



PROCEEDINGS
of the 10th Conference of ASECU:
TOWARDS POST-CRISIS PROSPERITY:
Alternative Economic Policies and Institutional
Reforms in Southern and Eastern Europe

Organized by Babeş-Bolyai University
Faculty of Economics and Business Administration
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OPENING PRESENTATION

Opening presentation by Prof.Yannis TSEKOURAS, President of ASECU, University of Macedonia, Thessaloniki, Greece, on *Towards Post-Crisis Prosperity: Alternative Economic Policies and Institutional Reforms in Southern and Eastern Europe*

Introduction

The theme of our conference, with its reference to post-crisis prosperity, urges us to seek alternative economic policies and institutional reforms in south-eastern and eastern Europe which will support economic revival and, by extension, prosperity.

Given that most countries of south-eastern Europe (SEE) and central-eastern Europe (CEE) are members of the EU (CEE Estonia, Latvia, Lithuania, Hungary, Poland, Slovakia, Slovenia, Czech Republic; SEE Bulgaria, Greece, Croatia, Cyprus, Romania), while five of them (Latvia, Slovenia, Slovakia, Greece and Cyprus, are also members of the Eurozone, and the remaining states in the region are negotiating future entry into the EU, their governments are required to keep their economic policy in line with that of the EU and Eurozone institutions respectively. Two Eurozone members, Greece and Cyprus, are obliged to implement the memoranda agreed with the representatives of their lenders, i.e. the European Commission and European Central Bank, and the IMF, and must therefore adhere to the policies and implement the measures demanded of them by the Troika of their creditors.

It would therefore be useful to examine the efficacy of European Union and Eurozone institutions and policies, in terms of their contribution to growth and prosperity for the European Union and Eurozone respectively, and for each member state individually. This is because each strand of economic, fiscal, etc. policy adopted for the EU, and particularly for the Eurozone, cannot possibly generate the same results across all 28 or 18 member states, respectively, since the level of growth, the structural features and problems differ from country to country, and especially when one takes into account that from the outset the terms of the Maastricht Treaty and the single currency were better suited to the stronger than the weaker economies. Furthermore, the EU has still not advanced to fiscal and economic union, has not appointed a Finance Minister or coordinator of the fiscal and economic policies of the member states, much less proceeded to social and political union, and any new institutions which are established, such as the recent banking union, instead of being supranational remain merely intergovernmental. This is because national interest continues to be favoured over supranational or European Union interests, to such an extent that the philosopher Jürgen Habermas fears that Europe might become, instead of the 'first democratically legitimized supranational community', the 'instrument for exercising a kind of post-democratic rule'.

However this may be, the institution of banking union, of which the Single Supervisory Mechanism (SSM) will come into operation in 2014, the Single Resolution Mechanism (SRM) in 2016, and the Fund in ten years' time, is at least a first step to combat the neoliberal

dogma of market self-regulation. Through this decision the ECB will function not only as the central bank, but also as the central regulator of more than 200 systemic banks across Europe.

It is a fact that the absence from the Eurozone of robust redistributive mechanisms, in combination with the architecture of the Maastricht Treaty, has led to the operation of a systemic exchange imbalance between the stronger North and weaker South, involving the wholesale transfer of resources northwards.

The case of Greece

In many respects, Greece was implementing economic, fiscal, income and credit policies – both before it entered the Eurozone and after it became a member, without timely control by the institutions of the Eurozone – which far outstripped its real capacity, and it is for this reason, over and above the broader global crisis, that it found itself in the disastrous situation we have been experiencing over the last six years.

The policies imposed on Greece by the Eurocrats (in essence, by Germany), characterized by strict fiscal austerity, with internal devaluation, since the common currency cannot be devalued¹ by a member of the Eurozone, and without the domestic banking system being able to finance (productive) investment, mainly in knowledge, research and innovation (because of the severe limit on liquidity, with interest rates ranging from 6.5% to 8.5%, compared to 2% to 3% in the core Eurozone countries), thus with almost no investment activity, all these factors have had (for 2013) a huge economic and social cost, with overall unemployment standing at 27%, youth unemployment at 56%, a 25% reduction in GDP over five years, a 35% fall in household disposable income, with 35% of the population now at risk of poverty and social exclusion, and at the same time an increase in the national debt by 45%, rising to 174% of GDP .

On the other hand, the measures required of Greece by the Memorandum have contributed to significant fiscal adjustment, with a primary public finance surplus for 2013 of 0,8% of GDP (according to the Troika method), a positive balance of payments for the first time in 64 years (0.7% of GDP in 2013), and with almost complete recovery of cost competitiveness, mainly owing to the reduction in labour costs per product unit, but not in terms of price. Of course, the budget surplus, generated mainly by a crushing tax burden on households and business, cannot be considered sustainable in the long run, unless GDP begins to grow at a satisfactory rate (3.5% to 4%). The same is true of the balance of payments, this too being mainly due to a fall in imports, the result of protracted recession, rather than a substantial increase in exports.

However, the first, dangerous, political consequence of mass unemployment and the impoverishment of great swathes of Greek society has been a significant rise in support for far-right, neo-fascist groupings and for anti-European and Euro-sceptic parties. Rigorous austerity measures and internal devaluation, together with a range of other structural reforms, may have a more positive long-term impact than the gentler approach of, for

¹ The retention of the hard Euro a) was an obstacle to competitiveness, but b) helped to keep inflation low and prevent currency speculation.

example, the Keynesians, advocating more investment and a stimulus for domestic demand. But if strict austerity continues, accompanied by a relatively unfair sharing of the burden of that austerity, and no investment is made to bring down unemployment, then we cannot rule out the risk of a breakdown of social cohesion.

In Greece the ranks of the Euro-sceptics have been swollen by a widespread view that the Eurozone, lacking any experience in responding to a major crisis, sought the assistance of the more experienced IMF, and together they designed and imposed on Greece, with its governments blinkered by ignorance and fear, a policy which was mistaken in several key areas, namely:

- (a) tardy diagnosis of causes of crisis,
- (b) the fact that emphasis was laid (by the Greek government, too) on increasing taxes rather than cutting spending, and at the same time they have been slow to reform public administration and stamp out tax evasion,
- (c) the use (by the IMF) of a low fiscal multiplier, which is partly responsible for the recession being more severe than expected; growth in GDP of 1.1% was forecast for 2012, and debt of 150% of GDP, instead of which growth declined by 6.4% in that year, and 3.9% in the following year, 2013, while the debt swelled to 174% of GDP. This mistake was later acknowledged by the IMF. Nonetheless, this admission could not change the fact that the Troika, and by extension the country's creditors, had acted in relative ignorance of the circumstances of the crisis, on the basis of erroneous information and in order for the Eurozone to gain time until it could take decisions on correcting its flawed monetary and fiscal policies, as was confirmed last January by the Commissioner for Economic and Monetary Affairs Olli Rehn, appearing before the European Parliament's Economic Affairs Committee.

Nevertheless, and despite the fact that a 'Grexit' had been discussed at 'certain private meetings' between Eurozone leaders, the Eurozone had made available to Greece by 2013 funds and guarantees in the order of 340 billion Euro, at relatively low interest rates. This averted a disorderly bankruptcy of the country, to which international markets were no longer willing to lend. Now, the first step has been done, testing the ability of the country to access the international finance markets. So, there is cautious talk of the so-called "Greturn" (Greek return), even for "Greecovery".

Obviously, despite the huge assistance from the Eurozone, Greece remains mired in crisis, and this shows, in the final analysis, that serious errors have been made, both in the creditors' choice of the most appropriate package of measures, and in their implementation by Greece.

Given, then, that the institutions, directives and rules laid down by the EU and the Eurozone and imposed on the member states are a reality which the individual members cannot alter, it remains to examine the institutions and rules which each member state, acting on its own initiative, can establish and/or alter in order to facilitate/attain the objectives of growth and prosperity, as well as competitiveness, without the economy once more slipping into unmanageable public finance and balance of payment deficits and massive national debt.

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Below the reader will find three tables –one for the EU-15, one for the CEE countries and one for the SEE countries– showing the six composite governance indicators for 2012, published by the World Bank Institute.

Table 1. Composite governance indicators for the EU15 member states in 2012

	Account-ability	Political Stability	Government Effectiveness	Regulatory Quality	Rule of Law	Control of Corruption
Austria	95.3	95.7	92.8	91.4	97.6	88.5
Belgium	92.9	74.4	93.8	86.6	88.6	90.9
Denmark	99.1	74.9	99.0	97.6	98.1	100.0
Finland	96.7	97.6	100.0	98.1	99.5	98.1
France	89.6	63.5	87.6	83.3	90.0	90.0
Germany	93.4	71.1	93.3	92.3	91.9	93.8
Greece	67.3	38.4	62.2	68.4	63.5	51.2
Ireland	91.9	77.3	92.3	94.3	94.3	90.4
Italy	73.9	63.0	66.0	74.6	62.1	57.9
Luxembourg	97.2	96.2	94.7	96.7	96.2	96.2
Netherland	97.6	90.5	96.7	96.2	97.2	96.7
Portugal	78.2	69.7	81.3	75.6	82.5	78.5
Spain	79.6	43.1	82.3	78.0	83.4	81.8
Sweden	99.5	90.0	98.6	99.0	99.1	99.0
United Kingdom	92.4	60.2	91.9	94.7	92.9	92.3
Average	89.6	73.7	88.8	88.5	89.1	87.02

Source: World Bank Institute, Worldwide Governance Indicators online database.

Table 2. Composite governance indicators for CEE countries in 2012

	Account-ability	Political Stability	Government Effectiveness	Regulatory Quality	Rule of Law	Control of Corruption
Czech Rep.	74.9	84.4	76.6	80.9	81.5	63.6
Estonia	83.9	64.9	78.0	90.4	84.4	80.4
Hungary	70.1	68.7	70.8	79.0	68.3	64.6
Latvia	70.6	60.7	74.6	79.9	72.5	62.7
Lithuania	74.4	70.1	74.2	82.8	73.0	66.0
Poland	81.0	83.4	71.8	78.5	72.0	71.8
Slovak Rep	76.8	87.2	73.7	80.4	64.0	60.3
Slovenia	77.7	76.3	80.9	72.3	80.6	74.6
EU-15 (Average)	89.6	73.7	88.8	88.5	89.1	87.02

Source: World Bank Institute, Worldwide Governance Indicators online database.

Table 3. Composite governance indicators for SEE countries in 2012

	Account-ability	Political Stability	Government Effectiveness	Regulatory Quality	Rule of Law	Control of Corruption
Albania	50.2	39.8	45.0	56.5	35.1	26.8
Bos. & Herz.	44.6	28.9	38.8	51.2	48.3	49.3
Bulgaria	58.8	58.3	60.3	69.4	51.2	52.2
Croatia	63.5	64.5	72.3	66.5	59.7	57.4
FYROM	49.8	33.2	51.7	61.2	47.9	59.3
Greece	67.3	38.4	62.2	68.4	63.5	51.2
Kosovo	42.2	15.2	41.6	52.6	35.6	30.1
Montenegro	56.4	64.0	59.8	53.1	55.5	55.0
Romania	57.8	48.8	43.5	68.9	55.9	50.7
Serbia	55.9	38.9	50.7	50.7	44.1	48.3
EU-15 (Average)	89.6	73.7	88.8	88.5	89.1	87.02

Source: World Bank Institute, Worldwide Governance Indicators online database.

A comparison of the indicators for the CEE countries with the corresponding EU-15 averages does not yield a great distance between them, whereas the SEE countries have a long and difficult road to travel before they achieve convergence with the EU-15 averages.

More specifically, Table 3 (SEE countries) shows that:

(a) **Accountability** ranges from 44.6 for Bosnia Herzegovina (BIH) to a maximum of 67.3 for Greece (GRE), while the figure for the EU-15 is 89.6. The indicators for the other SEE countries lie between the lower and upper limits (see Table 3, and the EU-15 average).

(b) **Political Stability** ranges from 15.2 for Kosovo (KOS) to 64.5 for Croatia (CRO), while the figure for the EU-15 is 73.7.

(c) **Government Effectiveness** ranges from 38.8 for Bosnia Herzegovina (BIH) to 72.3 for Croatia (CRO), while the EU-15 figure is 88.8.

(d) **Regulatory Quality** ranges from 50.7 for Serbia (SER) to 69.4 for Bulgaria (BUL); the EU-15 figure is 88.5.

(e) **Rule of Law** ranges from 35.1 for Albania (ALB) to 63.5 for Greece (GRE), while the EU-15 figure is 89.1, and finally,

(f) **Control of Corruption** ranges from 26.8 for Albania (ALB) to 59.3 for FYROM, while the EU-15 figure is 87.0.

There is a number of reasons and explanations for the distance separating the EU-15 from the SEE countries. They include a shortage of jobs and low flexibility in the labour market, which, combined with inadequate training, drives many people towards a rent-seeking economy, withdrawing entirely from the formal labour market and living on transfers of various kinds (e.g. unemployment benefit, early retirement or retirement at a relatively young age, as well as other social benefits, many of which are not targeted at those who are really poor and vulnerable), and, of course, to a grey economy much larger than that of the EU-15.

It is generally accepted that financial institutions are ineffective in the SEE countries. Although there is no generally accepted theoretical view in relation to the genesis of economic institutions, it is generally believed that most of them are designed and imposed by political process, through a top-down approach. This means that political institutions are prior to, take precedence over and may control economic institutions², a state of affairs which obviously runs counter to the Marxist view of an underlying economic structure supporting a political superstructure. It is our view that the genesis of economic institutions is complex: they are rooted in the special history of the region, which was under Ottoman rule for around four centuries, subject to the Islamic systems of law and public finances, and shaped by national cultures, religion, cultural practices (customs and traditions), and of course economic and social necessities, not to mention the special interests and expediencies which shape all political decisions.

² See Doran Acemoglu-James A. Robinson: *Why Nations Fail, The Origins of Power, Prosperity and Poverty*, Crown Business, New York, 2012.

However this may be, for new (economic) institutions to be created, or for existing institutions to be reformed, two things are necessary: political will, and a decision by the political leadership of a country. In the years since the collapse of the socialist regimes, the countries of south-eastern and central-eastern Europe have been preoccupied, in a region of great instability, with their own security and stability; they have paid little or no attention to the creation or real reform of existing economic and legal institutions.

However, the appeal of the EU, and the desire of the CEE and SEE countries to complete the EU accession process, has been 'the main driver of institutional reforms, particularly reforms of economic institutions to make them compatible with the institutions of the EU member states, the latter being viewed as beneficial to economic growth'³. One might, and perhaps should, maintain that 'the reform of economic institutions which was driven externally, must now be driven internally'⁴. Correct as this proposition might be, implementing it is no easy matter. Among other obstacles, there is the major problem of the electorate in these countries, as well as the ruling party/government and the role of the media.

Governing political parties, anxious to retain power (or at least administration) tend to avoid clashes with vested interests, especially when unemployment is high; opposition parties are always lying in wait, keen to increase their share of the vote and seize the reins of power.

When workers in state enterprises and agencies, and in the public sector in general, learn of an intention on the part of governing parties to reform institutions, especially economic institutions, they fear for their jobs; and this fear makes the public sector workforce an *ex ante* political obstacle to reform. If, in face of this opposition, governing parties proceed to reforms, with job losses not counterbalanced by the creation of new jobs in the private sector, then those who have been made redundant will now constitute an *ex post* political obstacle to the implementation of the reforms decided on, and to any further reforms, because they will lend their support to anti-reform political parties.

Failure to progress with institutional reforms (particularly of economic institutions) deters investment (both local and, more importantly, foreign) which might generate economic growth and new jobs, with the result that unemployment remains high, if, indeed, it does not actually increase.

Such a state of affairs leads, of course, to a forced redistribution of income, with a relatively small share going to the losers from the transition or reform. The bulk of the redistributed income is channelled to the 'new' political and economic elite. However, if this 'new' elite, whose members include the internally oriented economic and business class that live off the state (which, protected from competition, does not proceed to make any innovative investment that might involve risk) and the various vested interests, does not believe that its interests are sustainable, then it may concede the need for institutional reform, but will do its utmost to keep it within certain limits.

At all events, for economic growth and prosperity to be sustainable, it is necessary that economic, legal and political institutions not be closed, but be open and representative.

³ See Boris Begović, *The political economy context of economic growth in South East Europe*, Defining a New reform agenda. Paths to Sustainable Convergence in South East Europe, South East European Studies at Oxford (SEESOX), February 2013, p. 15.

⁴ Boris Begović, *op. cit.*, p. 16.

Because closed political institutions forge, in their turn, closed economic institutions, and these in their turn lay the foundations for perpetuation of the closed political institutions. Nor do closed institutions favour creative destruction (Joseph Schumpeter) and innovative technological change. They do, however, exacerbate inequalities and tensions between the elite in control of the closed institutions and those who challenge them – the result being either a pluralistic sharing of political power, or a prolonged crisis, probably ending in political instability⁵.

