as an economic system) has the highest level of transaction costs in Europe – 25%, and this is the key problem, which affected Russian regional development ICC;

3) compiled and formalized modern theoretical ideas about the subject, nature and structure (quantitative relations) of transaction costs of regional ICC are defined as the theoretical basis of this research;

4) the concentration of transaction costs is related to the pre-investment stage (35.7% – business planning process), where a choice of investment intentions and creation of appropriate communications is performed, as well as evaluation of risks and marketing environment research of areas and facilities.

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**Financial and Banking Services Market**

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Michał KRUSZKA

**BANKING SYSTEM IN POLAND:
STABILITY OVER THE CRISIS****Abstract**

The paper introduces performance of banking system in Poland during the period of European economic crisis. It also contains presentation of influence of financial supervisor on financial market and the real sector of the economy and possible threats to the institutional framework of financial supervision in Poland. Article presents how microeconomic changes of parameters of mortgage granted in foreign currency can be transformed into bank's capital needs. Some details about resolutions and recommendations issued by the Polish Financial Supervision Authority (KNF) are also magnified in the paper. The practice of last years indicates that activity of the supervisory authority is an important determinant of financial stability.

Key words:

Financial supervision, Poland, FX lending, macroprudential regulations.

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JEL: G21, G18, K23, O11.

Introduction

This paper introduces performance of banking system in Poland during the period of European economic slowdown, i. e. years 2007–2012. Main aim of authors is to present a stability of Polish financial market and to show influence of financial supervisor on financial market and the real sector of the economy. Moreover an attempt has been made to find out what are possible threats to the institutional framework of financial supervision in Poland. Authors present also how microeconomic changes of parameters of mortgage loans granted in foreign currency can influence bank's capital needs. Such an attitude is very important when one consider that in Poland some problems with mortgage lending (less serious than in the other EU countries) stemmed from changes of exchange rates rather than burst of housing bubble. The paper is divided into four parts. The first contains short presentation of key macroeconomic figures, the second is aimed at performance of banking sector, the third presents an example of FX lending problem while the last presents some details about resolutions and recommendations issued by the Polish Financial Supervision Authority (KNF).

1. Macroeconomic outlook

Poland macroeconomic performance over the period 2007–2012 can be considered to be favourable, especially if country is compared with the European Union and Euro zone. Polish economy avoided recession and output growth was resilient remaining above EU average. (see graph 1).

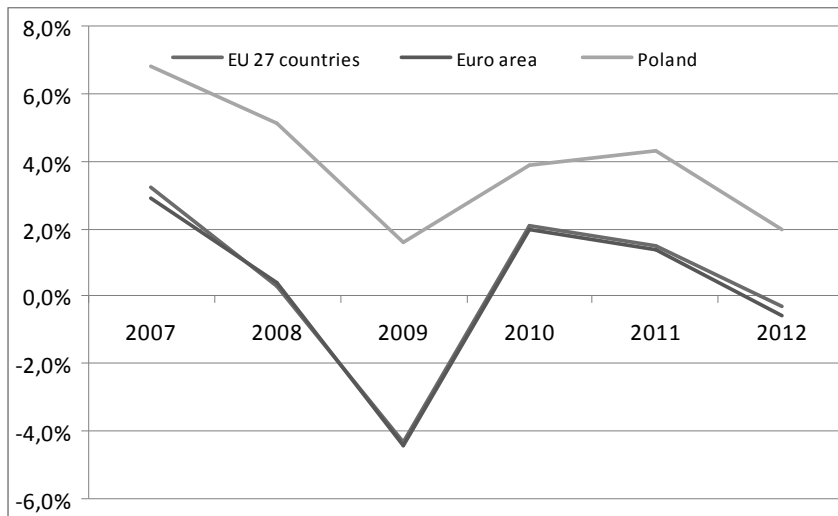
However, despite output growth, labor market remained relatively weak: economic activity did not rise substantially, suggesting so called jobless growth¹. This kind of problem had already emerged around ten years previously when Poland was hit by an economic slowdown (although there was no recession), and when weak output development was followed by an extremely high unemploy-

¹ Referring to the term «jobless growth» or «jobless recovery» one has to remember that both definition and causes of such phenomenon are controversial even among economist (Cantore, Levine, Melina, 2013; Aaronson, Rissman and Sullivan 2004).

ment rate of around 20 percent. It should be noted that policymakers were aware of it (Ministry of Economy, 2004). However there have been no significant changes to labor market institutional framework over last years. A deep sensitivity of employment to business cycles may curb demand for credit and pose problems with loan repayments.

Graph 1

Output growth in Poland and EU (in percent)



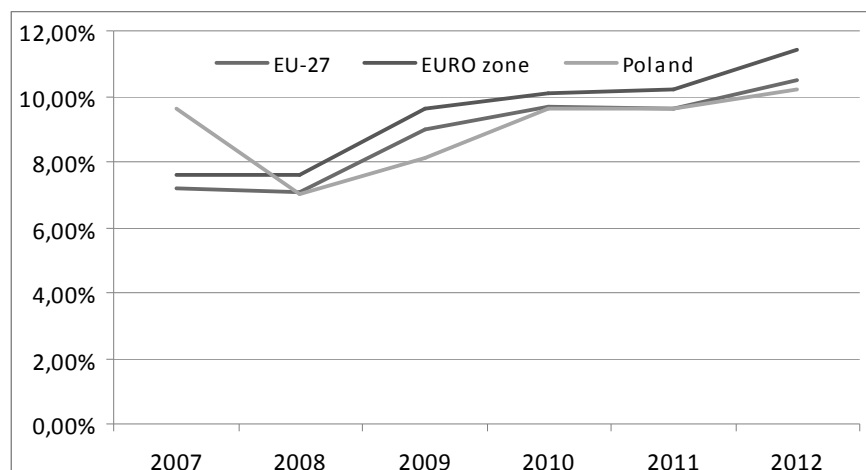
Source: Eurostat.

The adverse performance of economy is forcing banks to develop and use proper risk assessment models combined with cautious credit policy in order to minimize nonperforming loans ratio. On the other hand the authority responsible for financial supervision should develop proper requirements for the banking sector in terms of capital adequacy ratio or liquidity performance while also making recommendations covering the provision of credits and the assessment of borrowers' creditworthiness. Such an issue is extremely important when one con-

sider effects of loose mortgage lending policy, which resulted in housing bubbles followed by deep recession in Ireland and Spain².

Graph 2

Unemployment rate in EU and Poland (percent)



Source: Eurostat.

In the views of threats linked with vague assessment of the creditworthiness of borrowers it should be noted, that unlike in some other EU countries (for example United Kingdom)³, all potential borrowers in Poland were subject to income verification. As a result, even deterioration of labor market situation do not lead to sharp increase of nonperforming loans ratio. In the mortgage sector relationship between provisions for impaired loans and net value of credits was lower than 0,5 percent in Poland. This figure suggests proper attitude towards credit scoring policies and risk assessment in case of both supervision and of banks. In Spain, on the other hand, the ratio of nonperforming mortgages rose from 0,8 percent to 7,6 percent during the period 2005–2011 (IMF, 2012).

² Housing Prices Index published by Eurostat shows that average rate of house prices decrease for the period IV Q 2009- IIIQ 2012 accounted for 7 percent in Spain and 13 percent in Ireland.

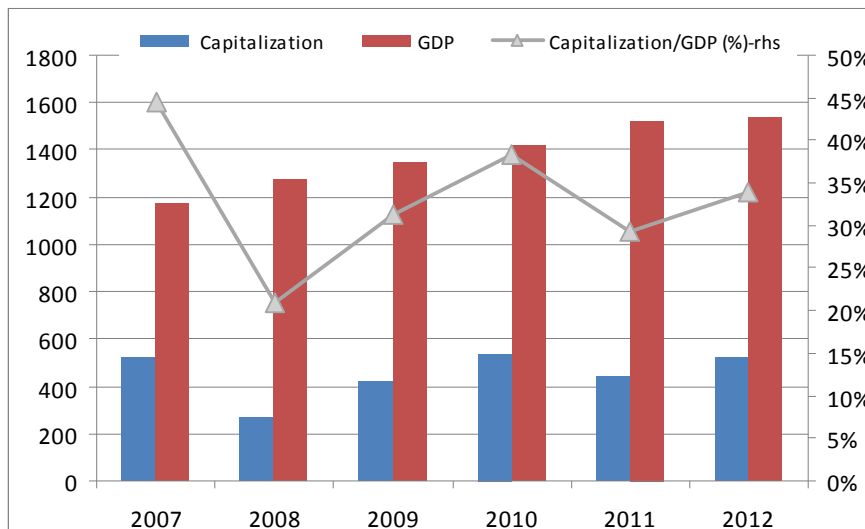
³ FSA (2012) data shows that income verification in UK ranges from 70 to 87 percent of potential borrowers.

Contrary to relatively sound situation in the real sector of the economy, the global financial crisis hit capital market in Poland substantially. In 2007 the capitalization of domestic enterprises listed on Warsaw Stock Exchange accounted for 45 percent of GDP but it fell 10 percentage points to 35 percent of GDP in 2012 (see Graph 3). The sharpest decrease was observed in 2008 when value of companies from WSE was below 30 percent of GDP (in nominal terms it expressed downwards movement from 500 billion PLN to around 250 billion PLN) However one should consider that WSE is classified together with other CEE stock exchanges in spite of the fact that its performance and size is much different from other similar institutions in the region. But for global capital market there is no clear distinction between Budapest stock exchange (where for example main market indicator-BUX is composed in 90 percent by four companies) or Prague stock exchange and WSE.

Yet it has to be stated that such a poor performance on the part of capital market was not accompanied by deterioration in the overall economic and did not amplify some adverse trends in the real sector. Data about capital market in Poland is presented on Graph 3.

Graph 3

Capitalization of domestic enterprises listed on WSE (PLN billion)



Source: WSE data.

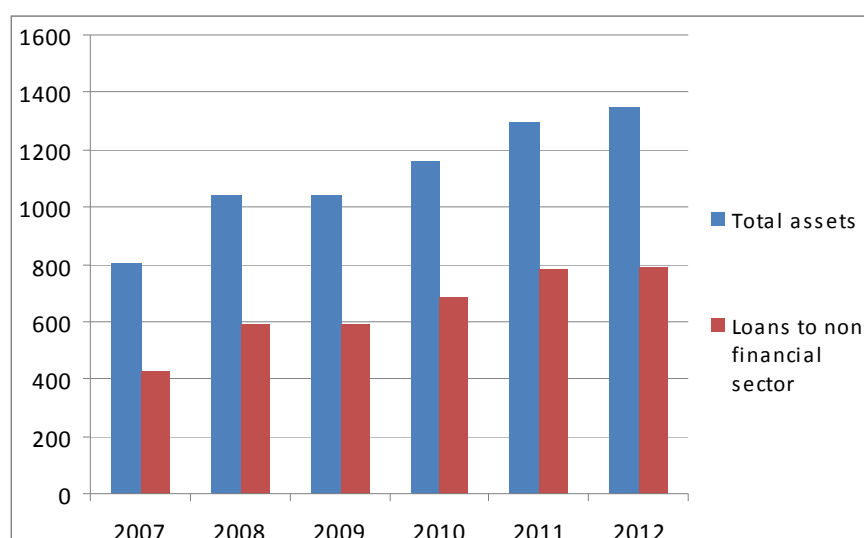
2. Banking sector performance

In the period from 2007–2012 the development trends in the banking sector can be assessed as fairly positive. In these years assets grew by 68 percent which implies a solid 13 percent of annual growth rate. In absolute terms such change means increase balance sheet increase from around 800 billion PLN in 2007 to 1,35 trillion PLN in 2012 (see Graph 4).

Growth of total assets was followed by increase of loans to non financial sector. The latter grew faster than sum of assets: the total increase reached 83 percent (i.e. 13,8 percent per year) rising from 430 billion PLN in 2007 to 788 billion PLN in 2012. Growth also expressed in absolute terms was rapid soaring from 36 percent in 2007 to 60 percent in 2012 as compared to GDP, whereas credit as a share of GDP equaled to 60 percent (in 2012) and was thus much smaller than many other EU countries⁴

Graph 4

Assets of banking sector in 2007-2012 in (PLN billion)



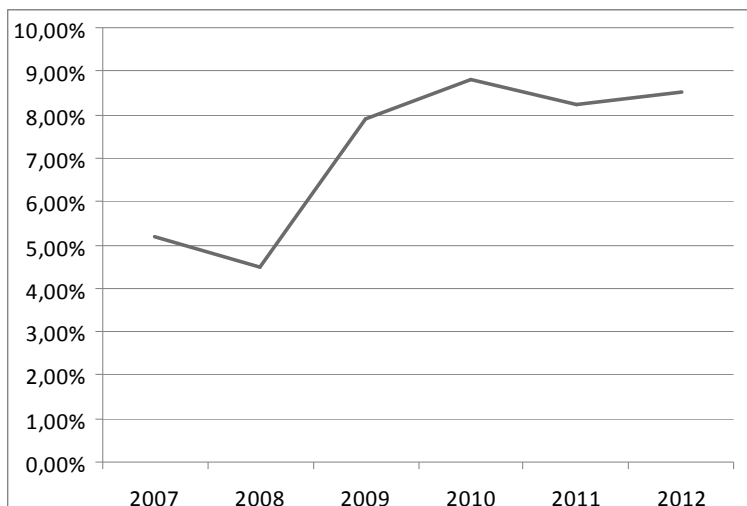
Source: NBP and KNF.

⁴ According to World Bank such ratio for UK was 186 percent, 208 percent in Denmark and 104 percent in Germany.

