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## **ENVIRONMENTAL STANDARDS AS A SOURCE OF OPERATIONAL RISK AND COSTS FOR COMPANIES**

### **OKOLINSKI STANDARDI KAO IZVOR OPERACIJSKIH RIZIKA I TROŠKOVA U KOMPANIJAMA**

#### **Abstract**

*Increasingly complex, complicated and demanding environmental regulations continually create higher and higher level of legal risk for businesses and society as a whole. It also puts on the companies the burden of additional costs that have to be included into the price of their goods and services. The legal protection of environment is complicated not only from the standpoint of legislation but also in terms of its implementation and compliance. The system of environmental protection must be the pillar that supports the development of sustainable nature, economy and society. To achieve that goal the system needs to be based on the “polluter pays” principle and it needs to include efficient cooperation between different stakeholders, amongst which companies have an important place. In addition to being an active partner in environmental protection, companies are at the same time the market participants so they must think about relevant costs. They must include into their decision making process all environmental regulations and all relevant financial and fiscal instruments.*

**Keywords:** ecology, environment, economic instruments, companies, operative risks

**JEL:** Q

#### **Sažetak**

*Sve kompleksnija, komplikovanija i zahtevnija regulativa zaštite životne sredine neprestano stvara sve veći i veći stepen pravnog rizika za privredu i društvo u celini. Ona takođe opterećuje preduzeća dodatnim troškovima koje ova moraju da uključe*

*u cenu svojih roba i usluga. Pravna zaštita životne sredine je složena, ne samo iz pozicije zakonodavstva, već i njenog sprovođenja i uvažavanja. Sistem zaštite životne sredine mora biti stub koji podržava održivi razvoj prirode, privrede i društva. Da bi se postigao taj cilj, sistem mora da se zasniva na principu da “zagađivač plaća” i mora sadržati efikasnu saradnju između različitih zainteresovanih strana, među kojima kompanije imaju značajno mesto. Kao aktivan partner u zaštiti životne sredine, kompanije su u isto vreme i učesnici na tržištu, tako da moraju da razmišljaju o relevantnim troškovima. One moraju da u svoj proces odlučivanja uključe sve propise o zaštiti životne sredine, kao i sve relevantne finansijske i fiskalne instrumente.*

**Ključne reči:** ekologija, životna sredina, ekonomski instrumenti, privredna društva, operativni rizici

**JEL: Q**

## **1. Introduction**

The purpose of this article is to present the relevant Serbian legislation concerning the costs companies are exposed to. The main goal of the article is to put the light on the fact that ecological problems linked to companies are complex and complicated and relevant costs must be carefully calculated and operational risks managed properly. The list of relevant works in Serbian economic and legal literature is not large but some articles deserve to be mentioned (Brnjas, Stošić & Dedeić 2015), (Brnjas, Ćurčić & Dedeić 2015), (Bošković & Radukić 2012), (Belokapić, Bogavac & Ristić 2012), etc.

Today’s companies in the European environment suffer, amongst others, a significant normative pressure. Increasingly complex and demanding regulations result in a higher degree of legal risk and generate additional costs for corporations that need to be incorporated into the price of goods and service.<sup>1</sup> The corpus of environmental standards composed of a growing number of increasingly complex regulations is a typical example of this. Companies that do business in the Serbian market share the same fate. Environmental issues that include energy efficiency and relevant costs are of paramount importance for high value investments of the private sector into infrastructure projects and creating partnerships with local government or privatization of companies that fall under the category of polluters (for example, the city of Pančevo).

Environmental standards aim at establishing a sustainable development both in terms of use of natural resources and in terms of sustainability in economic

and social terms (Pešić 2012, p. 8). Companies today are operating within a complex and demanding regulatory framework on environmental protection, and the protection itself represents a complicated process not just in terms of creating regulations but also their implementation. There are several reasons for this, and among the most notable ones is the complexity and multi-disciplinary nature of the object of protection and of instruments of the available legal relief. Such a situation imposes the need for all stakeholders to act in concert and the need for having a set of harmonized regulations that cover a large number of legal areas and disciplines. The complexity of the object of protection stems from numerous natural and social resources that it pertains to. The natural resources include water, air, soil, forests, etc. while the social values include goods created by man with its work. Consequently, effective protection implies the regulation of various physical, social and cultural factors that affect the survival and development of the wildlife (Dražković, Brnjas & Stošić 2015). Thus, relevant legal norms have to protect humans and wildlife from pollution of water, air, forests, etc. and regulate specific issues concerning waste and hazardous substances, incidents, noise and other phenomena that endanger people and the environment. Considering that companies, in the course of their operations, intensively affect the environment it is only logical that they are in the center of the protection system as a target group.