Greece is a case in point. It is a country which, by contrast with the SEE and CEE countries, with their centrally planned economies, enjoyed a ‘free market economy’ and democratic government (except during the seven-year military dictatorship of 1967-1974), and which has been a full member of the EU since 1981 and of the Eurozone since 2001. In other words, it had had ample time to be influenced by the ‘EU and Eurozone factor’ in respect of the necessary institutional changes, which should have proceeded to the stage at which they are internally driven. Nevertheless, the reality is that in comparison with those of states at the core of the Eurozone, Greece’s institutions remained relatively closed. The political and business class of the country had not risen to the challenge of the times, and long overdue reforms had still not taken place.

Now however, thanks to the great crisis and the consequent imposition of stringent controls by creditors, it should be possible for Greece to take steps towards modernizing its models of production and administration. Action is already being taken in the areas, among others, of opening up closed professions, and doing away with or at least drastically reducing the role of cartels in the market for goods and services, giving us reason to hope that the internal market will function more efficiently and production of internationally saleable goods and services will be boosted.

By way of example we might cite the OECD report which recommended the rescinding of 329 outdated legislative provisions on competition and tackling of market distortions in four sectors of the economy: food processing, retail trade, tourism and building materials. These four sectors represent 21% of GDP and 24.8% of total employment in Greece. If just 66 of those 329 provisions were removed, it would be enough to add 5.2 billion Euro to the country’s GDP⁶.

I myself would readily claim that after six years of recession and harsh austerity, and four years of strict supervision by the Troika, the outmoded features, closed professions, inhibition of production and growth, of both structure and superstructure have still not been dismantled, and this means that when supervision by our creditors is lifted the old, outdated establishment will once again attempt to rear its ugly head.

I shall now move on to examine some weaknesses of the political culture and practices in countries of our region, weaknesses which limit their ability to create and/or adopt contemporary institutions which would accelerate convergence, on the economic, social and political levels, with the developed countries of the EU and the Eurozone.

⁵ Doran Acemoglu-James A. Robinson, *op. cit.* pp. 145ff. (Greek edition).

⁶ See *Ta Nea* newspaper, The OECD has made 329 recommendations to stimulate competition. 3-5/1/2014.

The role of the state

The state is the most important, indeed vital, institution on the national level. Despite its relative weakening in an era of globalization, it continues to be the 'institution of institutions'. For this reason:

- A state must have democratic institutions which enjoy the confidence of its citizens and which operate transparently, rationally and efficiently.
- There must be clear separation between the legislative, executive and judiciary.
- The state must operate with intelligence and efficiency, both in legislating and governing, and in the administration of justice by an experienced, highly trained, non-bureaucratic, honest, independently minded judiciary and judicial system.
- The state and public administration must operate independently of party political interference, transparently, without excessive red tape, bribery and corruption.
- The governance of the state must be consistent and, above all, effective, both in the creation of an economic, social and internet infrastructure, and in the enactment of clear laws, easy to implement, which will promote growth and deliver:
 - ✓ A stable, simple, fair, transparent, pro-growth, revenue-yielding and internationally competitive tax system
 - ✓ Investment, (international) trade, the labour market, competition among businesses
 - ✓ Active and effective policies, financial transparency and access to credit
 - ✓ Responsibility and protection in the area of property rights
 - ✓ Conciliatory institutions to resolve business disputes, not only by means of the courts, which must overcome their deficit in the areas of suitability and independence, but also through alternative, non-judicial administrative mechanisms for resolving differences, such as arbitration, which is still underdeveloped in all the countries of south-eastern Europe.

Lack of clarity in legislation, which is often deliberate, allows too many different interpretations of the laws. This means the court schedules are overcrowded, and final rulings on cases may take as long as 10 or 12 years to be handed down. This delay weakens or nullifies the positive impact on economic activity expected from new legislation while increasing production costs and the costs of doing business, and reducing profits.

Obviously, the final success of any economic policy, in both its drafting and, most of all, its implementation, depends greatly not only on the quality of public administration and the political culture⁷, but also more generally on the patterns of behaviour and values current in the community; moving those patterns and values in a positive direction will take time and effort.

⁷ See Nikiforos Diamantouros: Δημόσια διοίκηση και ανάπτυξη: Οι πολιτισμικές διαστάσεις μιας κρίσιμης σχέσης [Public administration and development: Cultural dimensions of a critical relationship], in: Ελληνική Οικονομία: Κρίσιμα Ζητήματα Οικονομικής Πολιτικής, [The Greek Economy: Critical issues in economic policy], ALPHA BANK, Athens 2008, pp. 161-180.

The absence of a stable institutional framework, which usually manifests itself in frequent, sudden changes in the rules of the game, and in complex, non-transparent procedures, generates a general sense of insecurity, which encourages 'a logic of short-term perspectives and thus an inability to frame long-term, credible policy for the economy'⁸ and for other areas of national life. This is why the degree to which the 'rules of the game' are properly codified and institutionalized, the stability and predictability of a country's institutions, are such important factors in promoting the complex work of socio-economic and even cultural progress.

The cultural model for defining cost-benefit which governs the framing of public policy in many, if not all, countries in our region is constructed using zero-sum logic, leaving no margin for more consensual outcomes governed by the 'positive sum' logic and the concept, inherent in the latter, of compromise, compromise all too often being seen as a demeaning defeat. It is for this reason that the quality of being 'uncompromising' is valued so highly in the popular imagination, where it is associated with indiscipline and resistance to institutions and the state⁹.

'Zero-sum logic, then, and the cultural model associated with it, lead us back to the familiar concept of political cost, which is directly related to the absence of stable institutional frameworks for the framing of public policies with long-term development objectives'¹⁰. The political parties, parliament, the executive, the judiciary, public services, with their culture of red tape and bribery, and even the mass media have all lost to a greater or lesser extent their credibility. As a result, citizens and businesses feel even greater suspicion of all these institutions, particularly the mechanisms of public administration, and will resort ever more frequently to lawless or illegal practices.

It is worth mentioning here¹¹ that the quality of the democratic structure of a country is of decisive importance in the creation of an institutional environment able to promote economic growth and progress. The key features of such a structure are transparency, accountability, institutional counterbalances to the exercise of executive power, the smooth, unimpeded functioning of the rule of law, a consistent, clear framework of rules enshrined in legislation, robust judicial enforcement of legislative rules, and the various forms of interdependence and synergy which bind all these features together.

There is a need, then, not only for the appropriate policies, but also for the appropriate political procedures, which allow the implementation of effective public policy. Therefore we cannot separate the capacity of the state itself to reform (modernisation and rationalization of its organization, the process of taking decisions and, above all, their implementation) from the social capabilities of a community to tackle the issues arising from management of a large number of changes.

It is necessary a) that day-to-day government administration should conform to plan and function systematically, efficiently and in a coordinated manner, and b) that governance should lay down objectives for political intervention and the establishment of new rules, and

⁸ Nikiforos Diamantouros, *op. cit.*

⁹ Nikiforos Diamantouros, *op. cit.*

¹⁰ Nikiforos Diamantouros, *op. cit.*

¹¹ See Tasos Yiannitsis, Introduction to Ελληνική Οικονομία: Κρίσιμα Ζητήματα Οικονομικής Πολιτικής, [The Greek Economy: Critical issues in economic policy], ALPHA BANK, Athens 2005.

for the promotion of new attitudes and/or strategies, determining the ways in which the parties involved should function and defining their roles. Because there is not really any mystery about what needs to be done, or about the differentiation among the various political players. The difficulty lies in the 'how to do', rather than the 'what to do'. It lies in determining the method we should adopt to attain the goals we have set¹².

For as long as the political leadership and class¹³ lack the knowledge required to prevent their ideology and campaign promises, or their frequently ambiguous discourse, from taking the place of scientific analysis, and for as long as they lack the inspiration, will and determination to free society and the economy from excessive legislation and red tape, corruption and nepotism, client politics and absence of meritocracy, then, even if those classes are not seeking their own social advancement and enrichment (whether for themselves or their families), any reform of institutions will remain purely theoretical and will never bring about the anticipated results. It may even strengthen such 'informal negative institutions' as the grey economy and corruption.

Therefore, above and beyond the pursued convergence of our countries' socio-economic indicators with the EU averages, it is essential first to achieve 'political convergence', to bring methods of governance in our region closer to the models used in the more advanced European countries (see Tables 1, 2 and 3 above), even though these, of course, in the context of the European Union, do not yet give a proper democratic voice to the European Demos (electorate). By 'political convergence' I mean convergence in capacity of our political system and system of governance, in the context of the real capabilities of society and in a reasonable time frame, to realize objectives it has promised its citizens it will attain, at the lowest possible economic and social cost¹⁴.

It would appear that those who take an active part in politics have abandoned the old idea of public service in favour of the pursuit of a lucrative career. Management of public affairs has now become almost a form of asset management for political parties, and particularly their leaderships. The parties-as-corporations which are now run as 'businesses' and 'oligopolies' are proving the death of true politics (Alain Touraine). The very people who should be the bulwarks and pillars of democracy have become the greatest threat to it¹⁵.

In an interview given to *Repubblica* in June 1981, Enrico Berlinguer chose, instead of speaking from a left-wing vantage point on the 'structures of capitalism', to make the following remarks: '*... the moral issue as the primary and most substantive political question. Because on its resolution depend recovery of trust in institutions, effective governance of the country and the ability of democracy to defend itself*'. He had spoken of the transformation of political parties into '*power and clientele machines*', with scant awareness of the problems of society, which simply '*manage interests*' as they continue their mutation into '*federations of movements and conspiratorial cabals...*'¹⁶.

¹² Tasos Yiannitsis, *op. cit.*

¹³ See T. Veblen: *The Theory of the Leisure Class*, New York: Dover Publication, 1994.

¹⁴ See Tasos Yiannitsis, Η πολιτική διαχείριση της οικονομίας, [The political management of the economy], *To Vima* newspaper, 23.4.2006.

¹⁵ See Pavlos Tsimas, «Το ηθικό ζήτημα», [The moral question], *Ta Nea* newspaper, 28-29/12/2013.

¹⁶ Pavlos Tsimas, *op. cit.*

We should not, of course, overlook the fact that in an era of globalization contemporary economic and social developments have become far more complex, making it much harder for the legislature to generate clear and practical laws (and here vested interests are often protected by deliberate ambiguity), and for the executive to ensure (or even wish to ensure?) compliance with the laws, which are often flouted in the name of liberty. One attempt to fill these gaps has been seen in the rise of Independent Agencies and NGOs. The former are invested with power and resources and called on to oversee, regulate and ensure the implementation of legislation in all areas. The latter, usually established on a voluntary and not-for-profit basis, funded by civil society and the state, seek to respond, at home and abroad, to the various social, humanitarian, cultural and economic needs of contemporary societies. Sadly, in Greece at least, a number of NGOs have been insufficiently supervised and have failed to manage transparently the subsidies they have received from the state; in fact, some of them have misused public funds, perhaps even in collusion with political figures and government functionaries.

Therefore the battle against corruption needs to begin with the political system and with parliamentary candidates, before extending to take on the whole public administration. Parliamentary candidates spend large sums of money in their quest for votes, and this need for money delivers them into the hands of the businessmen and media moguls who can find and channel to the candidates what we call 'black political money'. The result: a loss of independence and credibility for the politicians, who end up as 'bad examples' to the electorate, as models of corruption. It would be preferable to change to an electoral system (e.g. election by open list¹⁷ or abolition of the cross system) which would make candidates less dependent on the current 'party list' system, and therefore on financial backing.

In light of current Greek experience, I believe that there are certain other practical steps we might take to reform the parliamentary system. For example: abolition of parliamentary privileges and immunity; a level of pay for MPs which is not an insult to the average wage-earner; a clearer division between legislative and executive functions, by making parliamentary and ministerial office incompatible. Moreover, rationalization of all instruments and documents embodying transactions, as well as all 'indirect' payments, together with a full utilization of contemporary technology, and last but not least a meaningful and verifiable process for declaration of MPs' assets, all these measures would significantly curtail red tape, tax and contributions evasion, and corruption.

Of course we should point out that the political system itself, at least in Greece, suffers from a type of 'institutional anti-systemism', in that the basic pillars of the system of government are incapable of reaching any understanding, however rudimentary, with one another. Also, many Greek citizens view with suspicion the rules of operation of society decided and imposed on them by the (central) state, perhaps because they regard these rules as 'unfair', and/or they believe that in a society without rules or laws, i.e. a state of anarchy, everyone will be free to live as he wishes. But the truth is, of course, that functional anarchy in a society makes life intolerable, especially for the weak, because the rule of law is replaced by the law of the jungle.

¹⁷ Open list of candidates: if the voter disagrees with the order of candidates proposed by the party, he can place a cross against the candidate of his choice. This system would respect the freedom of choice of the citizen/voter.

In conclusion, the countries of (mainly) south-eastern Europe, particularly in the contemporary era, will not be able to attain economic growth and prosperity without, in addition to the immediate defining factors such as investment, capital, a skilled workforce and technical progress, laws and rules, which will facilitate the introduction and consolidation of open political and economic institutions, like those found in the core nations of the EU. Progress in this direction will be assisted not only by domestic, creative forces, oriented to exports and the international arena, but also the EU accession process, and the pressure exerted by competition in the globalized market.

EDUCATION session

INNOVATIONS AS A FACTOR OF ECONOMIC DEVELOPMENT OF SOUTHEASTERN EUROPEAN COUNTRIES WITH EMPHASIS ON MONTENEGRO

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ABSTRACT

The purpose of this paper is to analyze the importance of innovation and investment in research and development (R&D) for the economic development of selected southeastern European (SEE) countries. The implicit hypothesis of this paper is therefore related to the question of sustainability of economic model of development of the SEE countries which is based on permanent investment in R&D and continuous innovation. In order to test the relationship between these two and economic prosperity measured by GDP per capita, the paper interprets results of econometric models for developed countries and explains the importance of innovation as a key to economic development of SEE countries.

In the modern business environment, the need for creative and innovative activities is permanent. Innovations significantly affect effectiveness and efficiency of a company, its capacity, as well as the quality of goods and services. If we have in mind the fact that a healthy economy is the most important factor of economic development of a country, we can see how lack of innovation could negatively affect the whole society.

The topic of innovation and its importance comes along with global recession. The policy makers did not see the crisis coming, and when it began, most governments and international institutions were taken by surprise. SEE countries were also affected and many of them did not recover up to 2012, so the main question addressed to the policy makers is how to come back to the path of economic growth. One of the most common proposed solutions are innovations that would enable the countries of SEE to exploit its full potential and in that way reduce the gap between them and developed countries.

The paper analyzes innovativeness of European countries, and we are explaining how innovations effect the economic development of these countries. Specifically, the paper addresses the question of SEE economies from the perspective of European Union integration, emphasizing the candidate countries and comparing them to the EU member countries from this region.

We give a special consideration to Montenegro, as a country where, unfortunately, importance of innovations is still not completely understood. There is no significant investment in R&D but situation is expected to improve in the future.

Key words: innovation, economic development, investment in R&D, creativity

JEL code: E2, E61, O15, O32

INTRODUCTION

There are a lot of definitions of innovation. One of them says that innovation is something new that creates value. Peter Drucker, leading management guru, defines innovation as “a change that creates a new dimension of performance”. Michael Porter defines innovation as “a new way of doing things that is commercialized”. Joseph Schumpeter defines innovation as “the doing of new things or the doing of things that are already being done in a new way.” But, there is something that almost all definitions contain: the fact that innovation is of crucial importance for both economic growth and the growth of a firm. Moreover, modern growth theory identifies three key determinants of productivity growth: accumulation of physical capital, accumulation of human capital and a rate of innovation and technological change.

Globalization, growing international competition, the information revolution and technological changes is something that describes today’s environment. In that situation, innovations became more and more important because they offer a chance for firms and countries to be different and better. Innovative firms can increase their efficiency and improve the goods and services they offer, and on the other side they can reduce the costs of production. Countries that create innovative environment are those that are experiencing high growth rates of GDP. A lot of studies prove that those variables are positively related.

Study made by Rosenberg (2004)¹⁸ emphasizes the importance of professor Abramovitz’s research (Stanford University) which was done in 1950s. This research showed that only 15% of the growth in USA from 1870-1950 was the result of increased use of labour and capital. The rest 85% of growth was unexplained by classical function of production. That leaves the possibility that technological progress and better combination of inputs can contribute to an increase in output. Later, in 1957 Robert Solow, with different methodology and the data set, got a similar result. The residual component has reached the value of 85%. That way his model has shown that the primary determinant of growth is “technical change”. His contribution was in the fact that he placed innovation in the centre of a great number of future analyses. One of the significant recent papers was written by Lucas (1988) who highlights the importance of highly skilled workforce for long-term growth. New growth theories put technological progress, new knowledge and investment in R&D in the centre of analyses. These factors are important at the global level and they have a huge impact on the increase of production volume and standard in recent decades. But there is a problem if we apply those factors in the analyses of less developed countries and regions, because they do not have easy access to new technology so they cannot use benefits of new knowledge to accelerate their economic growth.

Today, innovation is regarded as one of the key factors of competitiveness, both at the level of the national economy, and that of the business system. From the standpoint of the national economy, the importance of innovation is reflected in the fact that improves the national productivity. Countries should try to improve their competitiveness which means the ability to achieve success in the markets in order to increase the standard of living over time. Countries can become more competitive by improving their achievements in a wide range of factors that affect productivity growth. This applies to innovation, creating a favourable legislative environment, and transfer or adoption of a new technology, education, entrepreneurship, or new businesses.