It is important to observe that such rapid growth in exposure was not associated with a worsening of credit portfolio. The share of nonperforming loans grew from 5,2 percent to 9 percent between 2007 and 2012. At the end of 2012 total nonperforming loans amounted to a total of 71 billion PLN. One serious problem that has recently emerged is the relatively large exposure of banks in lending to the construction industry. Many construction enterprises lost their financial liquidity in the second half of 2012 and some of them (like PBG) declared bankruptcy. Others were liquidated while several restructured their debt. Such loans reached 60 billion PLN (the so called «large exposures») which account for 11,2 percent of total large exposures. It should be also underlined that construction sector accounted for 24 percent of impaired loans.

Graph 5

Share of nonperforming loans in total exposures (nonfinancial sector)



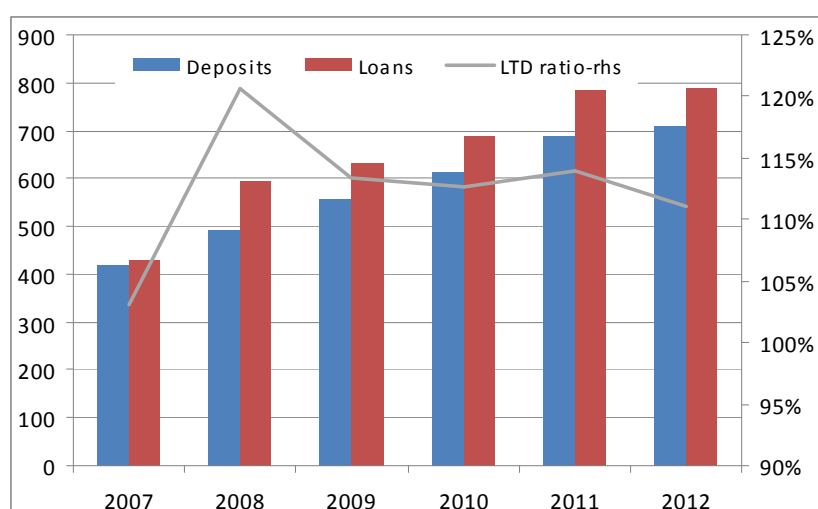
Source: NBP and KNF.

Changes in the assets were followed by increase of owners' equity and liabilities. Total amount of deposits grew from PLN 419 billion in 2007 to 931 billion in 2012. (=120 percent). Such numbers confirm the sustainable growth of banking sector in Poland in recent years. LTD (loans to deposit) ratio was around 110 percent. One flaw was the fact that majority of long term loans (especially

mortgages) were financed by short term deposits. As a result, the Polish Financial Supervision Authority (Komisja Nadzoru Finansowego – KNF) recommended strengthening the capital base, primarily by means of retention of profits, in order to stabilize situation of banks. The resilience of banking sector is also confirmed by Anayiotos at al (2010). They showed that bank efficiency increased in Poland during the boom, and even improved during the crisis.

Graph 6

Value of deposits and loans (PLN billion) and LTD ratio



Source: NBP and KNF.

Very interesting information is provided by Financial Stability Reports which is published semi annually by the National Bank of Poland. For the purposes of analyses conducted by the NBP three main strategies of banking asset financing are separated: (1) deposit based, (2) foreign financing and (3) mixed (NBP, 2012). Share of main financing sources (deposits and claims of non residents) in the balance sheet depends on strategy. In case of deposits such share is around 70 percent (deposit strategy), 40 percent when mixed strategy is applied and 30 percent when bank rely on foreign financing. In cases when another significant component –the claims of non-resident financial companies (usually parent companies) against banks- is considered, the share is 8 percent for the

deposit strategy, 16–18 percent for mixed strategy, and 46 percent for foreign financing. When the structure of total assets financing is analyzed, the corresponding numbers are 51 percent, 27 percent and 22 percent respectively. The dominance of a deposit based strategy is very important when one considers that majority of Polish banks are subsidiaries of foreign institutions: this made it possible to avoid sudden outflow of funds during economic slowdown when parent companies needed liquidity support – see Lahnsteiner (2010).

Polish banking sector maintained adequate capital buffers, which were higher than those recommended by Basel Committee. Moreover CAR (capital adequacy ratio) in Polish banks based mainly on Tier I capital which makes banks even more resilient to adverse economic conditions (see Table 1).

Table 1

Capital Adequacy Ratio

YEAR	2007	2008	2009	2010	2011	2012
CAR	12,0	10,8	13,3	13,9	13,1	14,7

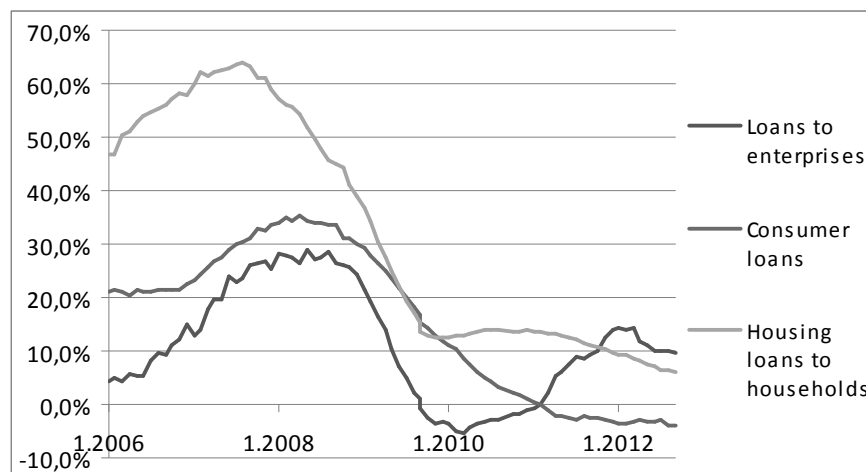
Source: NBP and KNF.

The value of CAR calculated for Polish banks over the period 2007–2012 was always above 10 percent⁵ and Piątkowski (2011) indicated that a relatively high capitalization of banks must be recognized as an important determinant of maintaining banking system stability. Moreover relatively high CAR did not lead to drastic reduction in credit supply (see Graph 7). The decrease in its growth stemmed mainly from economic slowdown and was not primarily caused by supervisory regulations. Such a slowdown is clearly visible in the case of mortgages (especially FX mortgages) which can be triggered by rational restrictions imposed by supervision. The Polish real estate market behaved similarly to the markets in the other countries, however downwards movement of housing prices was neither very deep nor possessed any threat to the stability of the banking system. With regard to the data presented above on nonperforming mortgage loans it is important to underline once again that the relatively conservative lending policy of Polish banks and provisions introduced by regulator protected Polish economy against substantial «bubble» in the real estate market. Problem of estate financing will be broader discussed in the next section.

⁵ According to Basel Capital Accords CAR should not to be lower than 8 percent, since 2011 the KNF has recommended to maintain at least 12 percent level.

Graph 7

Growth of credit (y/y)



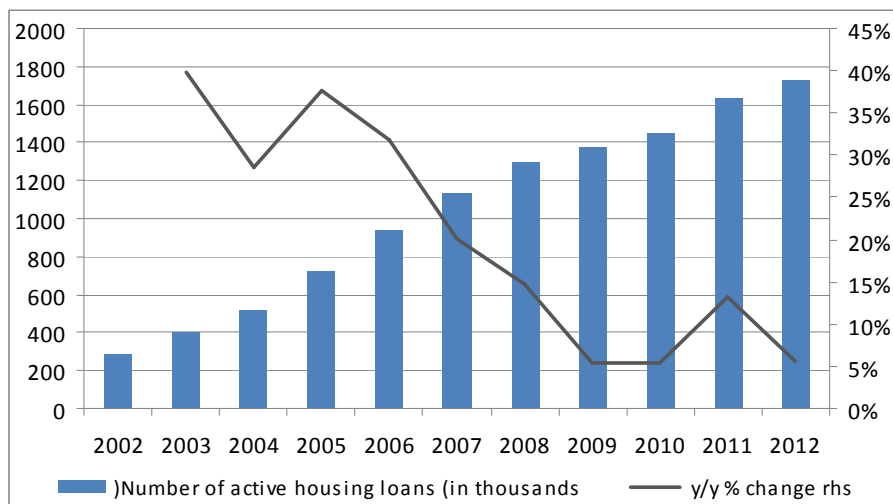
Source: NBP.

3. A problem of FX Housing Loans

Interesting element of the Polish financial market is estate financing. One can observe rapid growth of the mortgage lending which started prior to the economic slowdown in 2009. Mortgage lending was associated with broader phenomenon - a rising importance of credit to private sector in the Polish economy. As far as at the beginning of XXI century the ratio of domestic credit to GDP was roughly below 30 percent but it started to rise sharply after 2004. In 2012 the credit-to-GDP ratio reached 60 percent threshold. Low significance of credit stemmed from high interest rates and unemployment. Such an adverse situation changed after the EU enlargement, when Poland benefited from EU funding associated with outflow of labor force. Emigration, simultaneously with inflow of EU funds and foreign transfers from Polish citizens boosted economic growth. The good economic situation, deep fall of interest rates and availability of FX lending (in CHF) encouraged numerous Polish households to take out a mortgage credit. As a result number of active housing loans rose from around 200 thousands in 2002 to somewhat below 1, 8 million in 2012.

Graph 8

Number of housing loans in the period 2002–2012



Source: AMRON-SARFiN.

Yearly changes of such loans accounted up to 30–40 percent per year prior to economic slowdown in 2009 and tend to stabilize at 10 percent after 2009. Growing supply of mortgage lending resulted in rising estate prices which may eventually lead to so called «housing bubble». Data from AMRON-SARFiN⁶ reports show that in the 8 biggest Polish cities estate prices over the period 2006-2012 rose from modest 20 percent in case of Kraków to over 100 percent in case of Łódź.

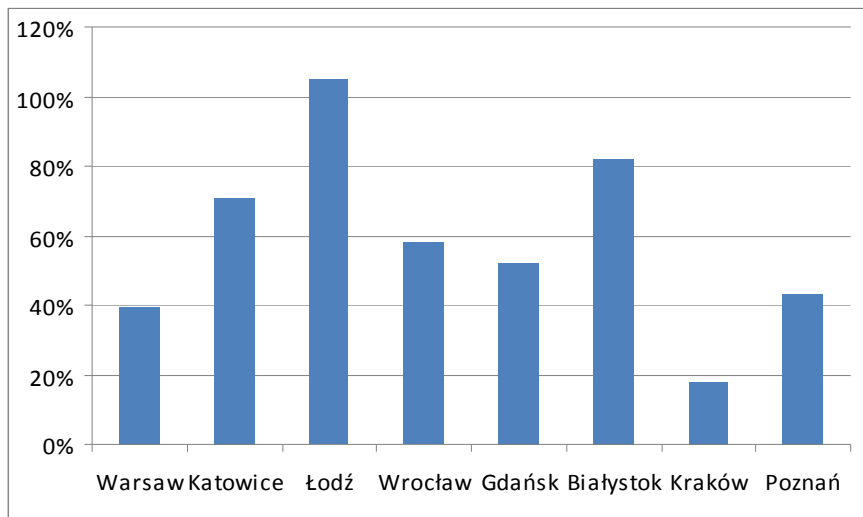
Due to a relatively cheap lending in CHF, compared to PLN⁷, majority of housing loans was granted in Swiss currency. The unlimited increase of FX credit posed possible threat stemming from rising CHF/PLN exchange rate. Especially when it is considered, that according to AMRON-SARFiN reports over 50 percent of total housing loans had LTV ratio over 50 percent while in case of 27 percent of total loans LTV was higher than 80 percent. Analysis of CHF/PLN exchange rate volatility in the period 2007–2012 confirms partial materialization of such risk.

⁶ AMRON is a database developed by the Polish Bank Association. The database contains information regarding characteristics of real estate, their location and information on transaction prices from deeds.

⁷ Swiss frank interest rate is much lower than WIBOR, i. e. Warsaw Interbank Offer Rate.

Graph 9

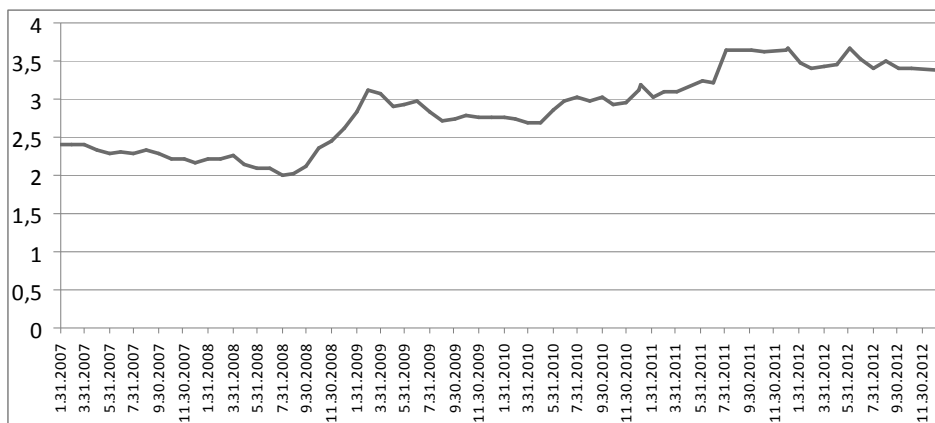
Change of real estate prices in selected Polish towns in (2006–2012)



Source: AMRON-SARFiN.

Graph 10

Exchange rate CHF/PLN



Source: NBP.