Our environmental law has been formed under the influence of several factors of international character. The first determinant of the content of our regulations is the membership of the Republic of Serbia to the United Nations and our acceptance to follow relevant regulations. Special importance in that corpus of regulations is placed on the Stockholm Declaration of the UN on the Human Environment of 1972, the Rio Declaration on the Environment and Development of 1992. It is worth mentioning the Aarhus Convention that we have joined recently (UN Convention on the Human Environment of 1972). The second relevant fact is the membership of our country to the Council of Europe that implies ratification of conventions that protect human rights and their key segment is the right to a healthy environment (Council of Europe 1950, 1993, 1998, 2004)<sup>2</sup>. And finally the third important moment in our efforts to create contents and principles of the environmental protection in Serbia pertains to our political aspirations to join the European Union. The primary legal requirement in that has been set by the conclusion of the Stabilization and Accession Agreement that requires harmonization of standards that, amongst other things, regulate environmental protection.

## **2. Basic principles of environmental protection and legal instruments**

International influences and reliance of our policy makers on key international documents have resulted in incorporation of certain generally accepted standards into our legislation, regulations and strategic documents. Those are the principles that protect rights such as the right to live in a healthy environment, to biosphere integrity, to the sustainable economic development, rational use of resources, etc. In that sense our regulations are built on principles applied in international legislative and judicial practice crucial for interpretation of the scope and reach of specific rights and obligations that apply to companies in the Republic of Serbia.

The principles (Lilić 2010, p. 22) of environmental protection permeate all activities concerning the object of protection. They are contained in obligation of all levels of government to act in concert, and this action includes measures to act preventively, to guarantee sustainable development, and to stimulate all the subjects covered by the system of protection. Clearly, the state authorities are the backbone of the system of protection and by establishing the principle of subsidiary liability for public authorities their responsibility in this area is further strengthened.

The most important element of the issue of responsibility of companies and other persons is the question of compensation for damage. The system of benefits is based on the principle of polluters' responsibility, or the responsibility of their legal successors –the “polluter pays” principle and the “user pays” principle. Such a system of legal protection that determines the level of responsibility for the state authorities and for those entities whose activity damages the environment or those that violate the right to a healthy environment complement and reinforce the principle of access to relevant information and public participation in the decision-making process. The right to a healthy environment becomes meaningful through the effective protection by the judicial and administrative authorities. The scope of protection anticipated by our regulations imposes a duty upon all entities, those in the public and private domain- the duty of care.

National legislation provides for specific measures of financial and economic nature, which should ensure compliance with regulations and prevent or reduce the consequences of pollution. If the infringements incurred causing damage to the environment repressive measures are applied with the purpose to improve the situation, punish the offenders and award tangible benefits to a person who has suffered damage. In addition to appropriate

regulatory framework, an efficient system implies a clearly defined and solid institutional framework. Successful functioning of the protection system is possible only with joint actions of the central and provincial and local authorities and their harmonized plans and implementation of regulations by means of licenses requiring technical and other standards and norms, adequate financing and incentives, efficient monitoring, etc. (Dedeić & Brnjas 2013).

One of the basic legal instruments of protection is called access to environmental justice. It is the backbone of the Aarhus Convention and together with the right to information and the right to participate in decision-making makes the basis of legal protection. The possibility to challenge the decision in regards to the protection of the environment before a national authority of any administrative or judicial authority is a vital part of the system of environmental protection.

The criminal law protection also represents an extremely efficient and important instrument of legal relief. The supervision over the implementation of the Law on Environmental Protection and other regulations is the task of the Ministry. Inspection supervision is implemented through environmental inspectors. The legal grounds for inspection supervision are contained in the Law on State Administration, as a *Lex Generalis*, and the Law on Environmental Protection, as a *Lex Specialis*. Also, laws adopted based on this basic environmental law (“Official Gazette of the RoS”, No. 36/2009 and 88/2010) are the Law on Environmental Impact Assessment and the Law on Integrated Environmental Pollution Prevention and Control and they also, indirectly regulate inspection oversight in this area.