¹⁸ Nathan Rosenberg, Professor of Economics, Stanford University: *Innovation and Economic Growth*, OECD, 2004 (online paper)

The lack of innovation in the use of new technologies and a new product development, high costs, and a lack of information about the needs of the market affect the poor productivity and economic growth of Montenegro measured by low level of GDP per capita. Accordingly, enhancing the productivity and competitiveness of Montenegro can be achieved by strengthening the SMEs (small and medium enterprises), with the main focus on the key actors of development - innovation and technological development.

INNOVATION INDICATORS OF EUROPEAN COUNTRIES

There are a lot of ways of measuring how innovations contribute to the economic growth and development. Before we move on to the Global Innovation Index, which is the central section of our paper, we will try to display the innovativeness of European countries using some separate indicators, in order to get general overview which countries are leaders in this area.

Firstly, we will talk about most frequently used measure of innovativeness- **Gross domestic expenditure on R&D**, also known as **GERD**. We define GERD as current and capital expenditures on creative work undertaken systematically to increase knowledge, including knowledge of humanity, culture and society, and the use of knowledge for new applications.¹⁹ Main advantage of this indicator is its universality, which originates from the fact that GERD is the sum of the R&D expenditures of the four economic sectors- business enterprises, government, private non-profit organizations and higher education industries.²⁰ In the chart 1, we are displaying GERD as a percentage of GDP for 28 European countries in the 2010.

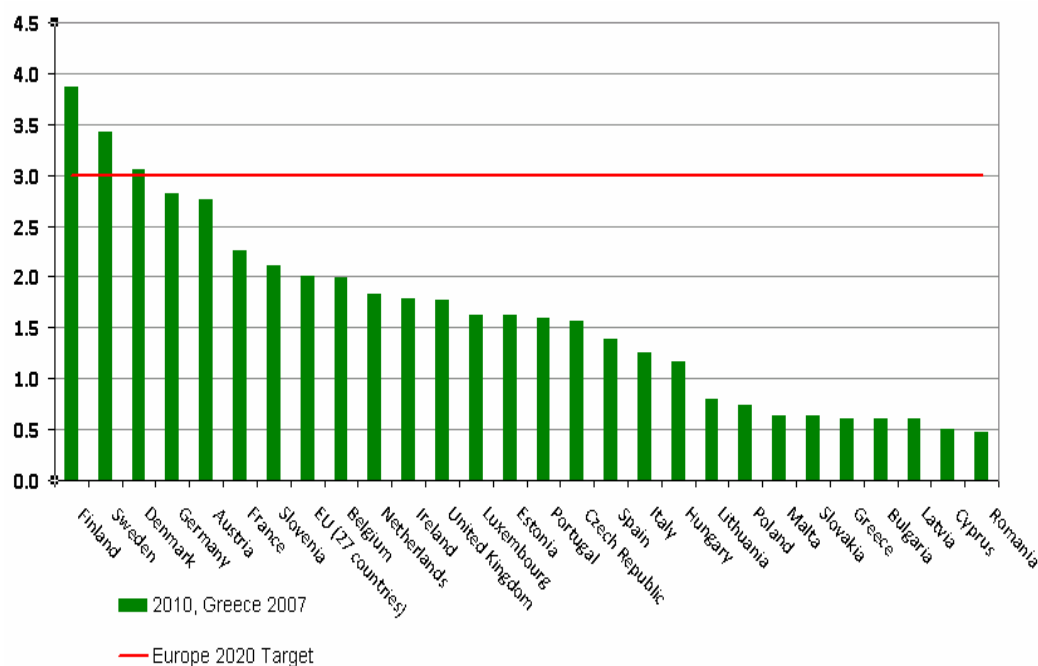


Chart 1: GERD as a percentage of GDP for 28 European countries, 2010²¹

¹⁹ <http://data.worldbank.org/indicator/GB.XPD.RSDV.GD.ZS> (accessed on March 12, 2014)

²⁰ [http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Glossary:Gross_domestic_expenditure_on_R_%26_D_\(GERD\)](http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Glossary:Gross_domestic_expenditure_on_R_%26_D_(GERD)) (accessed on March 12, 2014)

²¹ http://epp.eurostat.ec.europa.eu/portal/page/portal/science_technology_innovation/introduction (accessed on March 12, 2014)

As we can see from the chart above, the leading countries according to this indicator are Scandinavian countries- Finland, Sweden and Denmark (above 3%), followed by Germany, Austria and France, which belong to the group of most developed European countries. It is interesting to note that Slovenia (former Yugoslav republic) is above average of European Union, while the United Kingdom is below average. This data, in general confirms the hypothesis that countries with high investments in R&D are at the same time the most developed countries, with few exceptions mentioned above. Another data marked on the chart 1 is the Europe 2020 target. As we have already mentioned, Europe 2020 is the EU's growth strategy for the coming decade in order for EU to become a smart, sustainable and inclusive economy. One of the five objectives of this program is the innovation, which includes objective mentioned above- EU countries should achieve GERD at the level of 3% of the GDP. This shows the importance of investments in R&D for the whole community.

Another interesting indicator is **the number of patent applications** submitted by the countries in one year. Data refers to the applications filed directly under the European Patent Convention or applications filed under the Patent Co-operation Treaty and designated to the EPO (Euro-PCT). In the chart number 2, we can see the number of patent applications per country submitted in 2010.

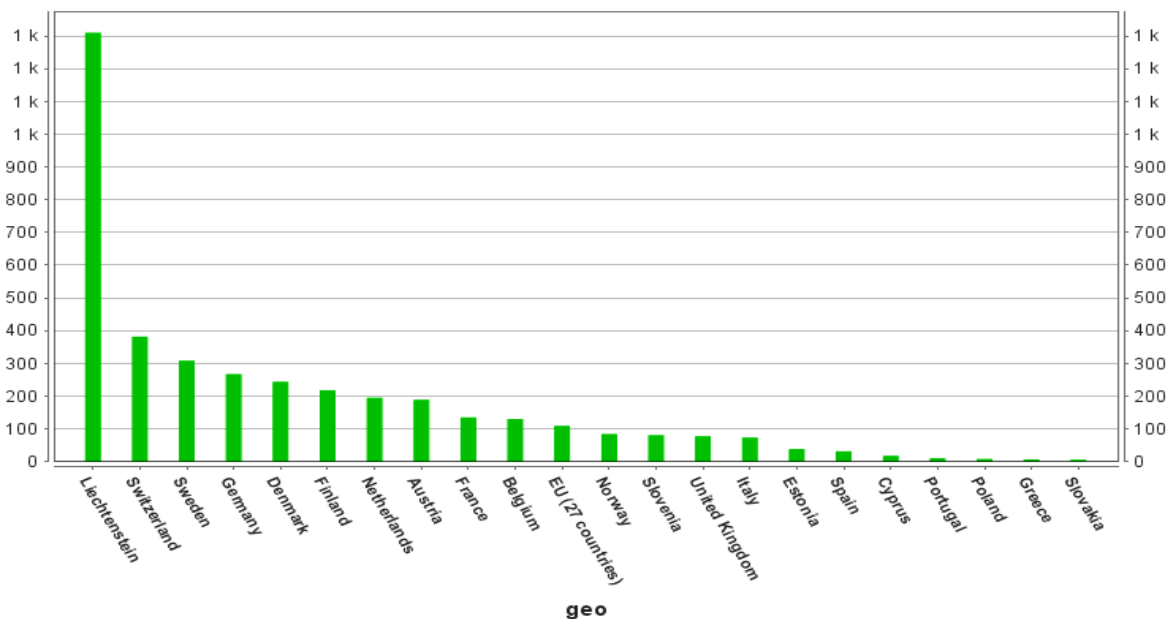


Chart 2: Number of patent applications per country submitted in 2010²²

This data also confirms the fact that countries which are investing a lot in R&D are the ones which are the leaders in economic development in Europe. Again, at the top of the ladder are Scandinavian countries as well as some of the most developed countries from the West and Central Europe. However, elusive leader is Lichtenstein, country from the Central Europe.

²²http://epp.eurostat.ec.europa.eu/portal/page/portal/product_details/dataset?p_product_code=TSC00032
(accessed on March 12, 2014)

If we analyze previous the previous two charts, we can see that countries from Southeastern Europe (with exception of Slovenia) are lagging behind most developed countries in terms of innovations and R&D. Their GERD is lower than the same indicator in the most developed countries and below Europe 2020's objective. Also, SEE countries had smaller number of patent applications submitted in the observed period. In addition, we analyze **the number of researchers per million inhabitants** in SEE, as another indicator of innovativeness. These data are displayed in the chart 3.

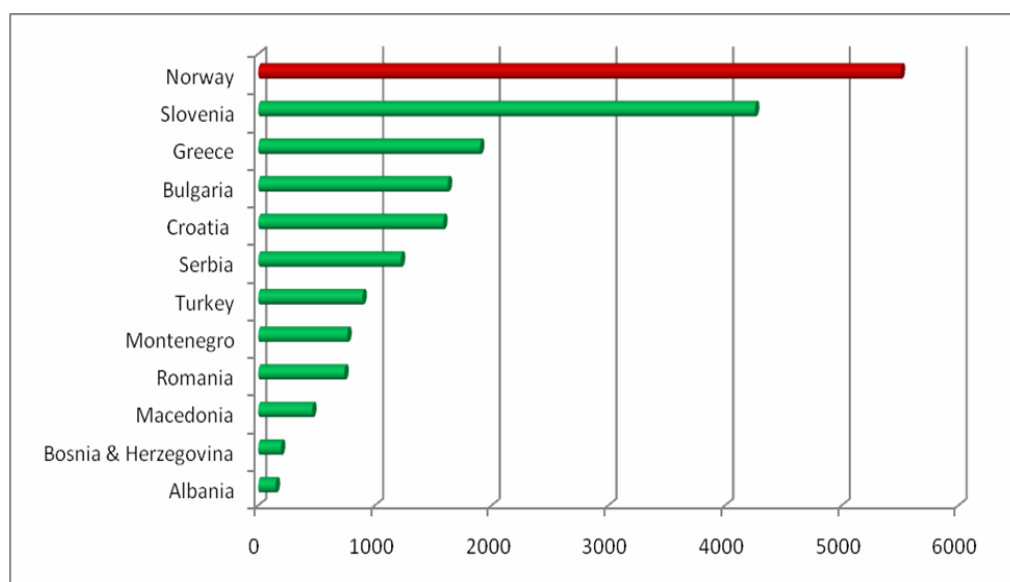


Chart 3: Number of researchers per million inhabitants (last available data for each country) ²³

It is obvious how much these countries are behind the most developed ones (in this case represented by Norway, country with highest level of indicators related to innovations). Half of these countries (including Montenegro), have less than 1000 researchers, which is potentially cause for concern in these countries. Slovenia is the only exception, with 4.255 researchers in 2011, which is the closest to 5.504 researchers in Norway.

When we analyze the stage of development in SEE countries, we can get the broader image of innovativeness of these countries. As we can see from the table 1, seven SEE countries are in the efficiency driven stage- stage where countries develop more efficient production processes and increase product quality in comparison to factor driven stage. However, only two of these countries are in the innovation driven stage where companies from these countries compete by producing new and different goods using the most sophisticated production processes.

²³ <http://stats.uis.unesco.org/unesco/tableviewer/document.aspx?ReportId=143> (accessed on March 12,2014)

Table 1: The stage of development of SEE countries²⁴

Stage of development				
Factor driven stage (FD)	Transition from FD to ED stage	Efficiency driven stage (ED)	Transition from ED to ID stage	Innovation driven stage
		Albania	Croatia	Greece
		Bosnia & Herzegovina	Turkey	Slovenia
		Bulgaria		
		Macedonia		
		Montenegro		
		Romania		
		Serbia		

All in all, every indicator that is related to innovations points, more or less, at the same conclusion- the more countries invest in R&D, the more they are developed. Finally, we can move on to the analysis of the Global Innovation Index, which is the overall indicator of the country's innovativeness.

In order to explain the estimated effect of GERD (research and development expenditure (% of GDP)) on GDPPC (GDP per capita, PPP (current international \$)) we use the Fixed Effect Estimator for panel data. Our data set contains information on 6 countries (Austria, France, Germany, Slovenia, Sweden, United Kingdom) for the time period 1998-2010.²⁵ The estimator eliminates the individual country effect and it is correcting for standard errors. The coefficient of logged value of GERD on logged value of GDPPC is significant at 2% level. Surprisingly, coefficients on EDU (Public spending on education, total (% of GDP)) and CPI (inflation, consumer prices (annual %)) are not statistically significant. It is possible that there is an omitted variable bias, but even when including other relevant variables for explaining GDPPC the coefficient remains significant. The results show the significance of investing in R&D as they seem to be one of the driving forces of economic growth. Many researches on this topic prove the positive and significant relationship between the two, and there are arguments in the literature that there is bidirectional causality. All in all, the importance of investing in R&D is undoubting, because it creates a background for innovation and invention which promote growth.

The result of our analysis is given in the table below:

²⁴ <http://www.weforum.org/reports/global-competitiveness-report-2013-2014> (accessed on March 12, 2014)

²⁵ Data source: The World Bank: World Development Indicators

Table 2: Fixed-Effect Estimator

```

Fixed-effects (within) regression          Number of obs   =       64
Group variable: countryname              Number of groups =        6

R-sq:  within = 0.2681                    Obs per group:  min =        6
        between = 0.4142                    avg =       10.7
        overall = 0.2512                    max =       13

corr(u_i, Xb) = -0.7990                    F(3,5)          =        5.87
                                           Prob > F        =       0.0430

```

(Std. Err. adjusted for 6 clusters in countryname)

lpcgdp	Coef.	Robust Std. Err.	t	P> t	[95% Conf. Interval]	
ledu	.377866	.6891599	0.55	0.607	-1.393676	2.149408
lgerd	.7872087	.2276382	3.46	0.018	.2020461	1.372371
lcpi	.0424002	.0278344	1.52	0.188	-.0291504	.1139509
_cons	9.025282	1.287522	7.01	0.001	5.7156	12.33496
sigma_u	.19350638					
sigma_e	.13232701					
rho	.68136862	(fraction of variance due to u_i)				

INNOVATION AS DETERMINANT OF ECONOMIC DEVELOPMENT

The Global Innovation Index (GII) is the result of cooperation between one of the world's leading and largest graduate business schools, INSEAD and World Intellectual Property Organization (WIPO), a specialized agency of the United Nations. Economic growth is determined by a lot of factors, and one of them is innovation, which has become very important in the period of globalization and growing international competition. Importance of the Global Innovation Index is in the fact that it helps creating an environment in which innovation factors are under continual evaluation and provides a key tool for refining innovation policies. The report pays attention to what companies and countries are doing and what they should be doing in order to stimulate and support innovation. This Index is one of the many research studies that build a ranking of countries related to innovation. The top three countries among all different indexes are Switzerland, Sweden and Singapore. The last Global Innovation Index Report was published for the year 2012 and our analyses are based on this Report.

In the picture below is presented the structure of Global Innovation Index:

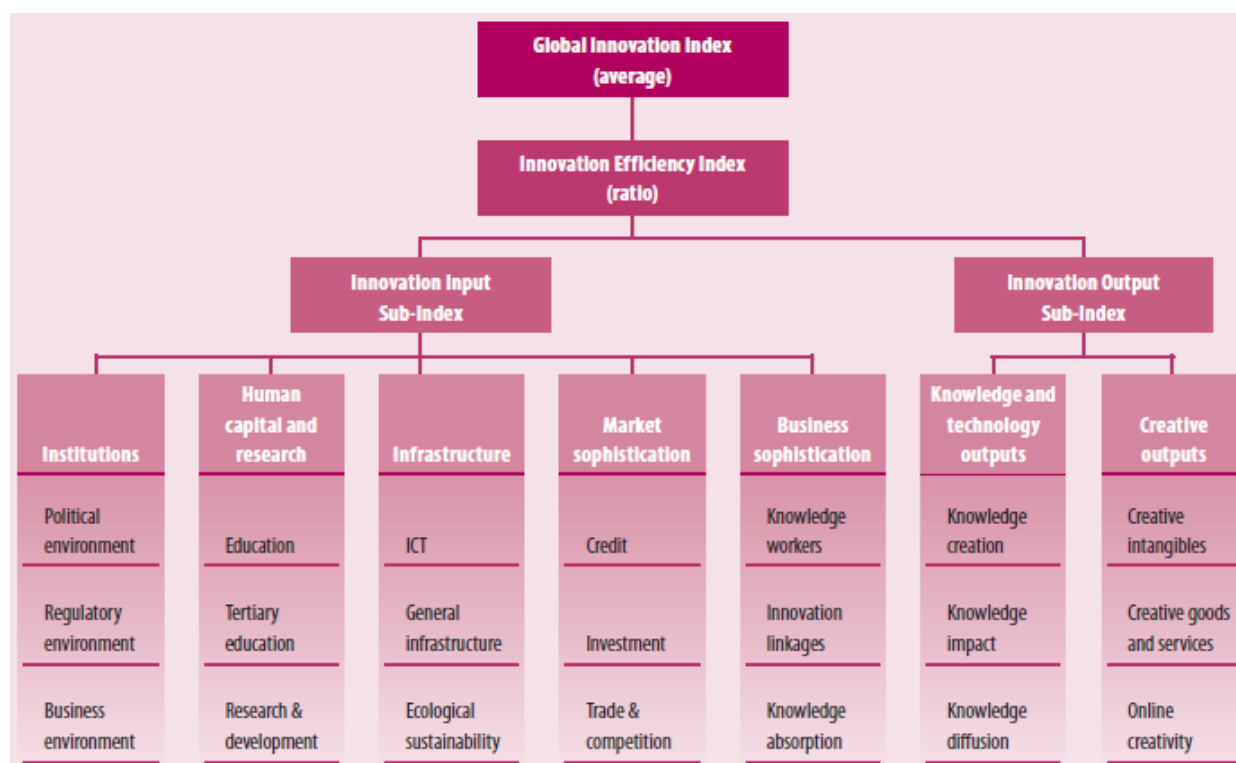


Figure 1: The structure of Global Innovation Index²⁶

The Global Innovation Index is a simple average of two sub-indices: Innovation Input Sub-Index and Innovation Output Sub-Index. Both of them consist of several pillars. Innovation Input Sub-Index is a simple average of five pillars which presents enablers of innovative activities in one national economy: Institutions, Human capital and research, Infrastructure, Market sophistication and Business sophistication. Innovation Output Sub-Index measures results of innovative activities and it is also a simple average of two pillars: Knowledge and technology outputs and Creative outputs. Although the Output Sub-Index includes only two pillars, it has the same weight in calculating the overall GII scores as the Input Sub-Index.