In order to magnify threats associated with combining high LTV with FX lending authors prepared a simple simulation. Main assumptions are:

- Household bought a 300 000 PLN worth dwelling in Warsaw at the beginning of 2007
- Purchase was financed through 125 000 CHF loan with monthly installments
- At the beginning of simulation CHF/PLN exchange rate was 2,40
- Initial LTV was 100 percent
- Household pays installments in CHF.

Over the analyzed period LTV raised from 100 percent when loan was activated to around 135 percent at the end of 2012. Such rapid growth of LTV ratio stemmed from change of CHF/PLN exchange rate which was around 3,5 CHF/PLN at the end of period. One should notify that there was no major decrease of real estate's value in spite of minor price correction (around 12 percent between 2008 and 2012). Vives (2006) underlined that sustaining of such trends might possess a serious threat to individual household and to banking system in case of labor market slump, further decrease of real estate prices or depreciation of local currency. However Poland avoided turmoil on financial market, mainly due to prudential activity of financial supervisor which prevented sector from risky behavior.

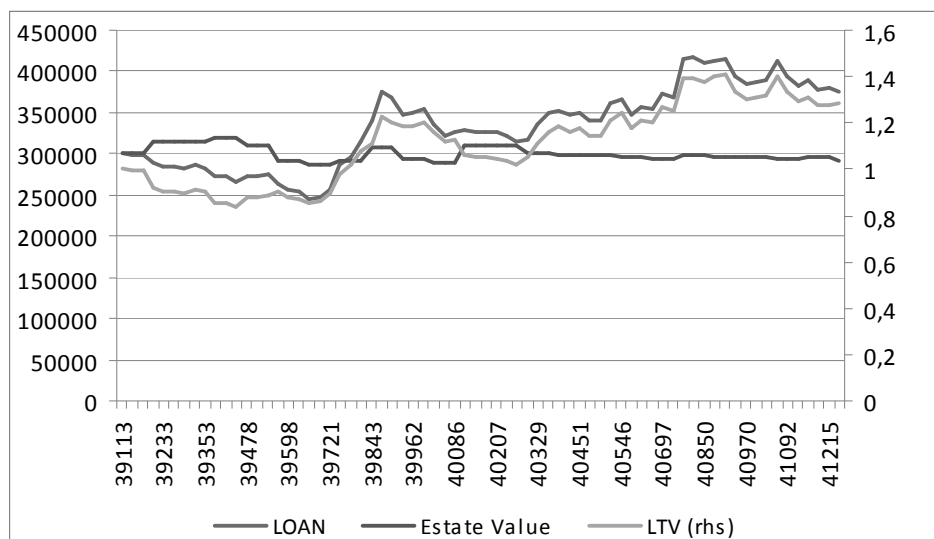
The above presented simulation refers to simple customer case. One has considered that if such behavior of market is countrywide there is a significant risk of contagion. In order to magnify this threat one more simple calculation can be used. Assume that one bank has 1/3 of its assets in CHF mortgage loans. Bank is financed through foreign financing strategy. For simplification it is assumed that financing is also provided in CHF and all assets are not risk weighted. CAR requirement is assumed to be 10 percent.

Increase of exchange rate from 2,40 to 3,50, ie. depreciation of Polish currency yields to decrease of CAR by around 1,4 percentage points which gives additional need for 4,5 unit of capital accounting for 15 percent of core capital. Such situation may result in curbing credit activity of banks and boost economic slowdown.

Being aware of such adverse conditions Polish financial supervisor issued recommendation aimed at limiting availability of FX housing loans (Kowalczyk, Kruszka, 2011). Such document was passed in 2010 and sales of new credits in CHF were curbed. This action reduced possible loss from changes of exchange rate. One has to remember that in the period 2008–2009 up to 60 percent of new sold mortgages was granted in CHF.

Graph 11

Changes of LTV over the period 2007–2012



Source: own calculation.

Table 2

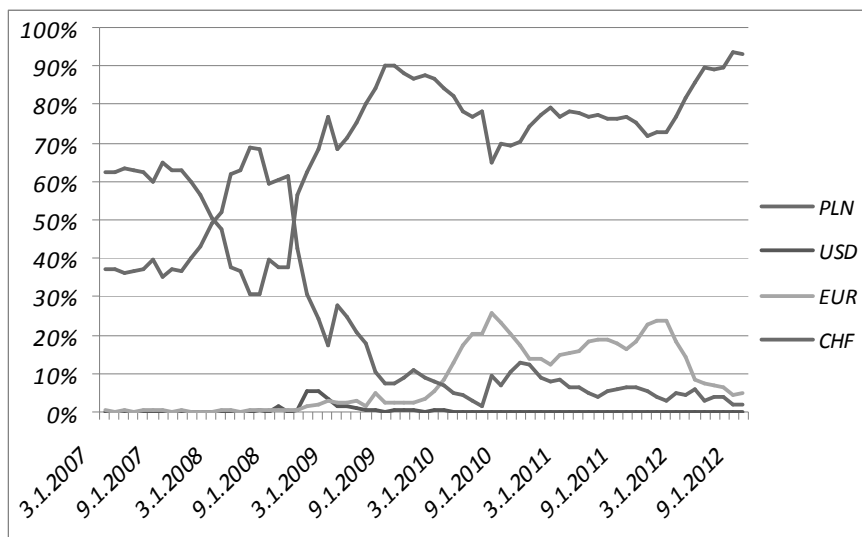
Influence of FX rate on CAR

CHF/PLN = 2,40				CHF/PLN = 3,50			
CHF assets	100	CHF liabilities	200	CHF assets	145	FX liabilities	290
PLN assets	200	PLN liabilities	70	PLN assets	200	PLN liabilities	70
		Core capital	30			Core capital	30
		CAR	10 percent			CAR	8,6 percent
				Additional Capital Requirement	4,5	As percent of core capital	15 percent

Source: Own calculation on the basis Cayazzo et al (2006)

Graph 12

Structure of new sold mortgages (according to currency)



Source: NBP.

After 2010 such share fell to below 10 percent. Banks resigned from massive FX lending after changes imposed by KNF resolution, the 75 percent weight of FX loans were replaced by the 100 percent weight (despite Basel requirement on 35 percent). This suggest proper, active behavior of KNF which managed to protect market against housing «bubble» and major turmoil on financial market.

4. Activities of the KNF during economic slowdown

The Polish integrated financial supervision system was established in 2006 when securities commission and insurance authority were merged under one roof of the KNF. The integration process concluded on January 1, 2008, when the KNF took over the tasks performed by the Commission for Banking Supervision, which functioned under the auspices of the National Bank of Poland. Such an action should improve the performance of the authorities and prevent the

country's economy from succumbing into crisis (Čihák and Podpiera 2006). In general integrated supervision in Poland operated properly because:

- there has not been any bank failure since the beginning of the global financial crisis and none of the banks in Poland required recapitalization using public funds;
- Polish banks are well capitalized, liquid and fully capable of satisfying ongoing credit demand;
- The off balance sheets positions of Polish banks are mainly financing provisions or guarantees, but there are virtually no OTC (over-the-counter) derivatives;
- Despite of weak labor market conditions the number of nonperforming loans did not rise sharply; and
- The balance sheets of Polish banks were free of any burdens stemming from investment in the securities or governmental bonds issued by countries struck by financial crisis (peripheral euro area countries, for example Greece or Spain).

In the period 2007–2012 the KNF drafted a numerous recommendations and resolutions aimed at stabilizing the situation in the banking sector. An important solution aimed at stabilizing the Polish banking sector was establishment of legally binding liquidity norms in 2008 – see NBP (2009). It is worth noting that such a solution was introduced prior to the issue of liquidity norms by Basel Committee. Its recommendations defining LCR (Liquidity Coverage Ratio) and NSFR (Net Stable Funding Ratio) were proposed in 2010 (BIS, 2010).

Stoica et al (2011) emphasized that financial system stability supported by proper supervision is an important factor for economic growth. From this point of view - in general - the activities of the Polish financial supervisor deserves a positive opinion not only because there was no financial crisis caused by of banks pursuing flawed policy but also because the probability of such threat in the future was reduced. Banking supervision in Poland has been active instead of being reactive. This is very important when Poland's rating position is considered. A good rating is one of the factors confirming the soundness of an economy and financial supervision performance is significant element in rating methodology. Rating agencies assess the activity of supervision and consider its results when determining overall rating score (S&P, 2011). In other words if any particular country suffered from financial crisis, especially in cases where banks required state-backed assistance or nationalization (see for instance TARP in US) then overall grade for supervision is poor. From this perspective one can state that the KNF effectively fulfilled its mission (Fitch, 2013).

Other important issues deserving further analysis are the role and position of the KNF in the new institutional framework proposals of the European Com-

mission linked with the Banking Union, or the way that Basel III and CDR IV have been implemented. Veron and Wolff (2013) pointed out the main pillars of the Banking Union: common supervision rules (single rulebook), the single supervision mechanism for the entire euro area, the common deposit guarantee scheme, and the harmonized framework for the recovery and resolution of financial institutions. Such supra national proposals, especially when one looks into intragroup financing, appear to change position of the KNF (as a host supervision authority) in the future. Yet it is premature to discuss this issue in detail since the majority of draft proposals require further analysis (some recommendations are controversial even for members of Eurozone, like Germany⁸) Moreover several foreseen instruments are mandatory for Euro zone members while other countries can voluntarily participate in this framework.

Conclusions

In Poland credit to GDP ratio rose from about 36 percent in 2007 to 60 percent in 2012. Such an increase itself might potentially be a source of risks to financial stability, but it was also coupled with relatively new phenomena, and above all – massive foreign currency lending. Thanks to proactive attitude of Polish authorities and sound economic fundamentals, the risks largely failed to materialize. In its recommendations for banks financial supervisor has addressed the problem of FX lending which contributed to the high quality of the portfolio. Before the economy slowed down, the KNF – Polish Financial Supervision Authority persuaded banks to accumulate an additional capital buffer that helped to protect them from negative consequences of the downturn. Some regulatory concepts that have been put into practice in Poland in recent years, including quantitative liquidity requirements, are now being implemented globally.

Poland participates in international (especially on the EU level) debates on a new regulatory regime for the financial system. The major message that Poland should to convey is that all new regulations must be tailored very carefully. Regulators should strive to ensure that the benefits of a higher quality capital base or of the countercyclical buffer are not compromised by international overregulation that could undermine national authorities' ability to pursue effective country-specific policies.

⁸See, press release from G. Fahrenschon, President of Deutschen Sparkassen- und Giroverbandes (DSGV), http://www.dsgv.de/_download_gallery/Pressemitteilungen_2012/121213_Einigung_zu_EU-Aufsicht_122.pdf

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Financial and Banking Services Market

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**FORMATION OF THE SYSTEM
OF FINANCING ENVIRONMENTAL
ACTIVITIES IN RUSSIA***

Abstract

The paper is devoted to the problems of formation of the financial mechanism of environmental protection in the framework of local production systems. The authors identified main sources of costs for environmental purposes and analyzed the trend of reducing the fiscal costs of environmental protection. Particular emphasis is placed on the legal aspects of the use of payments for negative impact on the environment, including the abandonment of the use of funds to the budget as the price of a negative impact on the environment. The importance of environmental funds in the financing of environmental activities is shown, the importance of programmer – oriented approach to solving environmental problems is marked. The possible elements of the financial mechanism for the implementation of environmental protection measures are proposed. The main diffi-

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culties including stimulating effect in the economic mechanism of nature conservation and environmental protection are marked.

Key words:

Financial mechanism of environmental protection, environmental measures, payments for negative impact on the environment, fiscal policy, the budget allocated for environmental protection, promotion of environmental activities.

JEL: Q50, Q58.

Local production systems (LPS's) are territorial-industrial combinations, which are characterized, first, by the presence of its own economic capacity for self-development of the territory and ensuring its competitiveness. Only in this case the necessary preconditions for the progressive modification of the production and spatial structure of the economy within the limits of the LPS's, for the growth of their level of economic development and creation of conditions for social prosperity.

Secondly, LPS's must have an efficient management system, in which as a control object are considered economic complex of the area, its social services and the natural environment. With this as the subject of management can act the public authorities, local governments, and special management bodies for the implementation within the LPS's of any long-term projects and programs. Management of local production systems should be understood as an activity to regulate the processes of socio-economic development of the area in accordance with a pre-designed program and aimed at achieving the goals of improved quality of life. Under conditions of economic crisis, an important task of management bodies is to create tools to encourage the output of the region's economy of the depression and the providing conditions for development. Obviously, the development of regions, surviving depression and their further prosperity should be stimulated by the authorities.

Third, the LPS's are characterized by the existence of various public (government) and private institutions that perform, in particular, the various functions

for the provision of educational services and training, research and implementation of innovation, securing funding, and others.

Thus, the formation and functioning of LPS depends on many factors, including:

- economic (economic and geographical situation and the level of infrastructural development of the territory, transport, energy, innovation policy, the investment policy and territorial forms of social organization of production, etc.);
- social (including human capital, labor, employment, social protection of the population, the demographic balance, etc.);
- environmental (natural-resource potential, ecological potential, human impact on the environment, etc.);
- institutional (legal system and rule of law, judicial system, scientific and technical, financial and investment aspects, the system of governance, the system of market infrastructure, including credit and financial and other aspects, the system of education and science, cultural and religious values, etc.).

One of the important aspects of the study of the LPS's is to provide reliable financing process of their operation. In this article, we will focus on the problems of the formation of the system of financing environmental activities typical of the different levels of government, including the level of the LPS's.

In the field of environmental protection level of the local production systems is concentrating financial resources of various origins – from state allocations of funds to individual industries and companies – sources of pollution.