The supervision system of the Republic includes the Autonomous Province and local self-government units that use their inspection services to control compliance with requirements within their respective remits. The court as a state authority which is called upon to settle any dispute caused by damages will initiate the proceedings based on environmental lawsuit which is a legal instrument available to the person who has suffered damage. The basic legal act that provides environmental protection in the Republic of Serbia is its Constitution. This legal document is the source of all laws, including those that govern environmental protection. Applicable environmental legislation in the Republic of Serbia consists of the following laws: the Law on Environmental Protection (“Official Gazette of the RoS”, 135/04; “Official Gazette of the RoS”, No. 36/09); the Law on Environmental Impact

Assessment (“Official Gazette of the RoS”, No. 135/04; “Official Gazette of the RoS”, No. 36/09); the Law on Strategic Environmental Impact Assessment (“Official Gazette of the RoS”, No. 135/04; “Official Gazette of the RoS”, No. 88/10); the Law on Integrated Environmental Pollution Prevention and Control (“Official Gazette of the RoS”, No. 135/04) and the Law on Environmental Protection (“Official Gazette of the RoS”, No. 36/09; “Official Gazette of the RoS”, No. 88/10). Laws that govern special areas like the Law on Water Protection, the Law on Air Protection, the Law on Protection against Ionizing Radiation and Nuclear Safety additionally build this corpus of general legal norms; the Law on Protection from Non-Ionizing Radiation and a whole series of bylaws (regulations, decisions and rulebooks).

### **3. Economic instruments in the environmental protection system**

The National, provincial and local self-government authorities need to have access to some economic instruments to be able to secure financing and attain the set goals concerning environmental protection. Those are instruments that enable collection of earmarked funds. The Law on Environmental Protection provides for those economic instruments, and regulates the position of the Environmental Fund with particular attention. The main task of the Fund is to secure finances which will be used to foster protection and improvement of the environment in various ways.

Economic instruments provided by the law directly impact businesses exposing them to additional costs that must be included in the price of their products or services. Those instruments are as follows: charges for use of natural resources, charges for pollution of the environment, other charges imposed by local self-government units.

The use of economic instruments may be counterproductive when a polluter has a monopoly position in the market (pollution is reduced, but so is output) (Ilić-Popov 2000, p. 28). Incentives have a special place in the environmental protection system and may be beneficial to companies. For instance, those can be tax, customs and other exemptions for technologies and products with better characteristics in terms of environmental protection. Exemptions may pertain to consumers and may aim at motivating them to build a positive attitude towards environmental protection (e.g. some benefits for those who help treat technical waste).

The basic principle is that the user of natural resources pays for their use. The user also bears the costs of rehabilitation. Both of these user charges are the embodiment of the “polluter pays” or the “user pays” principle. According to the Law on Amendments and Addenda of the Law on Environmental Protection funds generated from charges paid by users of natural resources are shared between the Republic and local self-government under a special law<sup>3</sup>. When it comes to polluters, according to the Law on Amendments and Addenda of the Law on Environmental Protection, 60% of funds generated from the charge are the share of the republic budget and 40% are the share of the local self-government budget<sup>4</sup>.

Local government units are authorized by law to prescribe a fee for the protection and improvement of the environment. If a local government has the status of endangered environment, it may introduce some special fees, for example, for owners of freight vehicles transporting oil and oil derivatives and the like.

It should be noted that funds collected based on the charge may be used only for specific purposes, that is, for the purpose of protection and improvement of the environment. The charge for pollution of the environment is paid by a polluter. Its amount depends on the degree of hazard to the environment. More specifically, in line with the Law on Environmental Protection (“Official Gazette of the RoS” No. 36/2009 and 88/2010) the charge is calculated based on criteria such as: the type, quantity or characteristics of the emission from a particular source; the type, quantity and characteristics of emissions from disposed waste, the contents of substances harmful to the environment in the raw material, semi products or finished products.

Payers are all natural persons or legal entities that cause environmental pollution. This obligation exist in relation to emissions of harmful substances, trade of raw material, semi products or products that include hazardous substances or in relation to any other form of pollution. The government specifies those criteria for specific calculation of the charge. We will discuss charges in the text below.