Whereas the aim of this analysis is to indicate the connection between innovation and economic growth (measured by GDP/pc) in this chapter will be given the comparative review of the GII level in several European countries. Analysis is based primarily on comparison between Montenegro and countries of the region (Serbia and Croatia), Estonia (which is often used as a benchmark when we talk about economic development of Montenegro)²⁷, Switzerland (as the country with the highest level of GII), the most developed countries of the EU (Germany, France and the United Kingdom) and countries with lowest GDP/pc in the EU (Bulgaria and Romania).

²⁶ <http://www.globalinnovationindex.org> (accessed on March 12, 2014)

²⁷ Montenegro and Estonia are both former socialist, small and open economies. They both have intensive cooperation with countries in the region. Difference is in the fact that Estonia had revolutionary transformation to the market economy, but Montenegro had evolutionary approach to market economy and the result of that process is different.

In table 2 is given the review of GDP/pc in 2012 as the measure of economic development of above mentioned countries and the score and rank on the Global Innovative Index list for the 2012:

Table 3: Comparative review of 10 selected countries

	GDP per capita (US\$)	Global Innovative Index	
		Rank	Score
Montenegro	7,317	45	40.1
Serbia	6,081	46	40.0
Croatia	14,457	42	40.7
Estonia	16,583	19	55.3
Switzerland	81,161	1	68.2
France	44,008	24	51.8
Germany	43,742	15	56.2
United Kingdom	38,592	5	61.2
Bulgaria	7,202	43	40.7
Romania	8,863	52	37.8

Analysis shows high degree of correlation between GDP/pc (which represents the level of economic growth) and the score of Global Innovative Index (which represents the level of innovation in one country). The correlation coefficient between the GDP/pc and the score of GII is 0.89, which means that there is a very strong linear relationship between these two economic indicators, as can be seen from the graph below.

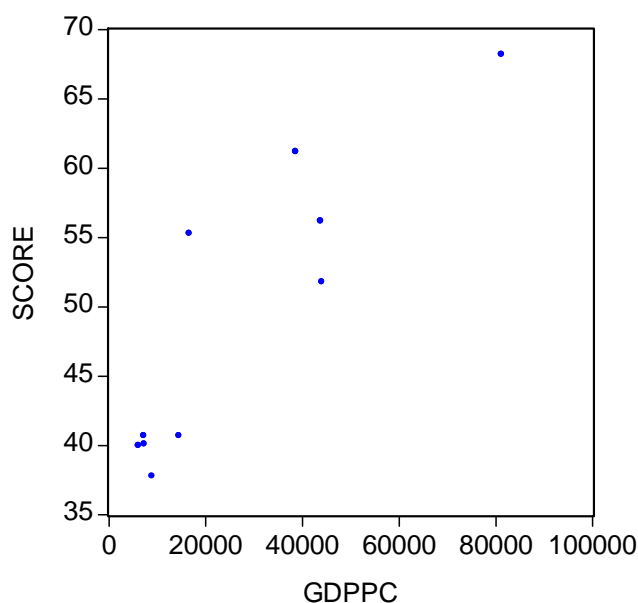


Figure 2: Relationship between the GDP/pc and the score of the GII

It means that those countries which recognize the importance of and invest in innovation benefit from this activity in form of economic growth. But, it is understandable that situation with less developed countries is different. Those countries are faced with a lot of obstacles and they often do not have enough resources to innovate. They can benefit from innovation only after they reach certain level of development. So, in those early phases of economic development it is very important for them to be able to understand importance and to be open for innovations. For those countries is very important the support of government in the field of innovation.

Switzerland has the highest level of GII in the world which makes it the most innovative country. In almost every pillar it has one of the top 10 positions. Its only weakness is the Institutions pillar rank (13th), because of poor showing in the ease of starting a business and of resolving insolvency. But, the fact that its economy is based on knowledge and that Switzerland has one of the highest GDP/pc makes it a friendly environment for innovation and makes easy transformation of innovation-input to innovation-output.

THE IMPORTANCE OF INNOVATION FOR EU INTEGRATION

Almost all countries in transition in Central and East Europe choose the EU membership as their strategic goal. Due the fact that development of the EU in this decade is based on Europe's growth strategy Europe 2020, those countries which want to become the part of EU need to follow that development framework. One of the priorities of the strategy is "smart growth" which includes development of an economy based on knowledge and innovation. This shows how importance of innovation is highly ranked in EU.

We already showed how far countries in transition are behind development countries. The best way for bridging the gap is innovation which can be the faster way too. Innovation gives the chance for those countries that thanks to small efforts make giant leaps. Information technologies have changed many aspects of modern life. Implementation and development of information technology is precondition and determinant of success, not only for companies and industries, also for whole regions and countries. Digital economy brings a lot of opportunities but at the same time it brings new rules of game. How countries will place themselves on the global market depends on their ability to learn fast new rules of market game. Important question is if new possibility can improve the position of developing country or they only make the gap between developing and developed countries deeper.

Dominant opinion is that globalization and all its consequences will help to decrease the differences between rich and poor nations, where innovations and technologies play the main role. They offer a wide range of opportunities for developing countries to transform their economies into digital economies which can compete with developed countries. Simply, developing countries cannot afford that "luxury" to dismiss the possibilities that those technologies and innovations offer.

One of the main determinants of innovation in those countries is public policy. Although governments in SEE countries made a lot of efforts to improve innovativeness, the result is still unsatisfactory. There is still a huge bureaucracy that makes obstacles for future development of SME, inefficiency of public companies, monopolies encouraged by government, problem with corruption, nepotism and unemployment that causes brain drain (or human capital flight), low computer literacy, and often the fear of people to accept innovation because of creative destruction: they first need to destroy all established templates if they want to create something new. That is especially problem in countries with cultures that do not accept the changes easily. Every government needs to find their own way to solve those problems, because they are specific for every country.

On the other hand, integrations are followed by the “brain drain”, characteristic indicator especially for SEE countries. The next table shows the country capacity to retain and attract talent, two separate indicators related to brain drain.

Table 4: SEE countries capacity to retain and attract talent in 2013²⁸

Country	Country capacity to retain talent		Country capacity to attract talent	
	Score	Rank	Score	Rank
Albania	3,6	63	3,6	63
Bosnia & Herzegovina	1,9	143	1,9	140
Bulgaria	1,9	142	1,9	144
Croatia	2,3	134	1,9	143
Greece	3,1	86	2,3	127
Macedonia	2,6	123	2,1	134
Montenegro	3,1	92	3,1	92
Romania	2,1	138	2,2	132
Serbia	1,8	146	1,6	147
Slovenia	2,9	107	2,5	120
Turkey	3,3	78	3,2	89

All these SEE countries are faced with severe problem- most talented and educated individuals are leaving country, while countries are not capable to attract other perspective individuals from around the world. As it is presented in the previous table, SEE countries are placed in the bottom half of the list of world countries ranked by country capacity to retain and attract talent in research conducted by World Economic Forum in 2013 (even seven of them are placed among last twenty in terms of attracting talents). This leads to the conclusion that SEE must improve their working environment in order to prevent additional brain drain.

²⁸ Country capacity to retain talent takes value from 1 to 7, where 1 = the best and brightest leave to pursue opportunities in other countries, 7 = the best and brightest stay and pursue opportunities in the country; while in case of country capacity to attract talent values: 1 = not at all; 7 = attracts the best and brightest from around the world, source: <http://www.weforum.org/reports/global-competitiveness-report-2013-2014> (accessed on March 12, 2014)

The topic of innovation and its importance comes along with global recession. The policy makers did not see the crisis coming, and when it began, most governments and international institutions were taken by surprise. SEE countries were also affected and many of them did not recover up to 2012, so the main question addressed to the policy makers is how to come back to the path of economic growth. There is evidence that the crisis hitting less innovative countries, especially ex-Socialist economies.²⁹ One of the most common proposed solutions are innovations that would enable the countries of SEE to exploit its full potential and in that way reduce the gap between them and developed countries.

THE IMPORTANCE OF INNOVATION FOR MONTENEGRO

According to the same index, Montenegro is the 45th most innovative country in the world. Being a country in transition, Montenegro has had various challenges in improving its economy. Unlike many other developed countries of the world, there is no significant investment in R&D by the government, or by the private sector. But still, Montenegro shows openness to innovations and changes which has been recognized by the EU and Montenegro has often been praised for being an open economy and for its willingness to make changes. Montenegro is the EU candidate country and has a lot to work on prior to becoming a member country. One of the things that are preventing the growth and development of Montenegrin economy is the lack of support for R&D activities. Studies show that private sector in developed countries is the main generator of innovation. In Montenegro there is no much expenditure on R&D in the business sector, due to global financial crisis, but also poor economic conditions in the country. In accordance with this is figure 3, which shows that almost half of R&D activities are carried out by the government sector, while 30% of researchers are also employed in the government sector. In 2011, the GERD in Montenegro was 13.2 million EUR, which makes 0.41% of GDP.³⁰

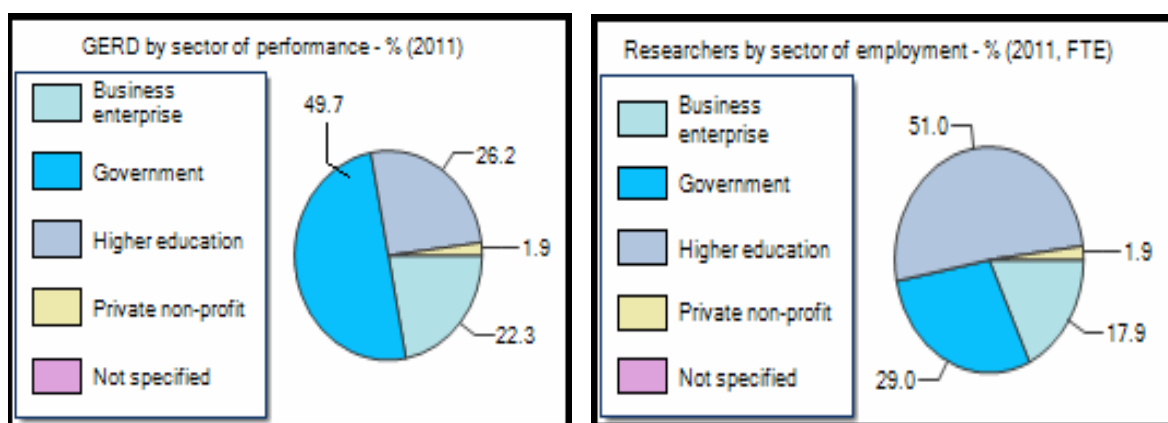


Figure 3: GERD and researcher by sector of employment in Montenegro in 2011³¹

²⁹ More detailed: Andrea Filippetti, Daniele Archibugi, Innovation in times of crisis: *National System of Innovation, Structure and Demand*, Elsevier B. V. 2010 (online paper)

³⁰ <http://www.worldbank.org/content/dam/Worldbank/document/eca/Western-Balkans-R&D-Montenegro.pdf> (accessed on March 12, 2014)

³¹ http://stats.uis.unesco.org/unesco/TableViewer/document.aspx?ReportId=198&IF_Language=eng (accessed on March 12, 2014)

We continue analysis with review of factors of demand and supply for R&D in Montenegro, which are presented in the Table 4. Montenegro is faced with the common problem of SEE countries- R&D demand gap. As we can see from the table, scores for supply factors are relatively better than demand factor for R&D. This means that Montenegro is not successful in employing its R&D capacities effectively. For example, this could be caused by the fact that high share of business processes do not use new technologies.³²

Table 5: Scores for factors of demand and supply for R&D in Montenegro³³

Montenegro							
Factors of supply for R&D							
	Quality of the educational system	Quality of primary education	Quality of math and science education	Availability of research and training services	Quality of scientific research institutions	Availability of scientists and engineers	
	4,4	5,0	4,9	3,8	4,0	4,0	
Factors of demand for R&D							
Extent of staff training	Firm-level technology absorption	Production process sophistication	Buyer sophistication	Degree of customer orientation	Company spending on R&D	Government procurement of advanced tech products	Capacity for innovation
4,1	4,5	3,5	2,9	4,5	3,3	3,9	3,6

One of the main factors of innovation is expenditure on R&D and on education. In Montenegro, most of expenditure on R&D goes to basic research, which is theoretical work undertaken primarily to acquire new knowledge of the underlying foundations and phenomena and observable facts, without any particular application or use in view. Montenegro is also limited by the country size, but as we have seen in the previous chapter, Switzerland is the most innovative country in the world, regardless its size.

Innovation outputs are the results of innovative activities within the economy. There are two output pillars: Knowledge and technology outputs (this pillar was labelled 'Scientific outputs' in the 2011 GII) and Creative outputs.

The pillars of GII show that Montenegro is among the top countries in the world when it comes to Knowledge Impacts and Creative outputs, which are the most relevant for measuring innovation output. Montenegro has the score of 71.3 in Online Creativity, which makes it the 10th best country by this criterion. Montenegro is ranked as the 1st country in sub-pillars *Generic top-level domains (TLDs)/th. pop. 15-69* and *Country-code TLDs/th. pop. 15-69*. These two sub-pillars focus on creation of internet sites. That is really important for generating innovations, since the Internet itself has been a great innovation, and it is a place where many innovations take place nowadays.

³² Radosevic Slavo, Research and Development, Competitiveness and European Integration of South Eastern Europe, Europe-Asia Studies, vol 61, 2009, page 634.

³³ <http://www.weforum.org/reports/global-competitiveness-report-2013-2014> (accessed on March 12, 2014)

Montenegro has a good score in *Human Capital & Research* pillar, being ranked 29th in the world. It has a really good score in Tertiary education, which is mostly because of increased number of college graduates in recent years. But still, even though education is the most important input for R&D, Montenegro does not have a good score in *R&D* sub-pillar; it is ranked as a 45th country in the world. Problems that Montenegro has are visible from the GII's sub-pillar on *Knowledge diffusion*, which reveals how good country is in diffusing knowledge. On the other hand, the country is ranked as 32nd in the world in knowledge absorption.

It has already been said that investing in education is the input for R&D activities, and therefore the input for innovation. Table 5 shows the number of finished scientific papers in Montenegro for the period from 2000 to 2010.

Table 5: Number of scientific papers (2000-2010)³⁴

Year	Number of Scientific papers
2000	60
2001	70
2002	84
2003	192
2004	216
2005	47
2006	62
2007	44
2008	59
2009	72
2010	87

The table shows that there are very few scientific papers in Montenegro per year, but in the last 5 years, the number of published scientific papers has increased and there is a positive trend.

WIPO ranks Montenegro as the 161st country by Intellectual Property activity for 2011. Data shows that there have been 1,179 patent applications in Montenegro since 2008.³⁵ That is a small number, but that has been a significant growth in patent applications when compared to the period prior to 2008.

Overall, there is little R&D activity in Montenegro which is due to many factors. But in the coming period, period of Montenegro's integration to the EU, there will be more expenditure on education, R&D and support towards creating an innovation friendly environment. In the last few years, even though by a small percentage change, there has been an increase in R&D as percentage of GDP. As it has been presented before, it is not easy for a less developed country to invest in R&D, and therefore generate innovations, so that becomes a *circulus vitiosus*. But Montenegro should put emphasis on supporting the small and medium enterprises (SME) in order to encourage the SMEs to make small

³⁴ <http://www.monstat.org/cg/page.php?id=77&pageid=77> (accessed on March 12, 2014)

³⁵ http://www.wipo.int/ipstats/en/statistics/country_profile/ (accessed on March 12, 2014)

innovations since that it also really important for one country's innovativeness, and therefore economic growth.