The main purpose of the economic mechanism in the field of the environmental regulation is not only providing accumulation of funds and compensation of expenses for environmental protection, but also (it's more importantly) stimulation of environmental activities, strengthening of the economic interest of industrial facilities in the rational use of natural resources and reducing pollution, in the organization of waste management and the use of secondary resources, etc. One of the important elements of the mechanism of the state environmental policy is the funding system. From as far as it is reliable and effective, depends largely on the state of the environment in the country and its regions.

Financial mechanism of protection of the environment is a complex of various financial and economic instruments aimed at promoting of environmental measures. These levers include an environmental tax policy, the system of payments for natural resources and negative impacts on the environment, environmental insurance, improving pricing for the products of industries that exploit natural resources, and other environmentally oriented industries, especially for environmentally friendly products and technologies, etc.

The purpose of the financial mechanism for the protection of the environment is to improve the environmental situation in the country with minimal material, financial and human resources through the provision of favorable economic conditions for environmental activities of the enterprises and industries. It is clear that the financial mechanism of nature management in any country reflects conducted by the state environmental policy.

To achieve these objectives it is necessary first of all to solve the following tasks:

- enhance the role of budgets of different levels of funding environmental programs, environmental activities and environmental government agencies; improve the system of public environmental funds;
- implement of the system of environmental taxation and compulsory environmental insurance schemes;
- clearly define the sources of funding for environmental activities between the company's own funds, extra-budgetary and budgetary sources, as well as to ensure the reliability and sufficiency of the funds in the market conditions.

In countries with developed market economies with typically a significant advancement in the field of environmental policy, the hallmark of the existing system of environmental management is the use of economic regulators to promote environmental management while maintaining and strengthening the state and public control and regulation in the field of environmental environment.

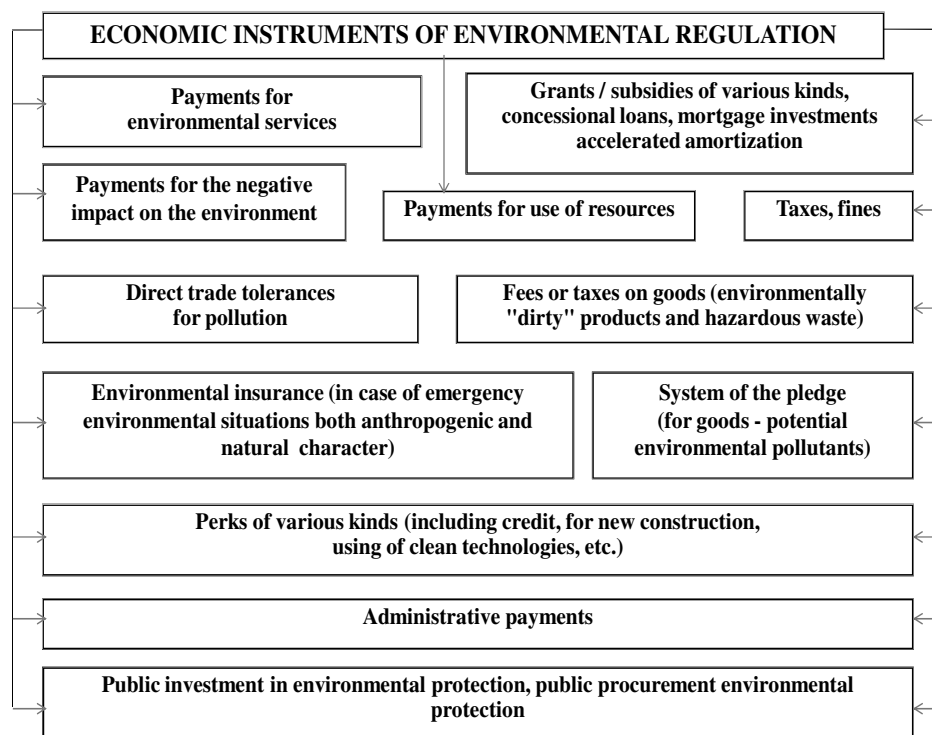
Economic methods of environmental regulation include a set of measures aimed at changing the attitudes of economic actors in a direction of changing favorable to the state of natural resources and the environment, by affecting the cost and benefits of the various options that are available to participants of economic activity.

The main purpose of economic methods is primarily in providing incentives of the environmental activities primarily through the introduction of environmentally friendly and environmentally sound technologies, and to find ways to minimize the economic costs which will be incurred by the company in order to achieve the desired state of the environment and its individual components.

Financing environmental measures in developed countries is both at the national and at the regional and local levels through national budgets, expenditures of regional and local authorities, facilities companies and enterprises. The main sources for expenditures for environmental purposes, as a rule, the government grants, loans, and loans with interest, fees and penalties for discharges and emissions, administrative fees, costs of environmental nature, payments for the use of natural resources, grants from the state and other tools (Figure 1).

Figure 1

**Tools of the financial mechanism of nature management
in developed countries**



In this case, the experience of developed countries shows that the focus is increasingly on not restrictive measures and punishment, but rewarding the efforts of those natural resource users whose economic behavior is to create the most favorable environment.

The existing financial mechanism of environmental protection in Russia is fragmented and consists of individual structural units. It consists of the following subsystems:

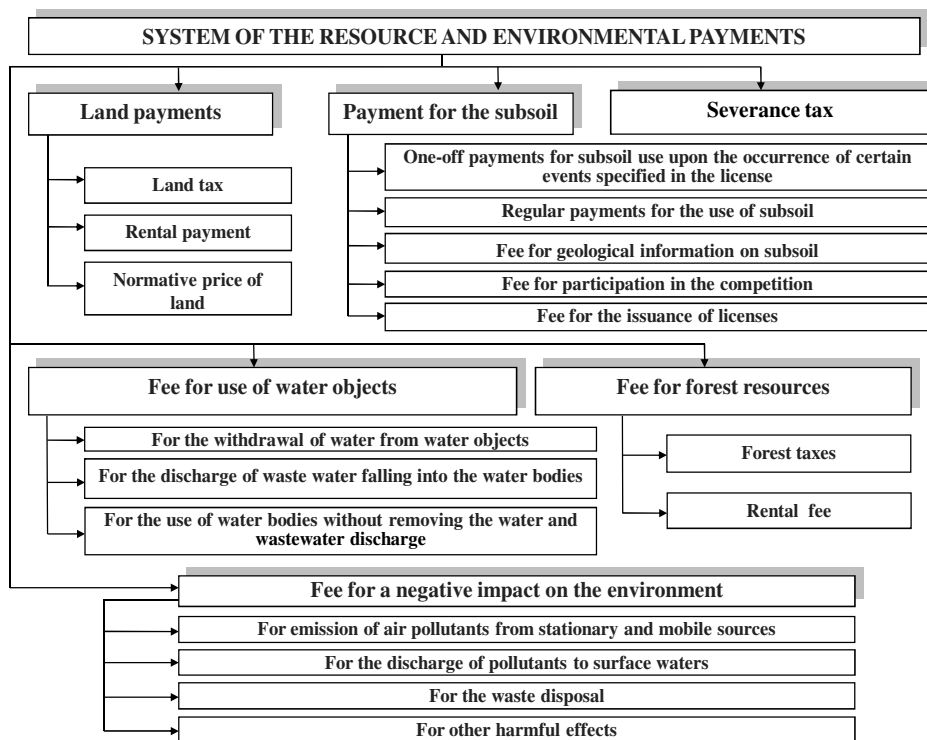
- financing of measures on the protection of the environment;
- forecasting and development of environmental programs;

- environmental pricing and taxation;
- payment for natural resources and environmental pollution;
- environmental insurance, etc.

Despite the importance of these sub-systems in environmental financing the degree of development and practical use of them is different; some of them have not yet been properly developed. To date, the basis of the mechanism of financing environmental protection constitute the payments for natural resources and payments for negative impact on the environment, including payments for emissions of air pollutants, water pollution, disposal of waste production and consumption, contamination of the subsoil and soil, etc. (Figure 2).

Figure 2

Resource and environmental payments in the Russian Federation



The introduction of charges for the use of natural resources and pollution of the environment in the Russian Federation was the result of changing relationships in the field of the nature management in connection with the transition to market economic principles. In this regard, one of the tasks of the national environmental policy is the organization of the work to ensure compliance with the principle of payment for environmental management. However, this principle does not always adequately reflected in the legislation on taxes and fees, which affects the receipt of resource payments to the budget of the country.

The implementation of the financing of environmental programs and environmental activities in the Russian Federation provides the possibility of using financing different sources, whose role varies. Among these sources, we can identify: budget funds (federal, regional and local budgets); funds of enterprises, institutions and organizations; environmental funds; environmental insurance funds; bank loans; voluntary contributions of the population; foreign legal entities and individuals, and other sources.

In general, the current Russian system of environmental financing is far from perfect and can not boast of any extensive array of different instruments and techniques, no significant grants from.

Since the early 90s there is a tendency to reduce budget expenditures for environmental protection in Russia. So, in 1995, for this purpose has been allocated 0.6% of the expenditure side of the budget, in 1996 it was 0.5%, in 1997 – 0.4%, in 1998 – 0.5% 1999 – 0.87% of the expenditure side of the federal budget.

The last decade government spending on environmental protection was scanty value being in the range from 0.14 to 0.2% of total federal spending. In the federal budget for 2011, the costs of environmental protection are provided in the amount of 14.5 billion rubles. It corresponds to 0.14% of the total expenditures or 0.03% of GDP (compared to developed European countries, the level of environmental costs estimated in the range of 4-6%, in Japan – more than 8% of GDP) (electronic sources 1-3 in bibliography).

At the 2013 budgetary allocation for environmental protection in the Russian Federation are expected to reach 16.7 billion rubles or 0,12% of the expenditures of the federal budget, which corresponds to 0.02% of GDP.

The plans of the Government of the Russian Federation is scheduled to increase to 2023 the share of the costs of environmental protection to 0.3% of the expenditure side of the federal budget, the problems, of course, does not solve. According to environmental experts, only to stabilize the environmental situation is required at least 2.5%, and for improving the situation need the facilities in the amount of 4%.

In 2000–2001 was liquidated Federal Environment Facility and, although formally environmental funds of the subjects of the Federation (regional funds)

and district (municipal and local) environmental funds are not abolished, but their activity in the majority of cases declined. Thus, the environmental activities lost, though relatively small, but reliably collected target means at the federal, regional and local levels.

The final blow to this source of funding caused the collapse of the system of payments for environmental pollution due to environmental funds was formed. At the same time, through a system of environmental funds has financed provision provision by equipment Inspections of analytical control, works on environmental monitoring, environmental research, environmental education programs, support of the reserves and other protected areas, a publication of environmental literature and other kind of environmental practices. After the destruction of the system of environmental funds these activities ceased in the vast majority of the subjects of the Federation.

In addition, under the conditions of Russian flexible mechanisms of environmental financing in the form of a market for pollution rights, environmental risks insurance and others is not being used.

In general, the existing system of government target environmental funds justified itself and, in our opinion, it is necessary its recovery. Means of such specialized funds could be one of the sources of funding of federal programs in the environmental field. Today, there is a reduction of funding and the closure of federal target environmental programs.

The abolition of federal target programs that have been funded primarily from federal and regional budgets (for example such as «Revival of the Volga», «Ecology and Natural Resources of Russia», «Waste», «State support of state natural reserves and national parks», «Protection of Lake Baikal», «Security and Development of Nuclear energy», «Energy Efficient Economy», etc.) has led to a decrease in the targeted budget funding for corresponding directions in the areas of environmental protection, which should be under constant supervision and care of the state. Since 2004, in the country is not realized none environmental program. Despite the fact that the current in the Russian federal target programs for the most part ineffective, and a number of them exist only on paper, under the closure were determined primarily environmental (or connected with protection of the environment) programs. This once again demonstrated setting the priority of the economy over the environment.

In the budget for 2013–2015 among federal target programs there occur only two environmental – Federal Program «World Ocean» and «Protection of Lake Baikal and the socio-economic development of the Baikal natural territory for 2012–2020». The share of program-oriented approach to solving environmental problems during this period is only 13-15% of the budget allocation.

Another important issue is connected with the fact that there is still the issue of payments for negative impact on the environment is not regulated in legal

terms. The relevant law has not been adopted so far, although its necessity follows from the federal law «On Environmental Protection» 2002. The current system of environmental payments, not having the necessary legal framework, essentially exhausted itself and is now playing a purely symbolic role – especially because of the exceptionally low base rates. Although in the 90-ies the system is practically and did not perform a regulatory function in the part of the capital environmental costs (due to the economic crisis and the difficult economic situation of enterprises), but it is done quite well with that function in the part the current activities of enterprises and served fiscal function. Now this system of environmental charges is based on the extremely low base rates (approximately 10% of the rates taken in Kazakhstan, Belarus, Moldova, Georgia, and only about 2% of the rates acting in most countries of the European Union). That does not stimulate enterprises to implement environmental activities.

It should also be noted, and such, in our view, an extremely important moment (again, who had a negative impact on the environmental sphere) as a rejection of the use of funds incoming to the budget as payment for pollution. If, before the adoption of the new Law «On Environmental Protection» in 2002, the card was designed exclusively for the purpose of restoring damaged environment, which was confirmed in the previous federal law «On Environmental Protection» of 19 December 1991, then after the cancellation of the last and adoption of the new law regarding the prohibition of the use of payments for pollution of the environment for any purpose, other than environmental, disappeared.