All natural persons or legal entities are responsible to care for the environment by obeying general principles of environmental protection while performing their activities. Amongst others, those principles imply the obligation to harmonize one’s business activities with regulations, exercising preventive measures aimed at protecting the nature from potential pollution or reducing it, sustainable use of resources and energy,

use of clean technologies and products that result in less pollution. Also, it is their obligation to implement specific control and maintain records. An entrepreneur or a company carries out environmental protection measures independently or through an authorized organization.

A polluter who causes damage to the environment is held liable on the basis of strict liability. When damage occurs the polluter must immediately carry out measures anticipated in the contingency and remediation plan (Kikić, Stanković & Brnjas 2011). If the damage caused is of such intensity and character that cannot be repaired then the polluter has to pay compensation up to the value of assets destroyed. The polluter bears the costs of appraisal of the damage caused and its removal. Also, the polluter has to provide financial and other guarantees of payment of compensation of costs, in line with the Law on Environmental Protection (“Official Gazette of the RoS” No. 36/2009 and 88/2010) during and after completing his activities. The government specifies the type and the amount of such guarantee. If the risk of pollution is high the polluter is obliged to conclude a contract with an insurance company about insurance from liability.

A project implementer, or a legal entity, an entrepreneur or a natural person who uses natural resources, performs construction works and other works outdoors must act in line with environmental protection measures<sup>5</sup>. Those measures are specified by plans, frameworks and programs and their main goal is to prevent any threat or damage to the environment or, at least, minimize them. If outdoor projects or activities have been implemented without predefined environmental protection conditions or in contravention to the specified conditions which resulted in damage to the environment or protected natural resources, the project implementer or activity implementer or the user of natural resources is obliged to immediately and at his own expense repair detrimental consequences of his own actions (Tomić, Komazec & Delić 2013).

For the use of the protected area a company or other legal entities, entrepreneurs or citizens (users) pay a charge to the operator of the protected area. The amount, the manner of calculation and payment of the charge are specified by the operator in line with the predefined criteria and the act by means of which the operator of the protected area defines the amount and the manner of calculation and payment of the charge is approved by the Ministry.



One of the basic rules of contractual relations is that whoever causes harm to another is obligated to compensate it. A person who suffers damage has the right to compensation and that request forwards to the polluter or insurer or guarantor. Companies have to align their solid waste policy with regulations (the Law on Solid Waste Management, 2009/2010). The basic principle applied is the polluter pays all costs principle. Policy makers require producers or importers to pay special charges on products that once used become part of special waste flows (the Government specifies the list of such products)<sup>6</sup>. The operator pays charges provided under the law (for a license, etc.).

Charges and fees in tourism are provided under the Law on Tourism (“Official Gazette of the RoS” No. 36/2009; 88/2010). Tourism charge is paid for the use of benefits while performing activity in a tourist destination and payers are companies that perform activity connected with tourism. Policy makers anticipated that persons who stay in a tourist destination pay a hotel fee prescribed by the city or municipality according to the category of the tourist destination.

Generally speaking a charge is an administrative cost of use of goods of public interest. Charges may be introduced for water, land, forests, roads, construction land, etc. The Budget System Law cites all the charges that may be introduced (charge for environmental protection, charge for the use of tourism area, etc.). Charges are not introduced or used with a fiscal goal in mind which is best illustrated by environmental charges which are the source of earmarked funds that can only be used for protection and improvement of the environment. Many local self-government units have used their rights to collect revenues on the basis of protection and improvement of the environment and in line with criteria specified in the Regulation on the Criteria for the Determination of the Charge for Protection and Improvement of the Environment and the Highest Amount of Charge<sup>7</sup> and by relevant decisions of their assemblies introduced specific fees and charges.

In the legal system of environmental protection a regulation that specifically defines all significant elements related to compensation is the Regulation on Types of Pollution, Criteria for Calculation of Charges for Environmental Pollution and Payers, the Amount and Manner of Calculation and Payment of Charges. Charge for produced or disposed waste is calculated according to the type, quantity and characteristics of the waste generated or disposed during the period of one year, which is determined by the used production

capacity and is expressed in units of mass in tons. Charge for substances that deplete the ozone layer is calculated according to the imported amount of these substances for a period of three months, etc. Payers of this charge are all natural persons and legal entities that cause environmental pollution. The Regulation specifies the formula for calculation of the amount of charge (Article 6 of the Regulation) and the annual amount of charge (e.g. charge for CO<sub>2</sub> emissions by ton).