SUMMARY

Innovation is often defined as “new ideas that add value”, so this automatically means that innovation is a driving force behind growth. There are various ways to measure innovation and innovativeness, and this paper presented the methodology of the Global Innovation Index, which was used to explain Montenegro's position compared to countries in the Balkans and in the EU. One way to measure how innovation affects the economic growth and development is by presenting the Gross Expenditure on Research and Development as a percentage of GDP. Studies have shown that the more countries invest in R&D, the more innovations there are, and higher the economic growth.

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HIGHER EDUCATION IN EASTERN EUROPE: POST CRISIS POLICIES AND TRENDS

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ABSTRACT

The paper presents an thorough analysis of the higher education systems of the Eastern European -- post-communist – countries (Romania, Hungary, the Czeck Republic, Slovakia and Poland) before, during and after the economic crisis. On one hand it focuses on quantitative aspects such as financing higher education and research, student fees and student support, the performance of the universities and colleges in terms of student numbers and research output. On the other hand it analyses qualitative features like governance, institutional, financial and academic autonomy, the value of the diplomas, the inclusiveness of higher education regarding mature students etc. The purpose of the analysis is to explore and understand the similarities and/or differencies of the higher education systems in these countries with similar historical paths, as well as to see the similarities and/or differencies in the effects of the economic crisis and the policies implemented as a reaction to it. The paper also deals with the question whether the higher education of the Eastern European region is getting closer to the Wester European countries, or it is still lagging behind, or it is not only lagging behind but experiences a widening gap after the crisis as far as the financing and autonomy of universities are concerned, or there is/will be a special “Eastern European” path in the field of higher education. It The paper also explores the disparities between the different countries of the region, and tries to forecast which of them has given the best answer to the crises and thus will be the Eastern European “center” of the European Higher Education Area. The analyses are based on literature, statistical data of Eurostat, OECD, outputs of European research projects like that of Center For Higher Education Policy Studies, European University Association and Embracing the Modernisation Agenda, and databases such as Eurypedia, Eurydice.

Key words: higher education, education policies

JEL codes: I210, I220, I280, H750, H810

Introduction

The paper presents an analysis of the higher education (HE) systems of the Middle-Eastern European -- post-communist – countries (Romania, Hungary, the Czeck Republic, Slovakia, Poland, and Slovenia is added to the comparison as a fastly developing country) before and during the economic crisis, ending with the latest available data. It focuses on the conditions the national higher education systems operate in (such as financing higher education, student/teacher rate, student fees and support), the output of higher education (rate of population with HE attainment), indicators reflecting the inclusiveness of higher education (like the rate of mature students, female students and professors), and data reflecting the 'value' of the degrees.

The purpose of the analysis is to explore the similarities and/or differences of the higher education systems of these countries having similar historical paths, as well as to see the similarities and/or differences in the effects of the economic crisis. The paper also tries to forecast which of them has escaped the negative consequences of the crisis the most, and thus will be the Middle/Eastern European “center” of the European Higher Education Area. The paper also deals with the question whether the higher education of the Middle/Eastern European region is getting closer to the Western European countries, or it is still lagging behind, or even worse: it experiences a widening gap after the crisis. The analysis are based on statistical data of Eurostat, OECD, and databases such as Eurypedia, Eurydice.

1. Types of higher education institutions and university governance

First I compare the different types of higher education institutions in the six countries regarding status and training profile (see Table 1.).

Table 1.: Types of higher education institutions

Czech R.	Higher education institutions: - Universities - Non-universities Tertiary professional schools
Hungary	Universities Colleges
Poland	Higher education institutions: - Universities - Non-universities (including schools of higher vocational education) Colleges
Romania	Universities Institutions Academies of study Post university study schools Doctorate organizing schools
Slovakia	Universities Professional training institutions
Slovenia	Higher education training: - Universities - Single institutions Higher vocational training: Higher vocational colleges

Source: Own construction based on Eurypedia 2013

The less complex is the institutional structure of Hungary, consisting only two types of institutions³⁶. In the Czech Republic and Slovenia higher vocational training is part of higher education but is pursued in a separate type of institution. In Poland teacher training, foreign language and social worker training colleges are separated from the rest. (Eurypedia 2013)³⁷

³⁶ In the next years HE institutions will be classified into more categories on the basis of their mission.

³⁷ There is no detailed information available about Romania.

Summarizing what has been presented, the institutional landscape is rather different in the countries, not showing memento of their common historic heritage.

The case is just the opposite concerning the internal management of the six countries. Before the communist era Middle-Eastern-Europe (just like the rest of the countries except the Anglo-Saxon ones) had the so-called continental type of university governance, giving the authority exclusively to the senate composed only of university members. At the end of the 20th century European countries have moved towards the Anglo-Saxon governance system, sharing the authority between the senate – dealing only with academic issues -- and a governing board focusing on financial issues. After the strict central control of the universities in the communist regime, reforms were launched in most of the post-communist countries to turn towards the Anglo-Saxon university governance system, but these reforms have subsided. (See Keczer 2010 for details.) In all six countries the traditional continental system has survived (see Table 2.).

Table 2.: Governance of higher education institutions

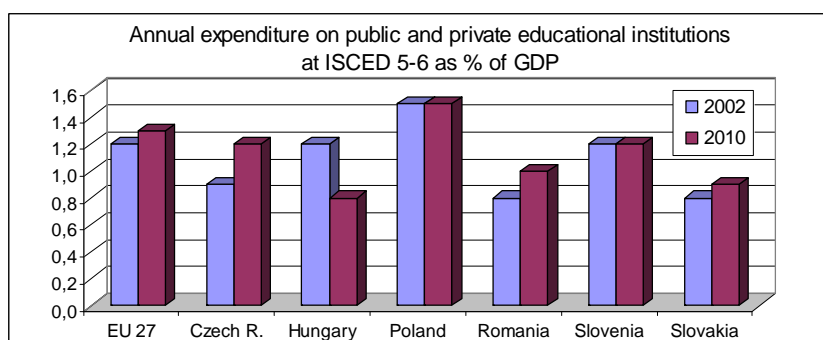
	Executive head	Academic body	Decision-making body	Advisory/Supervision body
Czech R.	rector	senate (only university members)		board of trustees (only external members)
Hungary	rector	senate (only university members)		economic council (internal and external members)
Poland	rector	senate (only university members)		council (optional)
Romania	rector	senate (only university members)		-
Slovakia	rector	senate (only university members)		board of trustees (only external members)
Slovenia	rector	senate, academic assembly (only university members)		Universities: - Indep. institutions: management board (internal and external members)

Source: Own construction based on Eurydice 2008 and Eurypedia

Academic and decision-making bodies are not separated, senate performs both functions. Although advisory bodies were set in each countries but Romania, their authority is limited. In this aspect Middle-Eastern-Europe's path differs from that of the rest of Europe.

2. Financial conditions

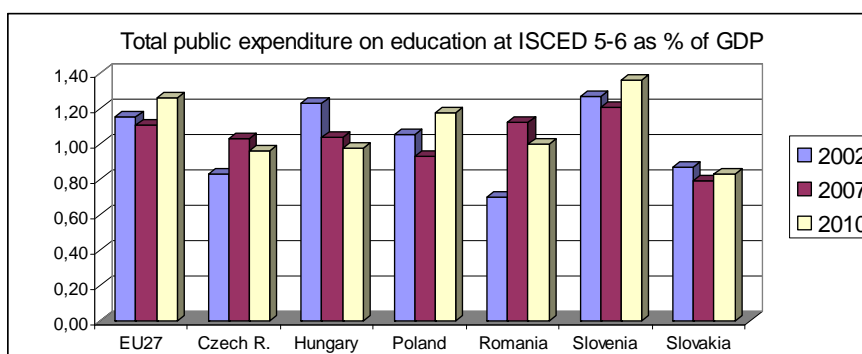
An often-quoted data regarding the financial conditions of education is the percentage of GDP spent on the sector. I display this proportion for the years of 2002 and 2010, to show the progression of some countries out of the six (see Diagram 1.).

Diagram 1.: Expenditure on higher education³⁸ as percentage of GDP

Source: Own construction based on Eurostat data

In 2002 only Poland's spending exceeded the EU average, and that of Hungary and Slovenia was equal with it. The Czech Republic, Romania and Slovakia spent significantly less. But by 2010 the Czech Republic has considerably increased the share spent on higher education, almost reaching the EU average, and Romania and Slovakia also have a promising tendency. Hungary did just the opposite, decreased the rate from 1,2 to 0,8, dropping back to the bottom of the country list.

If we examine the public expenditure on higher education, we get a slightly different picture. Here we can associate to the negative effects of the crisis in some countries (see Diagram 2.).

Diagram 2.: Public expenditure on HE as percentage of GDP

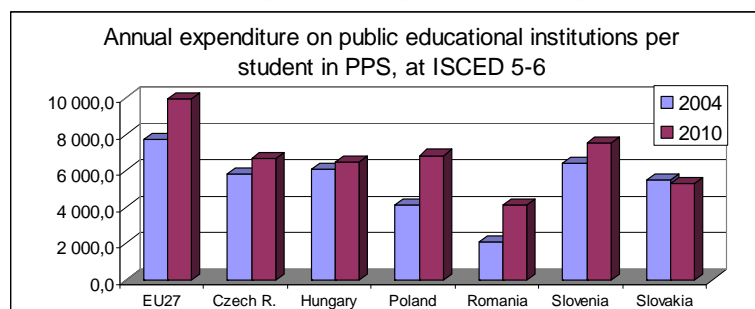
Source: Own construction based on Eurostat data

In 2010 only Slovenia exceeded the EU average, and Poland was close to it. Slovakia is obviously lagging behind. Hungary has suffered a decline in this indicator as well. The possible effects of the economic crisis may be seen in the Czech Republic and Romania, where after a positive tendency between 2002 and 2007, there was a fallback by 2010. Nonetheless, Romania has produced an impressive overall increase from 0,7% to 1,0%.

³⁸ Higher education is the 5th and 6th levels of the ISCED (International Standard Classification of Education) system.

Instead of overall and relative figures, a more interesting question for those studying and working in higher education, and a more expressive data is the absolute expenditure per student in public institutions (in private higher education the financial background is quite different). Here we experience a shocking difference between the majority of the Middle-Eastern-European countries and the Western-European ones (see Diagram 3.).

Diagram 3.: Expenditure per student in public HE

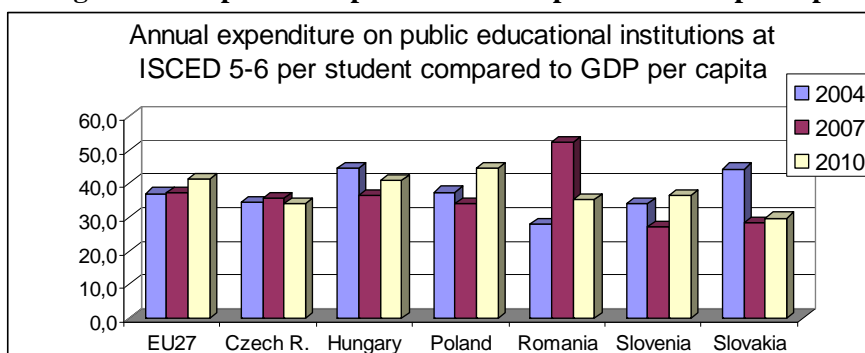


Source: Own construction based on Eurostat data

All of the six countries had and still have to operate with significantly less money per student than the average EU spending. In 2002, in Romania the expenditure per student in Euro PPS³⁹ was only ¼ of the EU average, and in Poland slightly more than 1/2! Since then these two countries have produced an impressive progress, but Romania still have to educate students with only half of the average EU expenditure. The closest to the EU average in this indicator is Slovenia. To make the comparison more shocking: the expenditure per student in Hungary is less than 6.500 Euro PPS, in the Scandinavian states it is 15.000, in Switzerland close to 17.000, in Japan 20.500. (OECD 2013) So in Japan the expenditure per student is five times more than in Romania.

It could be stated that the Middle-Eastern-European countries do not spend enough on higher education. To qualify this statement it is worth to compare the GDP per capita spending (see Diagram 4.).

Diagram 4.: Expenditure per student compared to GDP per capita



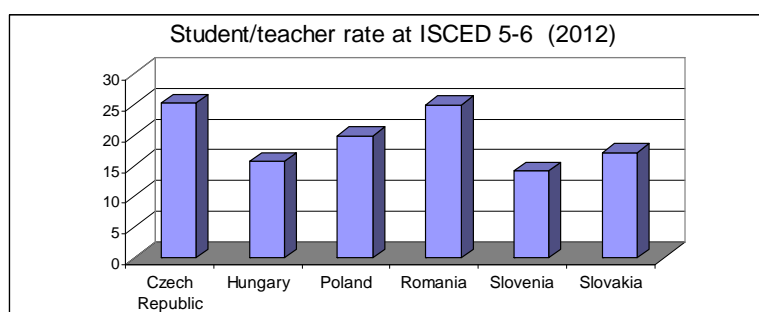
Source: Own construction based on Eurostat data

³⁹ Euro PPS (Purchasing Power Standard) is a fictive currency unit having the same purchasing power with that of 1 Euro in the EU on average.

In Poland the rate of GDP per capita spent on a student is higher than the EU average, in Hungary it is equal, and in the rest of the countries (except Slovakia) it is close to it. In the Scandinavian countries mentioned above this rate is 45%, only slightly more than in Poland or Hungary, yet, the expenditure per student is three times more. (OECD 2013) Thus, we can conclude that in the Middle-Eastern-European countries the poor financing is the result of the low level of GDP. In the case of Romania it is worth to mention the significant increase of the rate of GDP per capita spent on one student between 2004 and 2007, and the heavy decline by 2010. In Slovakia the rate was highly above the EU average in 2002, but they suffered a decline by 2007.

Another important indicator of the operating conditions of higher education is the student/teacher rate (see Diagram 5.).

Diagram 5.: Student/teacher rate in higher education (2012)



Source: Own calculation and construction based on Eurostat data

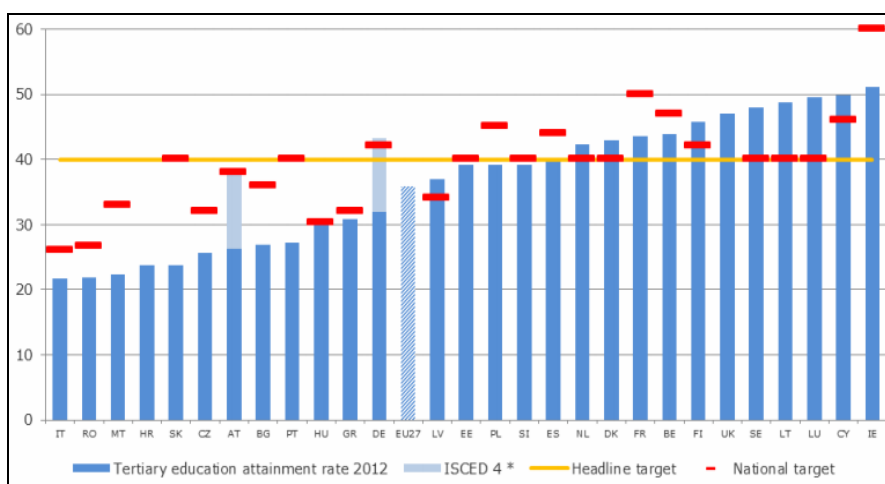
In the Czech Republic and Romania the number of students per teacher is considerably higher than in Hungary or Slovenia, making education harder. In 2011 the average in the EU21 was 15,9. (OECD 2013)

From the students' and the families' point of view it is important what fees the students have to pay in higher education and what support they and their families get. Among the six countries three major differences have to be noted. First, students do not have to pay tuition only in the Czech Republic. Second, in Hungary, Romania and Slovakia there is a special system of state-supported and not-supported student places in both full-time and part-time training. In this system the state finances a certain number of student places in each public higher education institution, and if a higher education institution has a capacity left, it can enroll students who pay tuition. The number of places in study programmes subsidized by the state is decided every year at central level by the ministry, depending on the national priorities. This system cannot be found anywhere else except some Baltic states. Third, there are only two countries where families of students do not have tax allowances or subsidies: Hungary and Romania, while there are several Western countries – Belgium, Germany, Ireland, France, Italy, Austria, Portugal – in which families are given some form of state support. (Eurypedia, Eurydice, OECD 2013)

3. The output of higher education

The numerical output of higher education is the number of graduates, but a more telling data is the rate of population with higher education attainment. In the Europa 2020 strategy the EU set the target of raising the average rate of the 30-34 year-old population to 40 percent. The member countries also set their national targets. Among the six countries Poland set its national target the highest, at 45 percent, and in 2012 they were at 40%. Romania set a more modest objective, 26,7%, and was above 20% in 2012. Hungary was also modest with its 30,3%, but is almost have reached it by 2012. The Czech Republic was farther away from its 32% target. Slovakia seems to be in the greatest trouble setting an optimistic 40% as a target but being below 25% in 2012. (See Diagram 6.)