Later, a similar approach was used in making new versions of the forest, water and other codes and federal laws. As a result, the sphere of environmental protection in Russia, has always funded at an unacceptably low level, and lost what little that was. According to Ministry of Economic Development of the Russian Federation, currently the payment within the standards for emissions (discharges) of pollutants and waste disposal is only 0.04-0.05% of the cost of industrial products, which actually imperceptibly as stimulating factor or punishment for environmentally hazardous activities.

Apart from the aforementioned shortcomings of the system of payments for negative impact on the environment, the practice of using them also showed that the set of substances for which payments were set far from complete. Besides that, there are major flaws with the point of view of the inflation factor: the value the correction coefficient is incomparable with the actual rate of inflation. As a result, the system of payments for negative impact on the environment, that is intended to be used as one of the sources of financing of the environmental sphere, and also to some extent, encourage enterprises to implement environmental protection measures, in reality (as a result of successive emasculating its essence) does not perform any fiscal or regulatory, much more stimulating, functions. The value of environmental payments should be such that not only create strong incentives for effective environmental management (and thus for the introduction of resource-and energy-saving technologies), but also be compatible (in

terms of technical and technological feasibility of attainability of ecological and economic parity) with the conduct of economic activity in all sectors of the economy. In addition, these payments must receive sufficient funds to provide targeted funding for environmental protection.

Not correspond to the actual economic assessment and prevailing in the Russian system of payments for the use of natural resources. The level of these payments artificially low, and significantly (at least one order of magnitude), which proves ineffective implementation by the state the function of owner of the natural resources when huge part of the revenues from natural resource passes by budget.

In light of this, it seems necessary, first of all, the widespread introduction and development of the following elements of the financial mechanism for the implementation of environmental measures (Burmatova and Sumskaya, 2012; Burmatova, 2005):

- establishing tax privileges for environmentally responsible companies who outsource production to the best available technology (in particular, this may be exemption such enterprises from value-added tax (VAT) for a period of technical and technological re-equipment of fixed productive assets, ensuring resources saving and environmental safety of functioning production, etc.);
- the establishment of higher taxes for environmentally dangerous products and kinds of activities;
- preferential lending (for example, on the creation and implementation of new resource-saving and environmentally friendly technologies and equipment);
- accelerated amortization of the fixed productive assets of the environmental appointment;
- establishment of price premiums for green products or for the use of environmentally friendly equipment, etc.;
- introduction of the various kinds of the payments that could perform stimulating, compensatory, punitive functions, as well as regulatory, above permitted standard and other functions.

Use of regulators to encourage the greening of production, transition to the advanced technology, requires of modernization of tax and budget legislation. It is absolutely necessary to establish clear, understandable rules for investors, for producers who, planning any economic activity, will clearly understand what would be the economic and administrative implications of the lack of attention to the environment. Require as well a revision of penal sanctions for environmental offenses, the level of which is now so low that companies simply ignore environ-

mental requirements. The problem consists first of all in the fact that on the one hand, to generate interest of business in environmental activities (including through the modernization of production and the introduction of new technologies, environmental innovation, etc.), and, on the other hand, environmental violations should be strictly followed the rigid responsibility, with using the appropriate penalties. In this case, success is possible only under condition of achieving a balance between sanctions for environmental violations and receiving the benefits of environmental activities. Greening the tax system will give an additional impetus for conducting the structural and technological policy, in particular, for the transition from the use of natural materials to using recyclable materials and waste.

Of particular note is the problem of development of economic mechanism of stimulating rational nature management and environmental protection, promotion and support of environmentally responsible business. As already mentioned, formed in the Russian mechanism of the environmental regulatory does not have a stimulating effect. This is manifested, in particular, in the imperfection of estimates of taxable base of using natural resources, including low interest rates of the payment for the use of natural resources and the restoration of natural resources; at extremely low base rate payments for negative impact on the environment; in unjustified reduction in the payment rates for the use of natural resources and their reproduction by individual of natural resources users; in an underestimation of the value of natural resources, the substantial absence of payments for re-use of collateral and natural resources.

Without the development and implementation of the relevant elements in a system of levers and methods of management a shift towards active transition to resource-saving and environmentally friendly technologies can not be achieved.

It's necessary the direct economic interest of business in solving environmental issues and the state's task – to create this interest, to support resource- and energy-efficient technologies and products, including through the introduction of market regulators in the field of environmental protection, which would stimulate enterprise actually reduce anthropogenic pressure on the environment, introduce modern resource-saving and environmentally friendly technologies. Business needs to understand that environmental protection – is not only an additional burden on the budget of the companies, but also one of the conditions to improve product quality, increase its competitiveness in world markets.

Under the conditions of Russia absolutely do not used the flexible mechanisms of environmental financing in the form of a market for pollution rights, environmental risks insurance, etc.

It is clear that the transition to eco-oriented technology – an extremely complex process that requires not only a huge time and money, but also the political will of the government. Such a transition is impossible without adequate serious preparation for the implementation of measures, including legislative and

regulatory support, development of new technical and technological solutions, creating an effective economic mechanism of environmental regulation, etc.

Modern crises are making significant features in the relationship of the economy and the environment. Impact of the crisis on the state of affairs in the environmental field is usually two-fold character, causing on the one hand, environmental degradation, and on the other hand – its relative improvement, allowing to reduce the load on the environment.

Decline in production, reduction of transportation leads to a reduction in emissions and discharges, as well as reduced energy demand, which in turn leads to a decrease in revenues of carbon dioxide and mitigate the greenhouse effect.

However, such a reduction in environmental impact is temporary and, as experience shows, as the crisis pressure on the environment not only restored to the same level, but, as a rule, much stronger. This occurs, in particular, because of the desire of enterprises during the economic crisis, to reduce production costs, saving on all reflected in the reduction of industrial and environmental safety of the facilities. In addition, during the crisis of power, especially in the local level, local authorities often mitigate environmental requirements in relation to individual producers and generally weakened control by the environmental authorities. As a result of the ecological situation in the region is usually much worse.

The decline in production is accompanied by a decline in the financial resources from the producers, forcing companies to seek out additional sources of internal funds. This is most often seen in curtailing environmental activities, as it is not directly involved in the main production process and the company will first try to save on the environmental costs, which leads off environmental equipment, saving on electricity, expensive reagents, etc. This was shown by the experience of the crisis of the 1997-1998's in Russia, when the reduction of environmental pollution was far inadequate drop in production, and in some cases there was a marked deterioration of the environmental situation.

During the crisis, reducing the cost of environmental protection is specific not to the production level, but also to all levels of territorial administration – from federal to local, leading to partial or complete curtailment of environmental programs.

Along with this economic crisis generates and some opportunities to solve environmental problems [6, 7, 8]. First of all, participation of the state in solving economic problems increases and thus the opportunity for radical structural and technological change, the transition from resource-based economy to an innovative environmentally sustainable economy are appeared.

Reduction of financial resources at the federal level may force the authorities to review the energy policy of the country and abandon the expensive and

environmentally hazardous projects for the construction of new (often highly questionable in terms of their economic and environmental studies, and did not pass most of the state environmental expertise) hydro-and nuclear power plants, as well as the implementation of many other nature-large projects.

The structural transformation of the economy requires significant investment and time to implement them. The action of the Russian government to rescue the major energy and metals companies shows not only the consolidation of the commodity nature of the economy, but also leads to a shortage of funds for investment in the modernization and diversification of production. As a result, instead of the formation and development of high-tech industries and, as a consequence, the reduction of environmental pollution and waste of natural resources, we will have the opposite effect.

The consequences of economic crisis in Russia, especially in Siberia, the impact on the ecological situation faster and stronger, if a significant missed opportunity to modernize production, which resulted from new technologies industry can become the new "environmental" track. However, one can not ignore the fact that in today's crisis, the Russian company in the search for additional sources of finance is not on the way to finding the best technical solutions, and cost savings, and especially the environment. Therefore, it seems that the appeal of the country's leadership for Russian companies to exploit the situation to the modernization of production (including environmental) is unlikely to be heard by them, and after the crisis should expect any significant increase of human pressure on the environment.

In keeping with today's financial crisis is problematic to expect a radical change for the environment for the better. It is also important to consider that environmental problems require, as a rule, long-term solutions, which focus on the crisis reduced.

An important aspect of financial support environmental measures in times of crisis (and not only) is that the lack of funds to main production activities pushes aside everything else, first of all, the environment. At the same time, environmental protection measures, as long-term, require long-term investment for a fairly large investment lag when payback not only requires long periods, but it can not be achieved at all (for example, under the existing criteria of investments, ignoring usually economic damage from pollution).

Under current conditions in Russia of the functioning the financial system, when one of the biggest problems is the lack of funding so-called "long" money (i.e. funds to banks for more than one year), environmental sphere remains outside the immediate interests. One solution to this problem is to use these new financing mechanisms, as collective investors (mutual funds), as well as syndication and bond issues. (Vasylenko) The advantages of these sources of funding are, first, their low cost compared to commercial loans, and second, their big attraction for investors through the use of new technologies, the effect of participa-

tion, transparency, operating international reporting systems, improve the quality of products and services and ensuring the environmental safety of the production.

In the end, what environmental scenario would have the best chance for the implementation will largely depend not only on the legislative and regulatory support, forming an effective economic mechanism of environmental regulation, and many other conditions, but also the political will of government officials, their real steps on the use of modern situation for the modernization of the economy. It should be added that in today's market the current level of environmental protection and resource saving technologies and determines the competitiveness of the Russian economy in the world (or rather, its lack of competitiveness). At the same time, the increasing demands for environmental quality and safety of products, the transition to the integration of environmental parameters of the technologies used for the production of products, is one of the important directions of increasing international competition.

Environmental innovation development can not only gradually reduce the level of negative human impact on the environment, but also bring benefits of environmentally responsible business (which requires the establishment of appropriate economic rules of the game), contributing to the overall output of the country on a sustainable path of socio-economic development. In turn, the choice of the ways out of the crisis give a chance and allows the state to conduct structural and technological restructuring of the economy in favor of resource-saving and environmentally safe production and establishment of an environmentally sustainable and innovative development of the country and its regions. One of the conditions for successful development in this direction and to achieve good environmental situation as a necessary element of a decent quality of life and health is to ensure coherence of the regional government, business and the public in the field of environmental protection.

Contemporary crisis showed that the state must be present in the economy, not so much as an owner, how much and above all as a regulatory and guiding force. It is not only the failure of the market, the need to internalize the external effects, including those related to environmental pollution. Launch large-scale processes such as modernization and innovative transformation of the economy by government forces only.

In general, the problems of modernization, facing the Russian economy, require a change of value criteria for a wide range of relationships, including relationships with the natural environment. Then reduces to only upgrade technological aspects seem unpromising without creating appropriate institutional environment, one element of which is to build relationships with the natural environment. A new paradigm in the field of environmental protection, based on the concept of sustainable development, proceeds from the awareness of the need to reject consumer attitude towards the environment and building a partnership with her.

Environmental and economic consequences of such a partnership, arising from the consistency of the coexistence of natural, technical and human capacities are obvious. It is not just about the transition to resource-saving and environmental-oriented technology with all its consequences for the economy, the environment and humans, but also the formation of an environmental ethic, respect for the natural environment, the strengthening of the principles of eco-efficiency and environmental justice.

In other words, it is necessary a change in the criteria, the formation of an adequate institutional framework, without which the modernization of the economy is doomed. Institutional reforms should be aimed at creating new and better legal and economic mechanisms to regulate the interaction of different levels of government and natural resources, subject to the mandatory inclusion of environmental requirements in the procedure for assessing the socio-economic benefits of management decisions.

In general, formed to date, financing in the Russian in the sphere of environmental protection (including budget) does not provide sufficient economic mechanism of respect for the right of citizens to a healthy environment. At the same time, environmental goals can the only really be prioritized and effective when for their achievement will be allocated prioritized resources.

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Financial and Banking Services Market

Iryna HRYNYUK

**SOURCE
OF WORKING CAPITAL**

Abstract

The article deals with the analysis of the main sources of raising additional funds, the risks and liabilities associated with them to meet the requirements of current legislation of Ukraine. There has been made the conclusion about the expediency of different funding sources.

Key words:

Debtors, creditors, debt, funding.

JEL: M2, M29.

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Introduction

In the process of activity a large number of enterprises are faced with the problem of debtors not paying off their obligations. As a result, the companies have insufficient amount of working capital for normal business operations and are forced to seek additional methods to attract it.

The problems of the theory and practice of analysis and management of the working capital were investigated in the works of many economists. A significant contribution to the solution of these problems was made by such researchers: F. Butynets, S. Golov, V. Orlova, S. Ryleyev, O. Surnyna, V. Sheludko and others.

The purpose of the research is to justify the sources of working capital and to develop practical recommendations for choosing the best of them, for the further improvement of the funds management that will cause the financial condition of the company improvement.

The main material

Analyzing the sources of financing it should be mentioned that all the borrowed capital is chargeable. Despite the fact that own funding sources are considered to be free, it's not always the case. The contributions of the founders accompanied by the payment of dividends, the amount of which sometimes exceed the rate of interest on the loans offered by the banks.

Consider the main funding sources types from Form 1 «Balance Sheet (Statement of Financial Position)» (Ministry of Finance of Ukraine, 1999).

Ensuring payments to personnel and other types of ensuring. Each company establishes an allowance for future expenses and payments to employees to reduce the outflow of funds from the main account at the time of the relevant supply, but in the absence of situations that are created for this supply, the company can use the funds for other purposes. These tools are free of charge sources of funding, as they belong to the company directly.