Charge that concerns environmental pollution has been anticipated by the Rulebook on Determining Compliant Charges for Environmental Pollution.<sup>8</sup> This Rulebook specifies a compliant amount of charge for: emissions from specific sources, for generated or disposed waste, for plastic bags and specific types of motor vehicles.

Charges concerning waste substances have been specified by the Regulation on Products that once Used Become Part of Special Waste Flows.<sup>9</sup> This Regulation specifies criteria for calculation of the amount and manner of calculation and payment of charges pertinent to specific products. Those are products that contain asbestos, batteries, oils, electrical and electronic products and payers are not only their manufacturers but also their importers. Funds generated by means of this charge are used for covering the costs of solid waste flow management.

Specific incentives are by all means a significant economic instrument of environmental protection. That mechanism is specified by the Regulation on the Amount and the Conditions for the Award of Incentives.<sup>10</sup> This Regulation specifies the amount and the conditions for the award of incentives for reuse and utilization of waste as secondary raw material or for the generation of energy and for the production of reusable shopping bags. Packaging is also an object for which specific charge is calculated. The administration of the charge has also been regulated by norms.<sup>11</sup>

#### **4. Conclusion**

Laws and other regulations in the Republic of Serbia, which govern environmental protection, are, in terms of their contents, dependent on the most important international documents, especially the regulations of the European Union. The legal framework is based on the following basic laws: the Law on Environmental Protection, the Law on Strategic Environmental Impact Assessment, the Law on Environmental Impact Assessment and the Law on Integrated Environmental Pollution Prevention and Control and the

Law on Nature Conservation. Special laws and numerous bylaws are built on this legal basis of the general character.

A large number of branches of law and legal disciplines partake in the protection as a result of multidisciplinary character of the protected object. The environmental protection itself is in the hands of different levels of government (central, regional and local), which imposes the need to harmonize rules and regulations, strategies and plans, and operational activities. One should not forget the supranational level phenomena and relevant regulations. Monitoring compliance of the company with increasingly demanding environmental regulations is imperative for a modern company. Failure to act in this way exposes the company to the high legal and other operational risks. From the standpoint of competitiveness of the company and in terms of cost management, the application of the “user pays” and the “polluter pays” principle is a significant factor which must be taken into account as such. The establishment of economic instruments to collect funds and spend them for specific purposes represents a particularly important segment of the legal protection.

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  - 20) Law on Environmental Protection (“Official Gazette of the RoS”, No. 135/04 and the Law on Amendments and Addenda of the Law on Environmental Protection (“Official Gazette of the RoS”, No. 36/09)

## Endnotes

- 1 The increase in prices as a consequence of the application of specific environmental regulations (charges and fees) directly impacts the competitiveness of the particular company or particular country's economy.
- 2 Council of Europe, European Convention on the Protection of Human Rights and Fundamental Freedoms, 1950; Convention on Civil Liability for Damage Resulting from Activities Dangerous to the Environment 1993, Convention on the Protection of the Environment through Criminal Law 1998; Convention on the Conservation of European Wildlife and Natural Habitats 1982, European Landscape Convention 2004.
- 3 See Article 49 of the Law on Amendments and Addenda of the Law on Environmental Protection.
- 4 See Article 50 of the Law on Amendments and Addenda of the Law on Environmental Protection.

- 5 In accordance with the Law on Environmental Protection (“Official Gazette of the RoS”, No. 36/2009 and 88/2010).
- 6 Article 79 Parafigure 4 of the Law on Waste Management.
- 7 The Criteria are as follows: area of the property, generated revenues from the activity, load capacity of the transport means, the maximum charge on multiple grounds.
- 8 “Official Gazette of the RoS”, No. 7/2011.
- 9 “Official Gazette of the RoS”, No. 54/2010.
- 10 “Official Gazette of the RoS”, No. 88/2009, 67/2010 and 101/2010.
- 11 “Official Gazette of the RoS”, No 8/10.