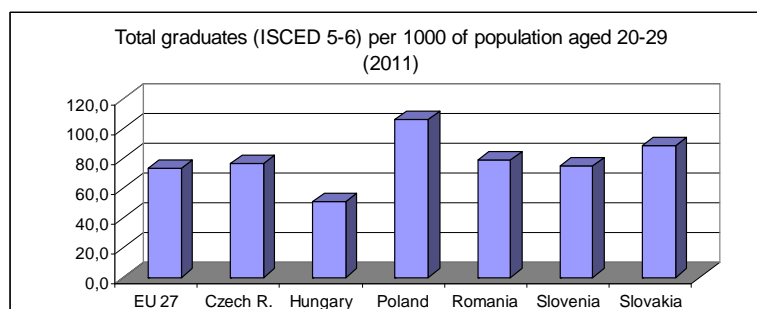
Diagram 6.: Europe 2020 strategy and its accomplishment in 2012for higher education attainment rate in age group 30-34



Source: EC 2013

But Slovakia may well be optimistic building on the high rate of graduates among the 20-29-year-olds, and Hungary's limited perspective as far as the rate of people with higher education attainment is concerned is obvious based on the low level of the same indicator (see Diagram 7.).

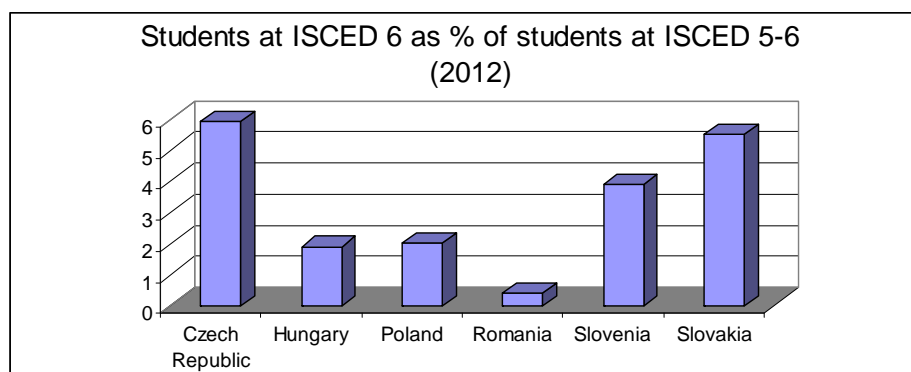
Diagram 7.: Rate of graduates among the 20-29-year-olds (2011)



Source: Own calculation and construction based on Eurostat data

For high innovation potential, „new blood” in research and development, a sufficient number of new PhDs is crucial for a county. It can be assessed by the rate of PhD students. In 2012 the Czech Republic and Slovakia was performing extremely well in this indicator, Slovenia fairly, Hungary and Poland modestly, Romania poorly. The progress Slovenia has made between 2005-2012, multiplying the number of PhD students fourfold, is rather impressive. (See Diagram 8. and Table 3.)

Diagram 8.: Rate of PhD students⁴⁰ among all students



Source: Own construction based on Eurostat data

Table 3.: Number of students at ISCED 6

	2005	2012
Czech R.	24 907	26 105
Hungary	7 941	7 254
Poland	33 040	40 263
Romania	22 348	23 818
Slovenia	964	4 098
Slovakia	10 290	12 145

Source: Eurostat

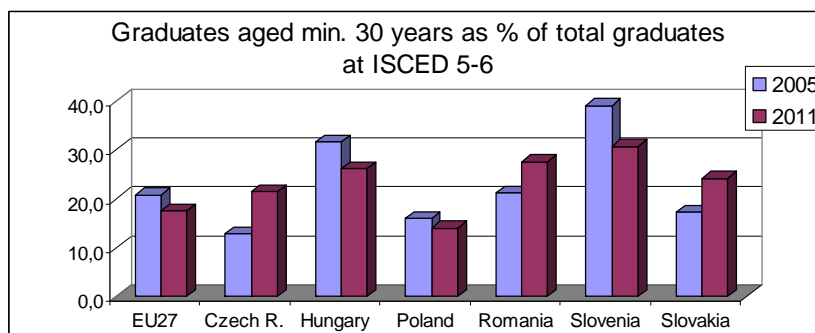
4. The inclusiveness of higher education

The inclusive character of higher education is going to be assessed by two parameters: the rate of adult/mature students (aged 30 or more) and the rate of women among students and teachers.

⁴⁰ It is ISCED 6 level.

The European Union in the Lisbon Strategy had set a target that 12.5% of the adult population should participate in lifelong learning. The Europe 2020 plan increased this proportion to 15%. Higher education plays an important role in achieving this goal, thus the rate of mature graduates is an important indicator. The Middle-Eastern-European countries, except Poland, are performing definitely well on this field, exceeding the EU average. Slovenia is leading the ranking. It is also impressive that some countries – including Romania -- made an increase between 2005-2011, while the EU in general suffered a slight incline. (see Diagram 9.).

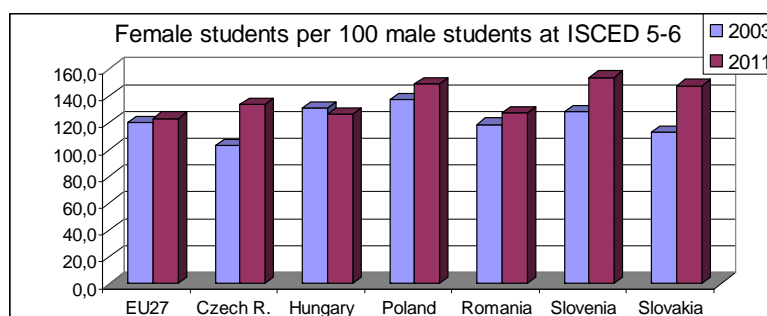
Diagram 9.: Rate of mature graduates



Source: Own construction based on Eurostat data

It is a well-known fact nowadays that there are more female students in higher education in the developed countries than males. It has been true also in the Middle-Eastern-European countries for more than a decade, and the rate of women among students went even higher between 2003-2011 (see Diagram 10.).

Diagram 10.: Rate of female students

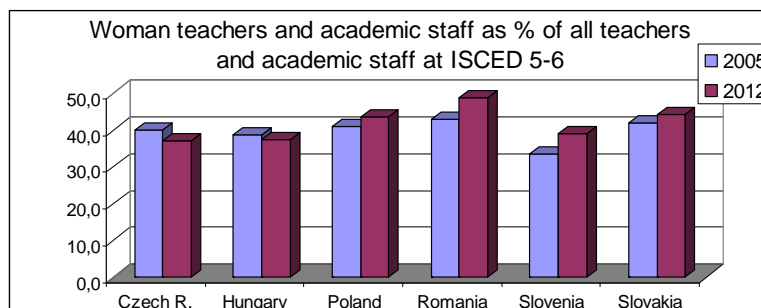


Source: Own construction based on Eurostat data

A hot issue related to the inclusiveness of higher education is the so called „glass ceiling” phenomenon, a traditional-socio-cultural barrier preventing women to get higher in academic setting. The existence of the glass ceiling can be tested against the rate of women among university teachers. Diagram 11. shows that there are less woman than men among the teachers and other academic personnel in all of the six countries, Romania performing the best, Hungary, the Czech republic and Slovenia worse. Thus, in spite of the fact that

more women graduates, less are employed in academic jobs. But in four countries the trend favors women.

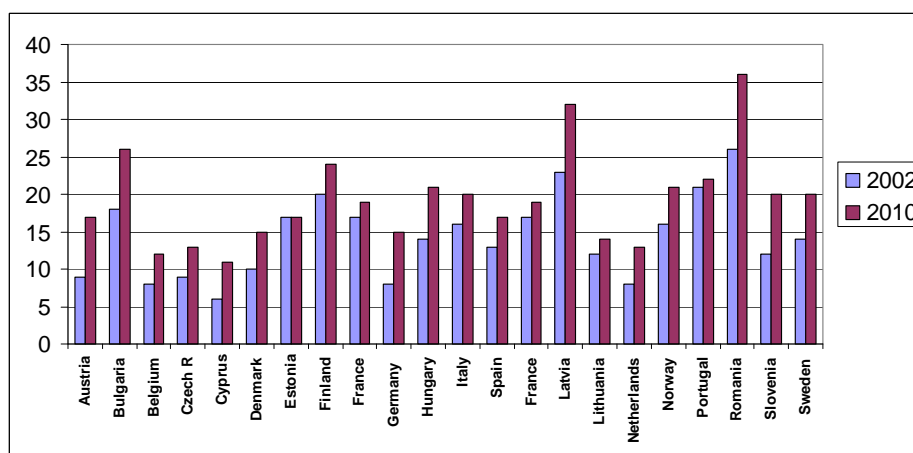
Diagram 11.: Rate of women in teaching and other academic jobs



Source: Own construction based on Eurostat data

It has to be noted that this indicator relates to the overall rate of women in all academic jobs, and experience shows that women are employed in higher rate in non-teaching academic positions. To qualify the issue further, it is worth to see the rate of women in higher academic ranks. It is remarkable that in none of the surveyed countries goes the rate of women in professorial position⁴¹ above 35 percent, thus, the glass ceiling definitely exists in higher education, although the trend is favorable for women (see Diagram 12.). The best-performing is Romania, where this rate was already high in 2002, and has made further progress by 2010.

Diagram 12.: Rate of women among professors



Source: Own construction based on EC 2012

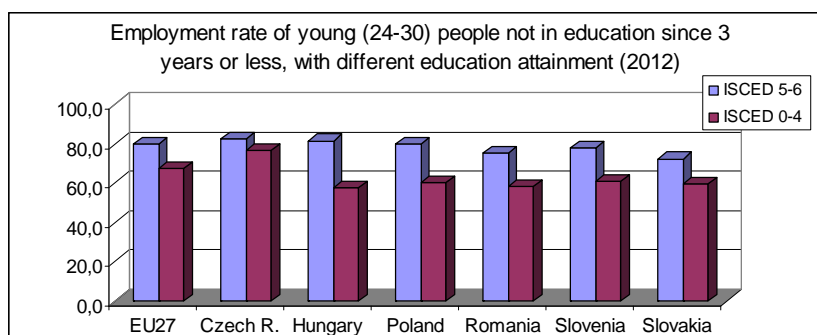
⁴¹ The highest rank of university teachers in the national higher education systems.

5. The 'value' of the degrees

A general indicator of the 'value' of higher education attainment is its weight on the labor market, that can be assessed by the employment chances and unemployment rates of people with and without university degree.

The employment rate of young people in their first three years after leaving school is higher with, then without higher education attainment in each of the six countries, and Middle-Eastern-Europe is above or very close to the EU average (see Diagram 13.).

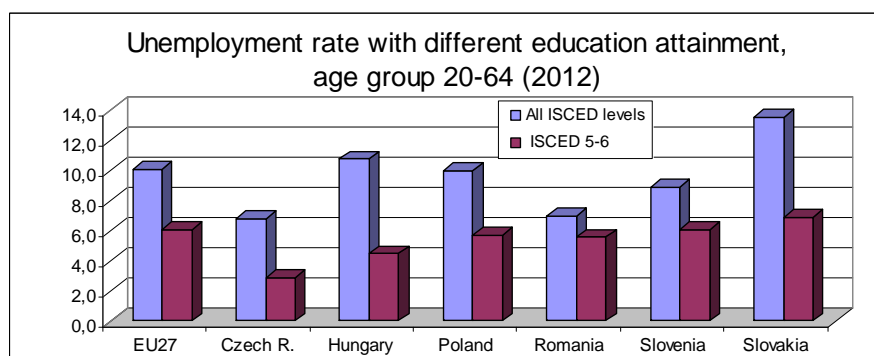
Diagram 13.: Employment rate of young people after leaving school with different education attainment



Source: Own construction based on Eurostat data

Also, the unemployment rate among people with degree is significantly lower than the overall unemployment rate in all of the six countries, and some of them (the Czech Republic, Hungary, Poland and Romania) performs better regarding the unemployment rate of people with higher education attainment than the EU average (see Diagram 14.). The greatest difference in the overall unemployment rate and that of people having a degree is in Hungary and Slovakia, in these countries the unemployment rate of people with diploma is the half of the overall unemployment.

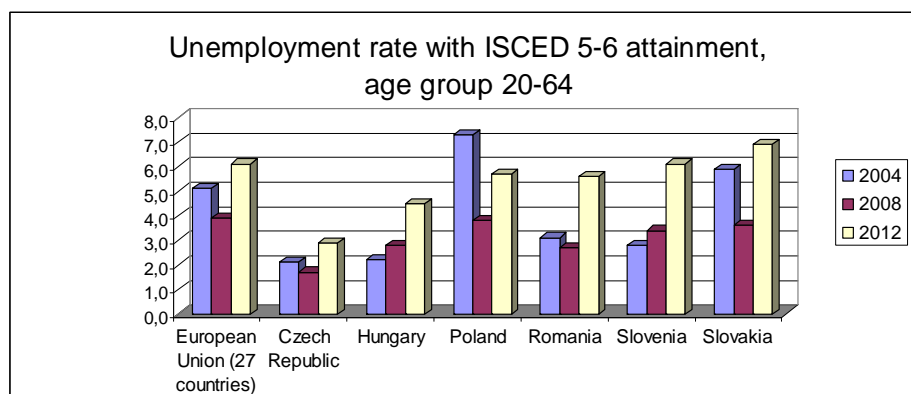
Diagram 14.: Overall unemployment rate and unemployment rate among people with higher education attainment (2012)



Source: Own construction based on Eurostat data

To see the whole picture trends are also of relevance. The economic crisis had a negative impact on the employment of graduates. Between 2008-2012, after a drop between 2002-2008, unemployment rate increased among people with higher education attainment in four of the six countries, in line with the EU average (see Diagram 15.). In Hungary and Slovenia the increase started earlier.

Diagram 15.: Unemployment rate with higher education attainment



Source: Own construction based on Eurostat data

6. Conclusions

Facts and statistical data show that national higher education systems of Middle-Eastern-Europe run on worse financial platforms than the EU average, and in significantly harsher conditions than the developed countries. They are lagging behind in terms of the rate of degree holders, but the tendencies are promising. As far as the inclusiveness of higher education is concerned, the region is in line with the rest of the continent. The value of the degrees is proven by the labor market in each country. The institutional setting of higher education systems and the student fee and support systems show great diversity inside the region, but the university management systems have a common character that differs from the Western trends. The effects of the economic crisis are discernible in the financing of higher education and in the increasing unemployment of people with degree.

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NATIONAL PERSPECTIVE Session – part 1

APPLICATION OF POST WASHINGTON CONSENSUS POLICIES IN TURKEY

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ABSTRACT

The paper begins with the analysis of transition from the Washington Consensus to Post-Washington Consensus and the implications of this transition. The basic distinctive feature of Post-Washington Consensus is its allegedly pro-poor orientation. The redefinition of the neoliberal agenda, that targets growth with equity and poverty reduction also bring about “new social policies”.

Paper asserts that this process could be observed during the Justice and Development Party (JDP) period in Turkey and this has serious repercussions upon the income distribution. Paper both focuses on the WC and PWC periods of neoliberalism in Turkey and examines the effects and results of PWC policies on Turkish economy and society; also evaluates the sustainability of the growth of Turkish economy in the future.

Key Words: Neo-liberalism; Washington Consensus; Post Washington Consensus; 2001 Crisis of Turkey; Post crisis development and growth policy of Turkey as an emerging market.

Jel Codes: O1; O15; I1; I2; I3.

1. INTRODUCTION

Neoliberalism not only determines the economic policies but also the reproduction of the social and economic relations on the basis of a new set of rules. These new set of rules strongly support free market fundamentalism, individualism and minimum state intervention. Based on structural adjustment and stabilization policies lead by the IMF and the World Bank (WB), neoliberal policies materialize by the application of Washington Consensus (WC) principles. According to neoliberal policies and WC principles, countries are poor because of misconceived state intervention, corruption, inefficiency and misguided economic incentives. Development is the inevitable outcome of a set of ‘appropriate’ incentives and outward-looking neoclassical economic policies, including fiscal restraint, privatization, the abolition of government intervention on prices, labor market ‘flexibility’, and trade, financial and capital account liberalization. Within this framework, related titles with development and income distribution were left to market forces and it is expected that achieved growth rates would also be functional for the elimination of the inequalities.

One of the consequences of the globalization and neoliberal policies on global scale is increasing inequalities in spite of the increasing growth rates. Increasing inequalities, the emergence of the crisis (Mexico; Asia) and arising discontents from the related policies lead the emergence of new form of policies differently from the (WC). At this point, Post Washington Consensus (PWC) policies that have been also carried out as a part of comprehensive growth strategies within the WB came into fore. Although it is not a breakdown from the neoliberal policies, PWC mostly concentrate on institutional setting of economic activity, the significance of market imperfections, and the potential outcomes of differences or changes in institutions. The PWC rejects the WC for its antipathy to state intervention, and questions the conventional stabilization policies for their adverse short- and long-term impacts. The redefinition of the neoliberal agenda, that targets growth with equity and poverty reduction also bring about “new social policies”. Hence, rather than focusing growth, inequalities and poverty reduction became one of the main target of the policies. Accordingly deregulation of the institutions, with a given importance to the “poor” by redefining the social policies could be named as “neoliberalism adjustment with human face”.