Target funding. Capital earmarked funding and trust income can come as subsidies, allocation of budget and off-budget funds, earmarked contributions of individuals and entities and others. These revenues are usually irregular. However, it is targeted, so that the company will use the relevant needs of these

funds and the funds on the main account can be used for the repayment of other liabilities.

Long and short-term bank loans. Credit is usually given to business loans of all the types of property for temporary use under the conditions stipulated by the loan agreement. The most important of these conditions are: supply, return, timeframes, serviceability and target orientation. Total lending practice defines the mandatory payment for funds received through the accrual of interest as compensation to the creditor.

Other long-term liabilities. Obligations of borrowing (excluding bank loans) is intended to account for the payments to other persons on issued and paid bonds maturing more than twelve months from the balance sheet date

Other long-term liabilities. These typically include payments to landlords for non-working capital transferred under long-term leases, as well as working capital, cash and securities received under the integral property complex lease settlements with other creditors and other transactions, taxes and duties (mandatory payments) arrears often deferred in accordance with the laws, financial aid on reverse basis and others. Such obligations are provided for a fee. Lease obligations are paid regularly at a constant amount in accordance with the terms of the contract. Enterprise Manager shall analyze and consider all the economic gains and losses due to decision to take property for rent. The amount of lease payments for the whole period may significantly exceed the cost of the asset, so purchasing the asset is economically more reasonable. If the lease stipulates income, cash value of the lease payments should be compared with the future value of money received under the loan from financial institutions.

With regard to deferred taxes, fees, financial aid reciprocally, these amounts are paid to the budget once in a constant amount. These funds are returned at no additional premiums, so it is reasonable for the company to attract them. However, the procedure for deferral of taxes shall be done in accordance with the Procedure of the taxpayers' financial liabilities (tax debt) deferral. It requires a lot of effort, so it is not always appropriate (State Tax Administration of Ukraine, 2010).

Notes payable. Issuing bills for wealth, works and services received and other transactions are a good way for a time delay payment of liabilities to suppliers in order to keep the amount of cash in a current account for a certain period. Bill is inherently fee. Interest bill guarantees payment of interest on certain deferred payment, the cost of interest-free promissory note is usually higher than the original cost of debt.

Payables for goods, works or services are most appropriate source of funding. Paying for a normal term (1 year, unless the contract states it otherwise) the buyer has no additional financial obligations. However, the failure of the accounts of creditors leads to an increase in accounts receivable and outflow of the

lender's funds. If there is the regular failure on a few buyers, supplying enterprises is threatened with insolvency.

Current liabilities for payments received on advance are also a very good way to raise additional funds. With the right organization of work with the buyers and arrangements for prepayment in brief manufacturing process, the supplier can use directly the funds of the buyer for the manufacturing process. However, not all the companies agree to pay money long before receiving the goods, but for the supplier guarantees the absence of the overdue debtor liabilities.

Current liabilities to the budget, extra-budgetary payments and insurance settlements are the most negative types of obligations. Any arrears of taxes, duties and other fees are paid, with a time payment amount increases. Late payment of the amounts in the budget accompanied accrual of fines and penalties. Therefore, the main recommendations on management obligations to the budget are the constant monitoring of accrual and terms of payment of the amounts in the budget.

Current liabilities for wages. Company may delay payment of wages to its subsequent deposition if they have other commitments that would require immediate repayment in cash, but sum in the account is limited and there is no additional funding. But we should not forget that the main motive wage workers to perform their professional duties and its failure can cause downtime or even complete cessation of production. Therefore, according to the Law «On labor» wages of employees is done on a priority basis, at least twice a month (Supreme Council of Ukraine, 1995).

Obligations for payments to participants and founders of the company, related to the distribution of equity (dividends, return of shares, etc.) can be viewed from two perspectives. On the one hand, participants must fully pay now for contributions to the share capital. On the other hand – the firm must pay dividends to the participants. The deadline for the payment of dividends by law prescribed only for public companies. The company should pay dividends only in cash. As to other business entities, such as limited liability companies, they can determine the deadline for the payment of dividends in the statute or by a decision by the general meeting. Following the decision by the general meeting accounting pays dividends in the amount of the order and the terms defined by these charges (Magazine «Economist», 2014).

When insolvency societies expedient to raise funds from the founders, believing it to be more profitable than obtaining a bank loan.

The funds can be drawn from the founder in several ways. One of them is receiving money from the founder as repayable financial assistance. According to Article 14, subparagraph 14.1.257 of the Tax Code of Ukraine (CLE) (Supreme Council of Ukraine, 2010) repayable financial assistance – is the amount of funds received by the taxpayer for the use under a contract that does not include the

accrual of interest or provide other types of compensation in the form of fees for the use of such funds, and is a must to return. If the rotary support received from the founder of the company, returned to him not later than 365 days from the date of receipt, the amount of such assistance is not included in income under paragraph 135.5.5 Article 135 of the Tax Code, if the recipient of such aid is liable to income tax or single tax in accordance with paragraph 3 of paragraph 292.11 CLE if the recipient is repayable financial assistance to a person who is subject to a simplified tax system. Real obtain repayable financial aid do not fall within the definition of operations for the supply of goods and services, so the VAT on such transactions is not charged. Thus, this method of raising funds is not accompanied by additional commitments and payments. It is appropriate if the company needs the funds in the short run for the immediate repayment of certain obligations and there is confidence in obtaining funds in the near future from debtors. This debt is accounted for as part of other accounts payable.

If care is not returned within 365 days of the founder, it extends the general procedure of how to help received from the defaulter and the payer of income tax (depending on the status of the founder). Such aid is registered in the company as a long-term loan

From 01.01.2014, the income tax rate for businesses under the regular tax is 18%. This rate is much lower than the rates on loans offered by the financial services market. A possible when the bank that serves the company can provide a loan at a rate lower than the market. Interest paid on the loan may be less than the value of the income tax that would pay for the company. Where the company is not sure in the flow of funds from debtors in the near future and need to raise funds for the long term, it is advisable not to make out a bank loan, because these obligations to repay the company is difficult and time of payment of the founder can be changed.

The funds deposited by the founders may increase the share capital. In this case neither the company, nor the founder has to pay VAT and income tax. It does not matter, whether the founder is a citizen or an organization. Increasing the authorized capital is not so easy. Since the decision must be adopted by all the members of the organization at their general meeting. Hence, the founders must agree that the proportion of those who contribute to grow. The next step is to amend the founding documents and register them in the government. A firm as a corporation will have to register and issue additional shares. All this can be done only after the share capital of the company will be paid in full (Surnyna, 2000).

In this case, the management personnel are required to analyze such fundraising in all material respects. The main points that you need to pay attention to are the amount and the period for which funds are involved and the terms of the credit. Basically, these costs will be involved for the long term, an average of 3–5 years. During this period the rates charged and interest paid may signifi-

cantly exceed the amount of the loan. However, the founder of the funds involved is paid as dividends. Founders' deposits to the statutory capital of the company accompanied by additional costs for convening shareholders' meetings and legal services related to changes in the company's charter and other statutory and regulatory documents, additional shares. Also making a significant amount of money one of the founders may give it a controlling stake – 50% + 1 share. Taking into account that the distribution of income and the payment is subject to the company, which determined based on the amount of income that may never be paid in cash, and remain within current assets in the form of accounts receivable, payment of dividends on these shares can make a significant cash outflow of the company, which was the cause of further involvement, as Art. 30 Law «On Joint Stock Companies» (Supreme Council of Ukraine, 2008) establishes deadlines for the payment of dividends. Just as every company seeks to continue normal production activities, which will be accompanied by fruitful cooperation with contractors and their timely repayment of its obligations in the future will increase the company for cash payment for sold products, goods and services. An obligation to the bank is finish during specified conditions of the loan agreement and will have no further impact on the economic activity of the company. Contributions from the founder accompanied by additional costs when received and will further impact on the economic activity of the company under any circumstances in the future, as the payment of dividends will be up to the release of the shareholders of the person making the contribution or liquidation of the company. Removing particles accompanied by additional costs of funds to changes in statutory and regulatory documents. Returning the shares to the founders may be done only with the consent of the shareholders, but as the owner of a controlling stake will not be interested in reducing their income, removing the funds will be very difficult.

Increase in share capital for the development of the company, which in the future will be accompanied by the payment of large dividends will greatly enhance the image of the company in the market and increase product profitability of the enterprise.

Current liabilities of domestic payments include payments from subsidiaries and associated companies, internal calculations of the production units and households allocated a separate balance sheet, mutually tempering items; selling products and services; transmission costs management activities; payment of wages to employees of these facilities; for other types of payments (Ministry of Finance of Ukraine, 1999). Preparation of cash, equipment, materials and goods for the personal use of the subsidiaries is free of charge by attracting assets.

Other current liabilities include:

- Payroll – amounts the company owes to his employee for the acquisition of his assets, which can be repaid for the availability of funds in

the company. Such amounts are usually small and are not a significant source of funding.

- Tax liability – the amount of value added tax, determined based on the amount of advances received (pre-payment) for finished goods, merchandise, other tangible assets and intangible assets, works and services which are subject to shipping (performance).
- Tax credit – the amount of value added tax, which the company acquired the right to reduce tax liability. When offsetting tax credit debt and tax liability is deducted on account of analytical accounting of VAT. As it has been mentioned above, the amount of tax to be paid on time to avoid any additional charges.
- Payments for accrued interest – accrued interest for the use of money or goods (works, services) received a loan; property derived from the use (rental, leasing, etc.) (Ministry of Finance of Ukraine, 1999). This type of commitment is not the source of funding, and only leads to an outflow of money as a payment for the use of another's property.
- Payments to other creditors – payments to various organizations for non-commercial operations, such as those arising from building houses, sewing clothing brand, create fixed assets for joint activities and more. The value of these obligations depends on the entity type of its operations and general economic factors (Ministry of Finance of Ukraine from, 2000).

Receivables as inventory are an asset that is not profitable. However, the presence of a certain amount of receivables is a necessary result of its economic activity, and optimization of its size – one of the most important tasks that should solve the financial manager in the management of working capital.

If a company operates in a transitional economy, significant and stable amounts of accounts receivable and payable, tend to show a low level of financial discipline in payments between companies. Receivables in this case are a type of immobilized assets, assets that are temporarily withdrawn from circulation and accounts – funds that are temporarily engaged in free of charge. Receivables and payables are worthless in terms of inflation, so it is feasible to reduce accounts receivable and accounts payable increase within certain limits (Sheludko, 2013).

Conclusions

After analyzing the possible methods of raising working capital for businesses the main recommendation of management personnel is ongoing, continuous, thorough and objective oversight for the development and use of revolv-

ing funds. If you need additional involvement must carefully calculate all the costs and benefits of such decision in the long run because it might have an incorrigible impact on the future of the company.

However, raising funds from the founders or other own sources of funding is always more profitable than attracting outsiders.

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Regionalization

Andrzej RASZKOWSKI

**PLACE MARKETING IN THE PROCESS
OF TERRITORIAL IDENTITY CREATION
AND STRENGTHENING**

Abstract

The paper discusses the problems referring to place marketing related to the process of territorial identity creation and strengthening. Territorial identity strengthened by the activities carried out within the framework of place marketing constitutes the crucial component of the development process occurring in the contemporary territorial units due to emotional relations of a given community with the place of its existence.

The core of the study is focused on the presentation of selected elements constituting place marketing areas which can have a favourable impact on regional identity strengthening. Each of the areas has been supplemented by the list of potential advantages in this particular context. The following factors were listed: brand and image of the place, an effective promotion process, entrepreneurship enhancement, the organization of events, regional (local) products, Corporate Identity for territorial units, international cooperation, the creativity of self-government authorities or flexible management systems.

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Key words:

Territorial identity, place marketing, territorial unit, socio-economic development, factors of competitiveness.

JEL: M31.

1. Introduction

In the times of intensified national and international competition between territorial units both methods and concepts, resulting in their competitiveness improvement and better socio-economic development, become more and more important. In this perspective place marketing, as the reaction to meeting both needs and desires of a particular space users, seems to grow in significance. Territorial identity, strengthened by activities performed within the framework of place marketing, constitutes the crucial element of the process aimed at contemporary territorial units' development resulting from emotional relations of a particular community with their place of residence.

Several key components can be distinguished as part of the marketing process analysis, referring to territorial units regarded as the core ones in place marketing and playing major role in the context of territorial identity strengthening (Kotler et al., 1993). One of them is designing and selecting the set of adequate components, which combine the most favourable qualities and services typical for a particular territorial community. Another one is the implementation of motivating incentives for current and potential customers and users of territorial products and services. Additionally, it is of key importance to carry out progressive promotion of any valuable activity areas, typical for a particular place, as well as its brand and image (Middleton, 2011) in the manner which facilitates obtaining, by potential users of the offered products and services, full awareness regarding their advantages, benefits and generated added value. The community, having been aware of a territorial unit offer value, is naturally more inclined to raise the level of its identity.

At this point it should be emphasized that self-government authorities represent the leading, however, not the exclusive creator of activities covered by

place marketing. Business, science and education, representatives of territorial communities (Stimson, 2006) and also activities performed by NGOs (Claval, 2001) are, in particular, included among other entities or institutions involved in the marketing process of a given territory development. The participation of actors, representing a wide spectrum of territorial entities in local development through the implementation of particular projects, is neither an easy nor an obvious process which, to a great extent, depends on creative initiatives as well as coherent and attractive vision of development promoted by self-government authorities (Wong-Gonzalez, 2001). It is important in the sense that communities often identify themselves with a territory by their commitment and attachment to institutions, economic system or development objectives it is influenced by.

The purpose of the hereby study is an attempt to point to selected areas and place marketing components, which are crucial in the context of territorial identity creation and strengthening processes.

2. Theoretical aspects of place marketing and territorial identity

An attempt to define the concept of territorial identity should start from characterizing a territorial community as such. It may be perceived as a group of individuals associated with a given territory by the system of relationships (justified by different institutions) featuring certain common qualities and distinct from other communities following the principle of otherness. In this case the principle of otherness refers to the feeling that a given social group, owing to some of its attributes, is different from others. Therefore, territorial community members enjoy the sense of sharing basic values, relations and ties with a particular territory, as well as their distinctiveness from other communities. Territorial community, as opposed to non-territorial one, which functions only based on common values and goals to be carried out, is usually assigned to particular administrative borders (Kornblum, 2011).

Social science offers a number of territorial identity definitions, frequently characterized by a certain divergence. In a simplified version it can be referred to as the sense of identity with a particular fragment of space perceived as part of ourselves. It is also emphasized that emotional bond with a given place, surrounding landscape, local community, material and spiritual culture products (Deffner and Mataxas, 2010) and broadly understood cultural heritage (Allmendinger and Tewdwr-Jones, 2006; Miranda and Adib, 2007) represent significant determinants of territorial identity. Such approach is of great importance in the context of place marketing, where emotional sphere of human existence is frequently referred to.

Residing or staying in a particular place is related to the whole spectrum of experienced emotions or impressions and therefore does influence our perception of reality. Depending on the scale of positive experiences our attachment and feelings, regarding a given location, are created and our identification with it, in a long time perspective (Hague, 2005), is established.

Another issue which requires explanation is the spatial aspect of territorial identity which may be analyzed from the perspective of different geographic or administrative divisions. For the purposes of the hereby study the problems discussed refer mainly to local level identity (town, commune), sub-regional (district) and regional (voivodship). The identity associated with an individual household, a city quarter or the identity at a national, European and global scale, require totally different research approaches. It should also be observed that in the modern world particular dimensions responsible for territorial identity do penetrate one another and create a peculiar network of ways in which one perceives his/her individual belonging and otherness.

Place marketing, in its aspect of competitive advantage construction, may be understood as an integrated set of instruments or activities resulting in higher competitiveness of the defined and utilized space with reference to other territorial units of this kind. However, having taken another perspective, place marketing is understood as such "arrangement" of a given place which meets expectations of its target markets. In this case success is determined, to a great extent, by the degree of territorial community satisfaction and becomes indirectly translated into the level of its identity (Kotler et al., 2002; Proctor, 2007).

Among the factors deciding about the competitiveness of a given place one can basically distinguish soft and hard factors. It has to be pointed out that the role of soft factors in terms of regional or territorial competitiveness (see tab. 1) keeps growing. Soft factors seem to be particularly important from the perspective of activities undertaken in the area of place marketing.

The following factors of competitiveness can be referred to as major ones in the context of place marketing:

- socio-economic environment featuring high efficiency in solving developmental problems of a territorial unit,
- the functioning of enterprises or organizations characterized by the above average absorption of innovative solutions, as well as creating innovative solutions in the course of their functioning,
- spatial availability of a territorial unit,
- the quality of life in a community with particular emphasis on the area of social infrastructure,
- intensified activities for the benefit of unfavourable demographic processes stabilization and improvement,

- high quality of public services,
- the condition of natural environment, the potential of natural resources,
- pro-innovative and modern methods for a territorial unit management by self-government authorities,
- major economic entities investing in the area of a territorial unit in the context of attracting more investors and constituting the form of investment recommendation.

Table 1

The selected factors of regional, territorial competitiveness in place marketing

Hard factors	Soft factors
economic stability,	quality of life,
production capacity,	culture and education,
costs of conducting business activities,	professional competencies (including international ones),
business environment,	the development of market niches,
technical infrastructure with particular emphasis on communicational infrastructure,	flexibility and dynamism in action,
social infrastructure,	professionalism in management,
private ownership structure,	human resources quality,
favourable geographic location,	professionalism in dealing with the market,
the system of investment incentives,	entrepreneurship ingrained in the community,
the supply and management of the area,	creativity in solving problems,
the availability of modern technologies.	the level of territorial identity.

Source: Author's compilation based on (Kotler et al., 1999)

Place marketing may also be referred to as overall range of actions undertaken and focused on attracting investors, tourists, residents to a particular region, as well as the construction of favourable external image aimed at the quality improvement of local community living standards (Clark et al., 2010). Another

attitude to place marketing presents it as the set of techniques and activities applied by local and regional organizations and communities in the process of local development project planning and covering economic, urban, social cultural and tourism sectors, as well as the identity oriented one.

Still other definitions indicate direct relation between place marketing and territorial identity (Govers and Go, 2009). Following them place marketing refers to the process of place branding value establishment based on territorial (local, regional) identity. In other words, this approach recognizes place branding as the derivative of identity and a favourable internal and external image.

3. Place marketing components influencing territorial identity creation

An approach to the role and significance of territorial units' place marketing in socio-economic development has been advancing in line with the occurrence of new components and areas manifesting its positive influence. Owing to its broad spectrum of impact place marketing plays an important role in territorial identity formation and strengthening. The table below presents examples of positive influence exerted by place marketing in the discussed context. It is definitely not the final and closed list. Its extension should be expected together with the changing circumstances of contemporary territorial units functioning.

The majority of presented components and areas depend, to a great extent, on the involvement presented by self-government authorities. The activities performed by due authorities have to be supported by the sectors of business, science, education and NGOs. Such configuration allows for relatively more effective and efficient implementation of place marketing potential in the process responsible for territorial identity strengthening.

One of the more attractive areas of territorial identity creation is represented by the role of regional (local) goods understood as products or services to be identified with by a given area residents. Such products are manufactured and services are rendered in a non-mass scale and following environmentally friendly processes, as well as using locally available raw materials. Local (regional) products may become the distinctive factor of a given place owing to their specific and unique nature (Bellini et al., 2010). By means of emphasizing the relationship of products with a particular place it is easier to activate local community entrepreneurial resources, to strengthen interpersonal ties and the sense of identity with the place of residence. The growing popularity of local products is also related to the fact that potential clients, in their attempt to escape from the generally available market offer commercialization and unification, do search for high quality, unique products and services.

Table 2

Selected areas of positive impact exerted by place marketing on territorial identity

Area (component) of place marketing	Potential advantages resulting from territorial identity creation and strengthening
Place branding and image	<ul style="list-style-type: none"> • the sense of pride and prestige related to residing in a given territory, • better perception of a particular place in the country and outside it, • mental identification of the place as recognizable and an elite spot, • the sense of belonging to an exceptional community, • an opportunity for becoming distinctive at the background of other units, • smaller tendency of residents to migrate, • residing in a particular territory as the manifestation of social status, • reduction of negative information about a given territory in closer and more distant environment, • higher level of satisfaction with life resulting from financial situation and internal self-assessment.
Effective promotion process	<ul style="list-style-type: none"> • more frequent involvement of territorial community in the promotion process, • perception of one's own region attractiveness by emphasizing its beneficial conditions, • intensified interest in promotional activities manifested by territorial community, • creating positive feelings about a particular place in the minds of territorial community, • perception of a town as an attractive place for spending free time.
Stimulating entrepreneurship	<ul style="list-style-type: none"> • gradual improvement of economic situation experienced by both local and regional entrepreneurs and employees, • higher level of trust in self-government authorities and local business, • creating favourable climate for the development of entrepreneurship and entrepreneurial attitudes.
The organization of events	<ul style="list-style-type: none"> • potential opportunity for strengthening interpersonal ties, • attractive way of spending free time by territorial community,

Area (component) of place marketing	Potential advantages resulting from territorial identity creation and strengthening
	<ul style="list-style-type: none"> • social awareness formation based on the leading themes of events referring to culture, art, history, relics of the past, nature, regional products, education, ecology, etc.
Regional (local) products	<ul style="list-style-type: none"> • products are manufactured from locally and regionally available raw materials, resources, clearly indicating the relationship with a given place, • awareness of the potential and unique resources featuring a particular territory, • products may become the flagship of a given place and stay permanently in the minds of local community.
Corporate Identity for territorial units	<ul style="list-style-type: none"> • implementation of corporate identity elements (visual identification system, the system of attitudes, communication system) confirms professional approach to place identity approach, • coherent image oriented manifestation strengthening competitive advantage of the territory over other units, • development of unifying elements for a territorial community to be identified with, • logical and coherent arrangement of all symbols and attitudes referring to a given territory in order to be clearly recognized and distinguished at the market.
International cooperation	<ul style="list-style-type: none"> • transfer and implementation of internationally applied favourable solutions in local and regional environment, • the possibility of territorial community representatives participation in international projects, • taking mutual advantage of cultural heritage, • upgrading qualifications of territorial human resources.
Creativity of self-government authorities	<ul style="list-style-type: none"> • higher trust in local authorities, • the ability to invent solutions prior to the occurrence of a need or desire expressed by territorial community, • the skill of stimulating local community in order to benefit from energy inherent in it, • giving good example and enhancing social creativity level, • searching for, promoting and taking advantage of potential ingrained in creative personalities,

Area (component) of place marketing	Potential advantages resulting from territorial identity creation and strengthening
	<ul style="list-style-type: none"> • increased loyalty presented by territorial community, • creating territorial community consensus for the benefit of finding solutions to key development problems.
Flexible management systems	<ul style="list-style-type: none"> • swifter response to the occurring expectations of territorial community, • upgrading the quality level of services rendered, • easier implementation of tasks arousing lower social acceptance, • facilitated implementation of development strategies for the benefit of territorial community, • higher level of professionalism in management, • enhanced cooperation with other territorial units and local community representatives, • the adjustment of management systems (in public and private sector) to the requirements of contemporary rivalry by introducing development oriented factors.

Source: Author's compilation based on (Anholt, 2007; Gelder, 2011; Kotler et al., 2009; Metaxas, 2002; Rainisto, 2003; Wong-Gonzalez, 2001)

The organization of events, which can be clearly associated with a given territory, may result in higher level of territorial identity and increase interest in a given territorial unit by tourists, local community, public institutions, enterprises or potential sponsors in subsequent editions. Stimulating entrepreneurship may influence better perception of conditions for running a business. Potential benefits for a territorial unit are, in this case, quite significant. New investments go along with innovative solutions, regional knowledge resources become more abundant, modern management structures are implemented, new jobs are opened, training cycles are held, revenues earned by local authorities usually increase, new products are available, new markets are created. Nowadays the places which enjoy strong economic position and are observed as adventurous do facilitate the process of territorial identity strengthening.

Regarding the creativity presented by self-government authorities it should be indicated that creative personalities seem to be particularly desirable and searched since they may bring significant input into development processes occurring in territorial units, which should take advantage of their creative potential owing to its role in solving civilization problems, generating new pro-development

policy, stimulating economic processes, strengthening territorial identity and social tolerance, as well as creating and implementing innovative solutions in economic and social sphere (Florida, 2005; Hall, 2000).

4. Final remarks

Referring to the presented above discussion one may assume that place marketing plays an important role in the process of territorial identity creation and strengthening. Both components and activities included in the broadly understood place marketing, among which there are brand and image of a territorial unit, the process of promotion, organization of events, international cooperation, entrepreneurship enhancement, creativity, definitely influence the establishment of territorial identity. The community residing in a given territory and featuring high identity level is more active, adventurous, involved in solving developmental problems occurring in a territorial unit and cooperative in relations with representatives of self-government authorities. Territorial identity stimulated by place marketing oriented activities may become the natural source of winning competitive advantage by territorial units.

Each place features the certain level of territorial identity. It is the role of territorial marketing to strengthen such identity, to upgrade its level and perform creative activities in the areas predisposed for meeting such objectives. The strengthening of territorial community identity is a long lasting process and should be performed in a consistent manner as well as take full advantage of the whole set of place marketing components. This process should be incorporated in an overall concept of territorial unit's development.

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Regionalization

Olga ZHABYNETS

**IMPLEMENTATION
OF CLUSTER INITIATIVES
WITH INSURANCE COMPANIES IN UKRAINE:
STATUS, EXPERIENCE AND PROSPECTS**

Abstract

The article analyzes the prospective directions of realization in Ukraine cluster initiatives involving insurance companies in the article. It commits retrospective analysis of the establishment and functioning of clusters in Soviet Ukraine, Ukraine and abroad (EU and USA). Outlines the prospects and create conditions in our country insurance and financial clusters.

Key words:

Clusters, cluster initiatives, insurance companies, insurance clusters, insurance financial clusters.

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Introduction. The globalization of the world insurance space and its significant impact on the national insurance market, increasing competition in the financial sector require domestic insurance companies find and use effective forms of improving their competitiveness. Cluster form of cooperation, recognized by international practice as effective system, can ensure the creation of competitive advantages through partnership, helping to attract and implementation of business ideas, increase productivity, development of innovations and more.

The range of forms and types of cluster structures are quite broad and creates significant difficulties in the formation of clusters, especially in the field of finance. However, clusters are recognized as one of the most efficient production systems of the era of globalization and knowledge economy, because oriented to prioritize their development.

Analysis of researches and publications, a highlighting of unsolved aspects of the problem earlier. A significant contribution to the development of cluster theory made such foreign scholars as Enright M., Fezer E., Porter M., Rosenfeld S. et al. Features and clustering problems in the financial sector, including in insurance, are discussed in the works of such domestic scholars as Achkasova S., Vnukova N., Zarichna N., Zheleznyak V. et al. However, not all issues of participation of domestic insurance companies in implementing cluster initiatives, including a creation of insurance, financial and insurance clusters in Ukraine, thoroughly researched. It defines the goal of this article.