Neo-liberal transformation of Turkish economy has started by the Decisions of 24th January 1980. There were three phases of Neo-liberalism in Turkey. In the initial period of neoliberalism (1980-1989) the labor costs were suppressed so that the exports were pumped and the capital movements was kept under control. In the second phase of neoliberalism (1990s) the losses of the labor were partially compensated and the distribution conflict lead to fiscal imbalances and in contrary to these capital movements were liberalized. In the third period of neoliberalism after one of the deepest crisis of Turkish economy (2001) the fiscal imbalances was kept under control and the distribution relations were determined by the market forces.

This paper both focuses on the WC and PWC periods of neoliberalism in Turkey and examines the effects and results of PWC policies on Turkish economy and society; also evaluates the sustainability of the growth of Turkish economy in the future.

2. WORLD-WIDE POLICY REFORM OF NEOLIBERALİZM

During the final two decades of the twentieth century, development theory and practice were dominated by a single paradigm that placed market forces at the center of policy. There was a wave of market oriented economic reforms, the likes of which have never been seen. Financier George Soros (2002, pp. 4-10) termed that prevailing paradigm “market fundamentalism”. In Latin America in particular the theory and practice came to be known as “neo-liberalism”. Many however simply call it “free market economics”. In 1990 economist John Williamson deemed it appropriate to term the policy core of this period “the Washington Consensus” (1990 p.9).

2.1. Washington Consensus

According to Washington Consensus an appropriate economic strategy emphasizes fiscal rectitude, competitive exchange rates, free-trade, privatization, undistorted market prices and limited intervention (save for encouraging exports, education, and infrastructure). In 1980s many countries began to shed their import substitution policies and endorsed market oriented ones. Williamson supplied us a useful list of policy desiderata. While Williamson determined ten major policy tenets, the list concentrates primarily in three areas of reform: liberalization, deregulation and privatization. Ronald Reagan, Margaret Thatcher and Helmut Kohl all came to power in the early 1980s as revolutionaries who would diminish the role of government and unleash market forces to bring prosperity to their nations. This free market revolution became a global revolution. The Washington Consensus became a global paradigm that dominated Third World development policy. Over the course of 1980s these policies were spread to a majority of developing nations. The export of Washington Consensus policies continued throughout the 1990s. These policies exported to the countries of the former Soviet Union and Eastern Europe after the collapse of the Berlin wall. Turkey was also one of the developing countries which adopted economic policies similar to Washington Consensus and tried to increase the integration of Turkish Economy to the world Economy in 1980s. Washington Consensus paradigm dominated development theory and practices across the globe during 1980s and 1990s.

This free-market revolution became a global revolution because of inter related set of developments among multilateral institutions that moved center-stage during this period, the Washington consensus became the global paradigm that dominated third world development policy. In 1980, the World Bank initiated a new policy-based lending instrument called “structural adjustment loans” that mandated that countries advance deregulation privatization and liberalization. In 1982, after Mexico’s inability to service its external debts, the IMF began to play a greater role in pressing Washington Consensus policies on debtor nations as the macroeconomic conditionality for new private and public sector loans. Over the course of the 1980s, these policies were spread to a majority of developing nations. The reforms were strongest and most sustained in Latin America, where countries like Bolivia, Mexico, Argentina, Peru, Colombia, and Brazil joined Chile in orthodoxy. But this was very much a global phenomenon “stabilization” and “structural adjustment” became the primary preoccupation of government leaders in Asia and Africa as well. Even India, the giant archetype of a closed import substituting economy among developing countries embarked on a process of economic liberalization in 1991(Rodrik, 1996,p.9).

In November 1993, the governments of the United States, Mexico and Canada passed the North American Free Trade Agreement (NAFTA) that knocked down barriers to trade and investment and reigned in government control over economic activity. A year later the WTO was created with the strong enforcement powers for Washington Consensus policies.

While each of these new developments met stiff resistance from citizen groups across the globe they were passed with strong elite consensus. The Washington Consensus became the only way; the desirability of its policies was presented as an objective economic truth.

World-wide acceptance of neo-liberal policies between different governments raised the important question of why so many countries have suddenly caught the reform bug. Some of the professional economists believed that the new orthodoxy was built on two mutually reinforcing pillars (Rodrik, p.13):

One was the set of policies that had been tried by the import substituting countries and had failed; the second was the set of successful policies implemented by the East Asian Tigers:

Once upon a time, many countries of the third world followed import-substitution policies. Such policies included import controls, overvalued exchange rates, binding ceilings on interest rates, a heavy dose of public ownership, and pervasive price regulation. Ann Krueger has been the most famous economist in documenting and popularizing the short comings of import-substitution policies. She points out a multitude of reasons for the initial adoption of these policies. Newly independent governments had a strong desire for industrialization, and the apparently successful example of Soviet planning invited emulation. Moreover the economic ideas of 1950s and early 1960s tended to dismiss the benefits from trade and emphasized the need for physical capital accumulation and infant industry promotion. According to Anne Krueger there was a strong emphasis on the primacy of market imperfections. Market failures were thought to be relatively strong, while it was assumed that governments could correctly identify and performs economic functions. Virtually no attention was given to the possibility that there might be government failure (Krueger, 1993, p.49) and there was plenty of government failure. Not only did many infant industries fail to mature but many countries succumbed to stop-go cycles driven by excessive government spending. Krueger explains that in viewing the government as a “benevolent social guardian” most economist had ignored a number of important forces at work. Individuals in the public sector were apt to follow their own selfish interest. They would be lobbied by pressure groups aiming to impose their own agenda on a largely docile majority. Policy interventions would create rent seeking incentives diverting entrepreneurs from productive activities. Finally the informational disadvantage of government bureaucracies over market participants would doom even the best-laid plans to inefficiency.

Meanwhile, four East Asian economies were making a mockery of the export pessimism that had persuaded policy makers elsewhere to follow an inward oriented strategy South Korea and Taiwan, in particular, were able to engineer a remarkable increase in their growth rates, thanks to sharp jumps in their investment and export efforts during the mid-1960’s. Among professional economists, there soon developed the view that the East Asian miracles could be attributed to market-oriented policies and the reduced role of government intervention (Ranis and Mahmood ,1992, p. 138).

If we turn back to the question of why so many countries have suddenly caught the reform bug, we can list, at least three reasons for this question:

- Governments received advice of international institutions like IMF, WB, WTO
- Failure of import substitution development strategy (crisis)
- Success of export oriented development strategy of East Asia

2.2. Post Washington Consensus

In the late 1980s and 1990s, the hegemony of the WC came under attack both in the academia and in the emerging social movements, with three criticisms pushed to the fore. (Saad-Filho, 2010) The first was inspired by the notion of the developmental state, thought to apply to the successful East Asian newly industrializing economies (NIEs), with Japan as the precursor, followed by the four “tigers” (Hong Kong Special Administrative Region of China, Republic of Korea, Singapore and Taiwan Province of China) in the 1960s and 1970s, followed, in turn, by China, Indonesia, Malaysia, Thailand and Vietnam. In all these cases, it was found that the state had violated the main tenets of the WC through long-term planning, protectionism, directed finance and other departures from the free market.

The second approach focused on the notion of “adjustment with a human face.” Irrespective of the merits of WC in bringing stability and growth, the adverse impact of the WC policies on those in, or on the borders of, poverty was highlighted by a growing literature beginning with Cornia, Jolly and Stewart (1987). They documented the human costs of the crisis, showed that poverty was rising in the “adjusting” countries, and demonstrated the tendency of the adjustment costs to fall on the most vulnerable. The WC stood accused of being at least oblivious to the disproportionate burden on the poor arising from the processes of adjustment and stabilization (see Chang, 2003 and Chang and Grabel, 2004).

The third criticism of the WC concerns the interface between economics and politics. The closely related transitions to neoliberal economic policies and to political democracy in several countries in the South and in Eastern Europe have introduced a potentially severe tension because of the deployment of democratic and supposedly inclusive political systems to enforce exclusionary economic policies. The neoliberal economic policies demand a state hostile to the majority, even though a democratic state should be responsive to majority pressures.

Discontent with WC policies spread since the 1990s, with disquiet reaching even some Washington institutions. Nevertheless, the IMF has continued to stress the “virtues” of the reforms, and to blame the poor countries for their own failures (see, for example, Krueger, 2004) The World Bank, on the other hand, has scrutinized WC policies more carefully, starting with the implications of the East Asian success and recognizing the association of this success with the distribution of income and assets, mass education and state guidance of investment.

The intellectual thrust of the PWC has been to shift the analytical focus away from the neoclassical emphasis on competition and the virtues of (perfect) markets, and towards the institutional setting of economic activity, the significance of market imperfections, and the potential outcomes of differences or changes in institutions. The PWC rejects the WC for its unwavering antipathy to state intervention, and questions the conventional stabilization policies for their adverse short- and long-term impacts.

Inspired by new institutional economics, the PWC can provide a more nuanced understanding of economic development (see Harriss and others, 1995). For example, the PWC acknowledges that at the core of the development process lies a profound shift in social relations, the distribution of property rights, work patterns, urbanization, family

structures, and so on, for which an analysis limited to macroeconomic aggregates is both insufficient and potentially misleading. Policy-wise, the rhetoric of the PWC is comparatively state-friendly but in a limited and piecemeal way, with intervention only justified on a case-by-case basis, should it be demonstrable by mainstream criteria that narrow economic benefits would most likely accrue. Despite its obvious limitations, the PWC offers a rationale for discretionary intervention across a much wider range of economic and social policy than the WC. Nevertheless, the PWC remains fundamentally pro-market, supporting a poorly examined process of “globalization” which, however, should have a more human face because it would be supported by appropriate institutions and the gentle steer of the national state and the international financial institutions (IFIs).

The outcome of these shifts within the orthodoxy was the *augmentation* of the list of WC policy reforms by a long but imprecise list of “second generation” reforms, to create what many have termed as the post-Washington Consensus. Rodrik offers the comparison of WC and PWC policies or reforms by the help of (table 1).

Table 1 The Post-Washington Consensus

<i>Washington Consensus</i>	<i>Post-Washington Consensus (Original WC plus)</i>
Secure property rights	Anti-corruption
Deregulation	Corporate governance
Fiscal discipline	Independent central bank and IT
Tax reform	Financial codes and standards
Privatization	Flexible labour markets
Reorientation of public expenditures	WTO agreements
Financial liberalization	“Prudent” capital account opening
Trade liberalization	Non-intermediate exchange rate regimes
Openness to FDI	Social safety nets
Unified and competitive exchange rates	Targeted poverty reduction

Source: Rodrik (2006, p.978).

3. APPLICATION AND PERFORMANCE OF NEO-LIBERAL POLICY IN TURKEY

3.1. Before Neo-liberalism

For most of its republican history, Turkey has adhered to a quasi-statist approach, with strict government controls over private sector participation, foreign trade, and foreign direct investment. As was the case in many developing economies in the world, the main economic development strategy of Turkey centered on import-substitution policies during the 1960s and 1970s. This period was characterized by huge public investment programs, which aimed at expanding the domestic production capacity in heavy manufacturing and capital goods. Foreign trade was under heavy protection via quantitative restrictions along with a fixed exchange rate regime that, on the average, was overvalued given purchasing power parity. The import-substitution strategy heavily relied on imported raw materials. Hence, Turkey’s terms of trade have deteriorated following the first oil shock in the 1973-1974 period. This

deterioration caused a huge burden on the balance of payments, while the additional burden was compensated by short-term borrowing. From 1977 onwards, since the required amount of imports could not be realized in due time, there appeared problems in the labor market, and important difficulties emerged on the supply side. Factories couldn't operate because of the scarcity of raw materials and couldn't hire workers for production purposes. Increasing unemployment rate effected social structure of the society negatively. On the demand side, expansionary fiscal policy was maintained. Imbalances in the aggregate supply and demand accelerated the already increasing inflation. Inadequate measures taken to overcome the crisis, as well as the negative effects of the second oil shock in 1979 deepened the crisis.

3.2. Application of Neo-liberal Policy in Turkey

The Initial phase of neoliberalism has started by the Decisions of the 24th January 1980 and after the 12 September 1980 coup the initial period of neoliberalism accompanies with "Özal legacy" since Turgut Özal's leadership had a decisive impact on the neoliberal transformation of the Turkish economy. The early 1980s constituted the heyday of the "Washington Consensus" (Öniş, 2004). As Boratav (2013) states in the initial period of neoliberalism (1980-1989) the labor costs were suppressed so that the exports were pumped and the capital movements was kept under control. The second phase of neoliberalism is also the period of coalitions (1990-2000). In this period the losses of the labor were partially compensated and the distribution conflict lead to fiscal imbalances and in contrary to these capital movements were liberalized. The third period of neoliberalism (after the 2001 crisis, 2002 -2014) has accompanied to Justice and Development Party (JDP) years, single party government. Within this period the fiscal imbalance was kept under control and the distribution relations were determined by the market forces. Below these periods will be examined respectively.

3.2.1. First period of neoliberalism in Turkey (integration of Turkish Economy to the world economy through WC)

The 24th January 1980 Decisions were announced in order to curb inflation, to fill in the foreign financing gap, and to attain a more outward oriented and market-based economic system. Within the framework of these decisions, export subsidies were granted and exchange rates were allowed to depreciate in real terms to make Turkish exports more competitive, which would lead to the promotion of export-led growth.

Turkey attempted to overcome weaknesses of import-substitution strategy by gearing towards a more outward oriented economic development strategy. Especially during the 1980s there was an accelerated reform and adjustment process in almost all sectors of the economic system. The reform process started with liberalization of the foreign trade regime and the financial sector and culminated in the liberalization of capital accounts during late 1989, the latter changed the whole pattern of policy making environment radically.

24 January 1980 Decisions included export subsidies; high devaluation; increases in public goods and services prices; increases in interest rates and implementation of heterodox

export incentive policies. By the help of these policies Turkey regained the confidence of international institutions. The IMF Stand-by and World Bank adjustment loans were rapidly arranged and disbursed in conjunction with additional debt relief operations. The trade reform process was facilitated by three characteristics of the policy environment (CBRT, 2002, p. 6):

- Firstly, net foreign lending allowed the resumption of intermediate goods imports and eased pressures on public finance. Because of the low rates of capacity utilization (at around 45-50 percent), industrial firms showed a strong export response to the rapidly altered incentive structure.
- Secondly, the exchange rate depreciation was high but sustainable.
- Thirdly, domestic absorption was significantly lowered in the first half of the 1980s to provide room for the initial push in export expansion. In this period, real wages and agricultural incomes were decreased substantially.

By the announcement of the decisions, economic integration to the world economy had started in Turkey step by step. The first step was the trade liberalization process. Financial liberalization followed trade liberalization and finally capital account liberalization fully completed when Decree No: 32 put into force in August 11, 1989. Turkish economy, became fully an open economy, to the shocks of the global economic system since then. Economic policies of Washington Consensus influenced all sectors of the Turkish economy. Turkey was among the reformist countries of 1980's which tried to operate free market economy. Strong adherence to neo-liberal policies of Washington consensus gained acceptance in all parts of the economy by the reforms realized after 1980.

3.2.2. Second period of neoliberalism in Turkey (results of WC)

The 1980s were characterized by the liberalization efforts of the governments on many fronts. The 1990s were lax post reform period in Turkish economy. First generation reforms were in place and the impact of these reforms was surfacing in 1990s. Economic fundamentals and the rules of the game were totally changed during those years. The 1990s were a decade of external and domestic shocks and crises for the Turkish economy.

The boom and bust cycles of the economy contributed to the political instability of the country in 1990s. Duration of the governments stay in office were 15 months on the average in those years. Turkey has been governed by coalitions of minority governments in that period. Coalition governments performed worse than majority governments in terms of budget discipline. Turkey experienced one of the deepest economic crisis of its history in 1994. There was a 60% nominal depreciation of the currency within four months and 6.1 % contraction of the GNP in the same year.

Foreign financing and integration with the international capital markets didn't raise the productive capacity of the economy, but helped the policy makers to postpone the necessary reforms. After crisis policy makers both in national and international quarters became aware of the importance of proper rules, institutions and governance in achieving stable growth. Second generation reforms and the issue of good governance were the main agenda items during the late 1990s. New reforms were unavoidable in the face of pressing

problems into an uncertain future through a rising debt stock. November 2000 and February 2001 crises revealed the fact that the current situation would worsen without more reforms addressing the public sector and the banking sector. The new economic program of 2002-2004 put a high priority in reforming the banking sector.

3.2.3 Third period of neoliberalism in Turkey (PWC)

Both 1994 crisis and 2001 crisis have emerged as financial crisis within this model of capital accumulation in the neoliberal era that cause Turkish economy to be called transition from one crisis to another (Yentürk, 2005:3). On the other hand the related crisis has also lead the neoliberal transformation policies to be applied more effectively (Tahsin: 2013:3). It is possible to claim that the 2001 crisis had also a function of opening a new era in the application of neoliberal policies. First of all the political will require for the application of neoliberal agenda was reconstructed under new power relations. Transition to “strong economy” program implemented in 2001, after the crisis, under the leadership of Kemal Derviş, the newly appointed Minister of State responsible for the economy was a major step Turkey’s encounter with “regulatory neo-liberalism” in context of the emerging post-Washington consensus (Öniş, 2012). Good governance, institutional restructuring, efficient state against corruption, transparency are among the related titles targeted by transition to strong economy under Derviş administration. These titles are also closely linked with PWC agenda.