The aim of the research. The aim of the article is to analyze the prospect of fulfillment of cluster initiatives with insurance companies in Ukraine and outline the conditions of creation of insurance clusters and financial – insurance clusters.

The main material. In English the term «cluster» means beam, bunch, and group. The founder of the classical theory of clusters is Harvard professor Michael Porter, who gave such definition: «a cluster – is geographically concentrated groups of interconnected companies, specialized suppliers, service providers, firms in related industries, and other organizations associated with their activities for example, universities, agencies of standardization and trade associations) in certain areas, that compete, but, at the same time, are working together» (Porter, 2005, p. 256). The purpose of clusters – is an opportunity to provide the competitiveness of enterprises – members of clusters in the long run. The success of the cluster lies in a competition, orientation on leaders, getting a support of leaders and state power in the region.

It should be noted, that clusters are not new concepts in Ukrainian economy. In 70–80 years of the twentieth century it was appeared production associa-

tions, concerns in the Soviet Ukrainian. These names are names of clusters in the Soviet economy. The difference between the cluster and the concern was only in the way of their formation: in the first case companies are combined on a contractual basis, in the second – combined of companies is a result of decisions of the relevant ministries in government.

An example of a cluster during this period in Ukraine it can be considered State concern «Elektron», which was created in 1989. The concern included production association and enterprises of trade and service. The concern consisted of about 450 trade representations throughout the Soviet Union. On the other hand, Lviv television factory was basis for creating of Lviv production association «Elektron» in 1970. Lviv television factory was the leading enterprise in the association. The association consisted of 5 manufacturing units, 10 factories were located in Lviv region and Transcarpathian region, 4 research institutions, college.

State concern «Elektron» funded a number of social development projects, urban infrastructure of the city. In particular, the concern founded and funded own football club «Karpaty», built stadium «Druzhba» (nowadays, the stadium is called «Ukraina»), built a mass housing for its workers and social infrastructure in the neighborhood of Lviv – Ryasne, built a water supply line from underground springs near Holohory village to the city (distance is 60 km).

In 1990 the concern produced goods to 1.5 billion rubles, it was equal to 25% of Lviv region's GDP, or 4% of GDP of the Soviet Ukraine (Syrotenko). These results show a high effectiveness of cluster within not only the city, but the region and the country.

In independent Ukraine clustering process has begun in 1997 in Khmelnytsky region. Despite the specifics of Ukrainian difficulties disorder of legal framework, lack of business infrastructure, Association «Podillya pershyi» united scientists, entrepreneurs, financiers and government officials. In the period from 1997 to 2000 the association formed several industrial clusters, including sewing, construction, food, tourism, food and green tourism, which operate to this day.

Should be noted, that from the middle of 1980s all EU countries have started form a regional policy aimed to increasing competitiveness at national level and European level. In 2007 the EU had already registered 154 regional clusters. Leading positions in the implementation of modern cluster regional policy occupy Budapest, Warsaw and Prague in the EU. There are seven largest clusters of EU, which differ by high employment rates: food industry, construction, transportation and logistics, financial services, hotel business and tourism, manufacturing of metal constructions, equipment and service. These seven clusters employ about 50% of the population of the EU.

Number of workplaces is growing every year, and geographical proximity of economically connected regions helps to create a competitive economy, increase the productivity and innovation. In Europe clusters are formed depending

on the specialization, they can be both inside the country and abroad (Vnukova, 2010, p. 103).

After independence in Ukraine it was established European principles of economic development, based on the theory of clusters through the creation of European regions. In 1993 it was created the first – Carpathian European region. It consists of border regions of five countries. European regions on the western border of Ukraine have become the cooperation vector of Ukraine – EU. In April 2003 it was formed the first European region with Russia – Dnipro. In addition to Ukraine and Russia the cluster includes one more partner – Belarus.

European regions of Ukraine promote the development of cross-border cooperation between the relevant authorities of States. In addition, during the process of cooperation with neighboring countries Ukraine can benefit from the experience of developed countries in order to improve the economic, political, environmental and social situation both in domestic and foreign activities. Also, Ukraine will be able an investment-attractive partner for the EU.

Activity of the European regions is improved every time. The regions become such independent subjects of global competitive market, as a state, a transnational company. As of July 2012, in Ukraine it was founded 10 European regions that covers the entire perimeter of the borders of Ukraine.(electronic source # 4 in bibliography)

It is planned a development of clusters in European regions. Today, there is only one project of finance cluster – in European region «Sloboganschyna». This European region was established in November 2003 within the Kharkiv region (Ukraine) and Belgorod region (Russia). For today, unfortunately, it is only generated a development strategy for cooperation within European region «Sloboganschyna». It is not until now formed a clear institutional structure, the European region uses potential very little and needs concrete implemented projects to solve urgent common problems.

European region «Sloboganschyna» has reason to be regarded as a cluster. The European region could have as a core – joint Ukrainian-Russian project of building the world class airport «Kharkiv-Belgorod» on the border. This project creates real economic conditions for cluster initiatives, especially in finance. A distinctive feature of this cluster is a forming own financial system from banks, insurance companies and other financial market participants.

Despite of a large number of cluster initiatives, until now in the national legislation there is no definition of «cluster». It is not given kinds of clusters, establishment and operation features. There are some developed projects of regulations to format principles of the state policy in the clustering of the economy. But these projects have not been approved: «The concept of clusters establishing in Ukraine» (Ministry of Economy of Ukraine, 2008), «National strategy of formation and development of trans-border clusters» (Ministry of Regional devel-

opment and Construction of Ukraine, 2009). Currently the only existing document in this area is the Resolution of the Presidium of National Academy of Sciences of Ukraine from 08.07.2009, № 220 «About formation and functioning of innovative clusters in Ukraine.»

Insurance companies, as financial intermediaries, in the implementation of cluster initiatives in Ukraine may, in our opinion, be involved through:

1. The formation of own branch clusters (insurance or financial – insurance clusters);
2. The participation in other clusters (tourism, medical, medical – pharmaceutical, transportation – logistics, etc.) As an auxiliary component;
3. An underwriting of risks of participants of industry clusters and other clusters.

The beginnings of clusters in insurance in the former Soviet Union can be seen in the following example. In 1990, the insurance company «Transmedstrah» (head office in Moscow) was first to introduce the health insurance. It should be noted, that this insurance company was founded on the basis of Railways under the Ministry of Transport of the USSR. Later it was selected basic medical organization, which was central transport Lviv Railway Hospital in Lviv. It was the first step to form cluster of insurance medicine. However, this cluster initiative could not be realized because in 1991 the development of the insurance cluster was stopped by the collapse of the USSR.

The formation own branch clusters (insurance, financial – insurance) can be considered as a priority direction in the implementation of cluster initiatives involving insurance companies. Moreover, in the global financial practice there are many examples of effective functioning of the financial – insurance clusters.

Today the largest cluster of insurance in the world is a cluster of Insurance and Financial Services (IFS) in Connecticut (USA). Founded in 2002, IFS cluster is strategic corporate initiatives aimed at creating a strong market of insurance and financial services, strengthening the economy of Connecticut as a whole. In the cluster demonstrated partnership between branch companies – leaders, government and academia. This partnership is intended to promote the growth of all segments of the insurance and financial services (Connecticut insurance market report, 2012).

Activity of IFS cluster aims to improve the business climate for existing and future companies of cluster. The cluster provides a framework for cooperation and collaboration of branch leaders across the state. This is manifested in the creation of competitive advantages for attracting and retaining business ideas, hiring and growing of skilled labor, increasing productivity, development of innovations and improvement of conditions in manufacturing.

IFS cluster has grown significantly since its establishment. In 2011 it included 29 corporate sponsorship organizations (banks, insurance companies, etc.). Staff of insurance sector totaled 61,583 people, or 3.1% of all workers in Connecticut (the highest percentage in the country). At the same time, in general, insurance sector workers make up about 1% of all employees in the USA. Wage fund of insurers is 5.7% of the total the fund of the state, while the overall the USA wage fund of employees, involved in the insurance business, is 0.5%.

The insurance created 9% of Connecticut's GDP, other financial services totaled 11% of GDP. According to our calculations based on the data source (Total Gross Domestic Product by State for, 2013), in monetary terms, it was 20 and 25 billion dollars respectively.

As the legal status of the cluster is not defined legally in Ukraine, in practice can be applied cluster approach (Degtyaryova, 2011). According to the approach companies already operate: associations, corporations, consortiums, trusts, business entities and more.

In view of this, insurance groups can be considered as some kind of cluster formations in the insurance market of Ukraine. Insurance companies – members of an insurance group, despite of a competing with each other, complement each other (through the exchange of insurance products and experiences). Also these companies follow a common insurance strategy and common insurance, financial and investment policies, thereby increasing their competitive advantages over other insurance companies that operate independently.

Thus, in 2000 it was established «Insurance Group «Garant», which included such insurance companies, located in Kiev, as «Garant-Auto», «Kyiv», «NFSK «Guarant RE», insurer of life insurance «Garant-life», as well as pension fund «Autoalliance», Ukrainian center of post-accident protection «Expert Service», companies: «Garant-Consulting» and «Garant-Assistance». In 2001 formed «Insurance Group «DASK», which united insurance companies from Dnipropetrovsk region: «DISCO», «DASK», «DASK-SP», «DASK-Pavlograd», life insurer «DASK-life» and 11 insurance brokers, enabling this group to provide a full range of insurance services for both corporate clients and individual clients. Today these insurance groups no longer exist.

In 2002 it was created «Insurance Group «Universalna», which brought together local insurance companies: «Karpaty» (c. Uzhgorod), «Universalna» (c. Lviv), «Teren» (c. Ternopil), «Salamandra – Desna» (c. Chernihiv) and life insurer «Arta» (c. Ternopil). After 2 years «Insurance Group «Universalna» was eliminated in connection with the performance of the tasks, assigned to the group: the participants of group were formed the success of branch leading company – Open Joint Stock Company «Insurance company «Universalna». Now «Insurance company «Universalna» includes in the holding company «Universal Investment Group».

A participation of insurers in other clusters can be traced, in particular, through the creation of the medical cluster, the core of which are insurance companies, of course. We consider that the clustering development of healthcare is a promising direction of government policy. It should be directed to improve the quality of medical services and reducing the cost of their provision.

Cluster initiatives in this direction have already implemented in Ukraine. 14–15 June 2013 in Kherson region it was «The First Baltic-Black Sea Economic Forum», which has become the starting point of a number of projects, including a creation of international medical and pharmaceutical cluster «Industry of Health», as well as the development of international health insurance (electronic source # 8 in bibliography). Due to the fact, that Kherson region is annually visited by about 2 million tourists, the worked out mechanisms of health insurance will attract additional funds into health care. In addition, in the framework of the international medical and pharmaceutical cluster citizens of Baltic region can be recreated at the local hospital. It is funded by insurance companies.

For insurance companies, as financial institutions, function of safeguard of economic units by providing insurance protection from unforeseen events (risks) is a priority now. Because of risks in business and other activities are inevitable in the current economic conditions. In particular, during the functioning of industrial clusters it can be arise following groups of risk:

1. Non-receipt of income by basic enterprise because of enterprises-suppliers failed their obligations
2. The property risks of a customer and property risks of suppliers
3. Forced stop business activity as a customer and suppliers.

Consider the different types of insurance in relation to a particular group of risks arising from the functioning of industrial clusters:

I. Supplying enterprises have certain obligations in relation to the main enterprise. Failure to meet these obligations (insufficient supply raw materials, products, etc.) leads to a reduction in economic activity or stop production, which results in failure to obtain profit. The insurance company undertakes to compensate the losses. Supplying enterprises own fixed assets and working capital. In this case it can be concluded an agreement of insurance of fixed assets in favor of the supplier. But working capital can be insured in favor of the customer.

II. Any company that is part of the cluster owns material resources: buildings, special facilities, warehouses, land, building facilities, transportation, etc. All these facilities are at risk of fire, explosion, accident, natural disasters and other emergencies. A damage may be caused to the property as the main enterprise, as and property of the supplier. In this case, the insurance company will reimburse loss incurred by the enterprise.

III. Insurance against loss of income due to forced break in production (also known as insurance against business interruption or insurance from idle). Damage of property due to fire, accident water supply systems, natural disasters, robbery, etc. can be so serious that entail a stop of production. It will bring additional losses: loss of profit, operating costs – staff salaries, rents and other costs. The company has the costs regardless the state of means of production. In this case also there is insurance coverage. For a policyholder the insurance contract provides a compensation of missed revenue due to business interruption or reduction of normal business activity. Contract of insurance against business interruption may also provide reimbursement of expenses required for an early resumption of functioning of the company.

So, insurance is an effective instrument for protecting of material resources of the company and reducing of business risks. Today an availability of insurance coverage guarantees the stability work of the company in the future. Insurance can not protect the company from the onset of these risks, but may take on the compensation of losses in the event of unexpected damages.

Conclusions. Today Ukraine is only at the initial stage of formation of clusters in the financial sector. Such facts, as a globalization of the world market, the hard pressure from foreign insurance companies encourage domestic insurers to unite in order to increase their competitiveness. In view of this, the establishment of insurance, financial – insurance clusters in Ukraine can be considered as logical and inevitable. In addition, perspective directions of insurance companies participating in the implementation of cluster initiatives should be: participating insurers in clusters as an auxiliary component and underwriting of risks of insurance cluster members. However, the implementation of cluster initiatives will depend on government support as a determining factor in the formation of national cluster policy.

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