Based on this program the necessary regulations and laws for restructuring the state on the basis of neoliberal principles were taken with an increasing role and effectiveness of the independent regulatory agencies that also meant acceleration of the neoliberal transformation (Öniş and Şenses, 2007).

Turkey is a prime case study demonstrating how the effects of a precipitous economic collapse can be reversed (Hakura, 2013:2). As the liberalization of the 1980s went unsupported by sound macroeconomic policies and institutional reforms, the economy suffered repeated crises in the following decade: in 1991, 1994, 1998, 1999 and, worst of all, 2001. Lack of fiscal discipline and heavy reliance on monetary financing led to high inflation and real interest rates. An inadequate regulatory and supervisory framework for the banking system encouraged financial institutions to funnel short-term borrowing from depositors into loans of dubious quality and government securities. Inefficient state enterprises dominated several economic sectors. Policy durability was undermined by a succession of short lived coalition governments that implemented populist measures.

Then, under the aegis of Economy Minister Kemal Derviş, Turkey recovered swiftly from the 2001 collapse. He concluded a stand-by agreement with the International Monetary Fund (IMF), liquidated insolvent banks, privatized state-owned enterprises, liberalized the energy and telecommunication markets, introduced a free-floating Turkish lira (TL), created an autonomous central bank, and set up independent financial and market regulatory bodies. Turkey’s European Union accession process and policy continuity under the subsequent single party JDP government accelerated the recovery. Erdoğan’s leadership had brought more efficiency and predictability to economic policy-making since 2002. Turkey’s central bank had earned plaudits from financial markets for bringing inflation under control. Credibility became a corner stone of Turkish economic, fiscal and monetary policies,

enabling the domestic business community and foreign investors to engage in long-term planning within a more stable political environment.

The sources of 'easy' economic growth from macroeconomic stability and fiscal discipline have been largely exhausted, however. Turkey's consumer-driven economic model cannot sustain consistently high growth rates and is being undermined by low investment and savings rates, limited export sophistication, pervasive gender inequality and inefficient use of its 'demographic dividend'.

Turkey's growth potential will be constrained unless it implements productivity enhancing reforms before the problems of an ageing population start to be noticeable around 2025. To avoid reform 'fatigue', it should focus on tackling the main bottlenecks to economic growth: the quality of human capital, and incomplete reform of governance and institutions.

4. CONCLUSION

By the announcement of the 24th January 1980 decisions, economic integration to the world economy had started in Turkey step by step. The first step was the trade liberalization process. Financial liberalization followed trade liberalization and finally capital account liberalization fully completed when Decree No: 32 put into force in 1989. Economic policies of Washington Consensus influenced all sectors of the Turkish economy. Turkey was among the reformist countries of 1980's which tried to operate free market economy.

The 1990s were a decade of external and domestic shocks and crises for the Turkish economy. Transition to "strong economy" program implemented in 2001, under the leadership of Kemal Derviş was a major step Turkey's encounter with "regulatory neo-liberalism" in context of the emerging post-Washington consensus. Policy continuity under the subsequent single party JDP government accelerated the recovery.

After the 2001 crisis, during the last decade it is clear that a fast growth rate period with an increase in GDP per capita has been realized in Turkey. On the basis of the economic growth ratios a "concrete" improvement has been achieved. The sources of 'easy' economic growth from macroeconomic stability and fiscal discipline have been largely exhausted, however. Past performance based on 'easy' growth released by lower inflation and fiscal discipline is no guarantee of future success. Turkey's growth strategy suffers from a serious flaw in its excessive reliance on domestic demand-led growth, putting at risk the sustainability of a fast-paced economy. Given current institutional and policy constraints, it might struggle to achieve even modest growth rates of 2-5 per cent and will be vulnerable to foreign investor sentiments unless it bases growth more on productivity gains. After about 2025, it is anticipated that Turkey's 'demographic window of opportunity' will start closing, population ageing will be in full swing and its middling prospects for prosperity may well become the norm.

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THE ROLE OF FINANCIAL STANDARDS IN HUNGARIAN PUBLIC SECTOR ACCOUNTING

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ABSTRACT

Improving the quality of Public Finance and Government has become ever so important recently. All European countries set high expectation regarding the efficient use of public monies. The right financial information system is a prerequisite of value for money public financing. The European Union has established rigorous accounting requirements for its members' public finance. As a result major changes had to be introduced into the representative practice of budgeting. Union members had to reshape their national accounts system parallel to their public finance accounting. This process has been lead by Western European countries.

Hungary must follow their examples in public accounting. Since the economic and social transition took place in Hungary, a series of public accounting reforms has taken place. This study focuses on introducing such reforms specifically in regard to public financing and accountability. After discussing the key characteristic of the reforms, we conclude that Hungary is lagging behind in regulating public accounting when compared to other Central Eastern European countries. This shortfall is mainly due to the instability of the transition period. Most efforts were directed towards economic progress and thus information generation lacked. This special case will be outlined through the practice of special accounting standards developed for public financing (IPSAS). Such practice is particularly prevalent in Anglo-Saxon countries. However, globalisation and supra/national cooperation led to the adoption of accounting standards in other countries. In Central Eastern Europe, the level of using accounting standards varies from country to country. Certain countries fully support the adoption of accounting standards while others approach them with caution.

Our study also aims to outline the managerial approach in the Hungarian Public Sector closely related to these standards. This new practice will be discussed in the specialist area of water management. We shall investigate how much of business accounting standards and practice has been introduced to the public sphere. Our research will also entail the studying the usefulness of accounting information.

Key words: public sector, public accounting, reform of accounting system, IPSAS standards

JEL code: H83

1. Introduction – Public Sphere Information System

Information system is the complementary networks of components among which new informations is communicated. Informations are necessary not only in the management of private entities but also of public institutions. In modern market economies, the public sphere has historically evolved to serve all state functions. The public sphere is a sub-sector of the economy which produces and manages collective goods Public entities can operate following public budgetary, non-profit or business regulations (Sivák-Vigvári, 2012).

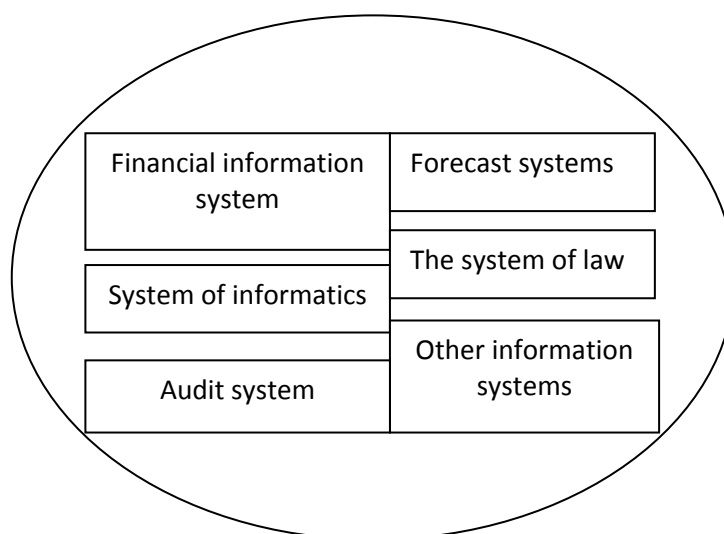
During the last few decades, the public sphere's significance has increased. The public sector has become an integral part of the economy. The sector's main objective is to fulfil its obligations to the public.

In the public sector, many sub-sectors can be distinguished according to their character or operational mechanism. Key differences in the operational objectives and methods; financial techniques; or the informations systems of the sub-sectors can be underlined. As such then information system of the public sector has a widely applicable definition.

The Public Sector Information System involves all components producing information necessary for the operations of the Public Sector. The Public Sector Information System forms a sub-system of the Public Sector Information System. The State Finance Information System forms part of the Public Sector Information System. Just like all other systems, the complex State Finance Information System can also be divided into smaller sub-systems. *Figure 1* describes the key sub-sections of the State Finance Information System.

Financial information play vital role in the State Finance Information System. In addition, public finance accounting is another key element in the information system.

Figure 1: State Finance Information System



Source: own editing

The State Finance Information System's environment

The typical function of the public sector is to provide public goods for society. Public sector institutions primarily carry out non-market activities. However, these institutions often have functions where efficient management and cost-benefits analysis play vital roles. However, a profit-oriented approach cannot always apply to public functions as public benefits are hard to account for or measure in monetary terms (Csermák, 2004.).

In addition, unlike in the private sector, public entities do not have a clearly defined managerial objective such as profit realisation or asset accumulation. Objectives for the public sector are often defined as functions open to individual interpretations. Often such functions are interpreted from a political angle as opposed to purely economic ones. As public management objectives are difficult to quantify, measuring objectives leads to various problems.

Subjectivity plays part not only in measuring objectives but also in defining them. In some areas of public management, profit oriented activities are mixed with activities aiming to produce public goods. Most typical of such behaviour are public utility companies (Horváth M., 2002).

Public management can be viewed as managing a large factory where public goods and services are produced (Kassó, 2006). Managing the production requires the co-ordination of a vast array of activities which consequently involves large number of agents, often working in different geographical units.

State financing also differs significantly from the financing of private enterprises. Financing public functions involves both internal and external resources. External resources arrive mainly from the central government budget, while internal resources include local tax revenues and asset utilisation. Additionally, some activities are financed from both public and private monies. To make matters more complex, the financing of certain tasks are realised through a multi-level decision making process. Three main levels of decision making can be distinguished: central government budget, local government and specialist agencies.

The effectiveness of operations is also measured in a significantly different manner in the private and public sectors. Public goods and services primarily cannot be replaced with other goods and services, even their non-consumption is limited. As a result, society's freedom of controlling or even influencing the quality of public good and services is highly limited (Vigvári, 2005).

The above observations lead to another characteristic of management, the different definitions of bankruptcy. If a private enterprise cannot cover its costs it can go bankrupt. On the other hand, as a consequence of soft budgetary limits, public entities can be, and are often, bailed out i.e. saved through additional central budgetary funds (Kornai-Maskin-Gérard, 2004.).

Planning plays a special role in managing public entities. The most important product of planning is the budget, providing a frame for the operations of any particular year. The budget details the objectives, the necessary resources, the operations and the timing of operations as well as the units responsibly for the operations (Csermák, 2004.).

The basic unit of planning in the public sector is the institution itself as opposed to the product or a service. In addition, the timescale of planning is generally shorter in the public sector than in the private sphere. Short- and medium-term planning is a special characteristic of local government systems.

There are significant differences in public and private management regarding ownership. Assets are owned by the State or local governments. Sometimes fulfilling a public function involves the temporary transfer of ownership of public assets. As the owner and manager of a public asset are different agents with different motivations asset management causes problems.

Measuring productivity of public entities poses various problems as a result of objectives not being clearly defined and difficulties with assessing effectiveness. Performance indicators commonly used in the private sphere have limitations in the public sector.

Following the above discussion, we can conclude that public financing and management requires a complex and multi-dimensional information system.

2. Public Sector Accounting

Three major periods can be distinguished in the history of modern public sector accounting in Hungary. During the first period, the 1990s, the same accounting techniques were applied as in the previous socialist, direct economy era. Unfortunately, the accounting practice of Western European countries could not find fertile soil to take root in Hungary during that period. On the other hand, during that time a frenzied legislation took place in general but also in relation to a public finance system. Due to the shortage of time and urgency of the matter, consultation with all parties concerned and detailed impact assessment studies regarding new legislation were often lacking.

The second period, from 2000 till 2013, can be characterised by providing a certain degree of stability in the system. Early legislation was reviewed and amended as well as new methodology was introduced.

Key legislation in the period included Act C of 2000 on Accounting and Government Order No. 249/2000. (XII. 24.), on the specifics of the annual reporting and bookkeeping tasks of state budgetary organizations. The latter government order adopts the regulations of the Accounting Act for government financed institutions. In the following part of our study we shall outline the main characteristics of this period.

The key guide in public sector accounting at this time was the traditional cash flow approach. In our view, most problems and shortcomings of public financing relates to adoption of this approach. This traditional viewpoint results in a misleading image of healthy public finances. Under the surface, however, major tensions could prevail.

The objective of the accounting and recording system in this period was to register cash flow items at completion. The adoption of pure cash flow approach in public sector financing leads to negative consequences for several reasons. In other words, the cash flow methodology presents a significant information risk for all areas of management.

Furthermore, the applied methodology is not able to reduce such risks. During this accounting period, research is limited to revenues, outgoings and related indices. Such data can only show a distorted picture of finance management.

Due to the cash flow management, Hungarian government institutions cannot budget accurately. Without accurate budgeting, tasks cannot be fulfilled properly. Hence, the government cannot fulfil its ownership and investing obligations as the current methodology does not allow for the full evaluation of its operations.

Accounting and compulsory data service only serves cash flow based planning, public monies accounting and related internal and external auditing (Kassó, 2006). However, the feedback function cannot work properly due to imprecise and liberal of administration practice.

Determining the real value of their financial capacity would be vital for budgetary institutions. However, the management of public finances is hindered in performing proper financial analysis. Data necessary for analysis cannot be generated. The balance sheet, cash flow and balance account fulfilling the functions of a profit and loss statement, as well as revenue and outgoings based budgets generate unreliable information. Furthermore, the balance sheet is incapable of supporting any asset related decision-making.

In order to secure the quality and financing of managing public assets and tasks, it is vital to fully understand the value and structure of accounts payable. Sustainable management cannot be maintained by inadequate handling of accounts payable and liabilities. Two types of accounts payable are particularly significant, one is suppliers' accounts and the other is long-term liabilities (loans and bonds). Both types of liabilities present degrees of indebtedness. Current account deficit and government indebtedness have far reaching consequences through the financial markets and the EU.

The balance of the public sector budget is also deceptive. The method of achieving a balanced budget is equally important. Analysing the internal coherence of budgetary and management decisions is a must.

Managing depreciation needs special attention. Depreciation is compulsory following set depreciation formulas and methodology. However, the accounted depreciation has no consequence or bearing for the management. The regulations ignore the most vital part of depreciation i.e. which resources are to be used for replacing the amortised asset. Furthermore, this fact cannot be presented in the registration and accounting system resulting mainly from the imprecisions of the asset records and the methods of accounting for changes in the equity account. In other words, the value of depreciation is corrected by short-term liabilities and new asset acquisition. All in all, accounting aims to maintain the overall value of assets. As non-asset items get incorporated in the calculations and the analysis ignores any changes in the asset needs of the entity, the accounting picture becomes hazed.

For politicians a cash flow based budgetary planning seems advantageous, as it clearly shows which institutions receive what amounts and at the end of the financial year all monies spent are accounted for. For the decision-makers it might seem that all objectives were fulfilled. However, this cash flow based financing mechanisms only answers the question of how much was spent by a certain institution in a certain year and ignores any concerns of efficiency and effectiveness.

An institution based financing practice will also disregard cost and benefit analysis. Rational management assumes the cost assessment of tasks and cost comparison of alternatives. However, budgetary institutions do not possess reliable information regarding actual costs.

Another issue regarding the management of public entities is the quality of asset management. This issue, however, meets with disinterest. Neither the account based not the market based valuation provides reliable information. Already the exact account of assets poses a problem as depreciation is not offset with money flow. As a result, the effectiveness of asset management cannot be correctly assessed.

The institution based approach does not follow the accounting concept as laid out in legislation, since in the institutions' budgets costs are not accounted and accumulated for each tasks separately. Most institutions carry out multiple tasks, thus their aggregate accounting makes the situation even more complicated.

Even the separation of tasks might not necessarily mean an obvious solution. Unfortunately, legislation regarding the operation of public entities allows for various tasks to mix and overlap and no methodology of separating such tasks exist.

Thus, the validity of information in the final accounts of public entities is highly questionable. On one hand, revenue items are presented without following a centrally regulated itemised financial reporting standard. On the other hand, the itemised financial statements only contain half of all outgoings. Furthermore, financial audit is only required for 30 percent of the itemised accounts (Kassó, 2006.).

Another problem concerning accounts is that information is aggregated ta institutional level.

The above mentioned characteristics of the accounting, registration and budgetary system negatively influence the adoption of ESA95 methodology in public sector accounting. The new approach set significant methodological challenges for the government statistical system where all problems of the itemised accounting and registration system accumulate.

Major reforms and changes

The above discussed shortcomings hinder the development of a responsible and efficient public budgetary management. Despite the fact that concerned institutions (public entities, controlling and auditing agents, specialist consulting organisations) constantly emphasise the problems, the situation has shown little improvement. However, the underlying causes for this lack of change must be seen in a wider context. In conclusion, the conditions for change were not present.

In the meantime, the European Union has expected an ever increasing rigour in the public accounting system. Reports on Hungarian public accounting system emphasise the need for more transparency and responsible budgetary management. Political circles perceive the criticism in relation to the actual and maximum levels of indebtedness and budget deficit. The EU provided the final push for the Hungarian Government to institute changes. It became apparent that only a newly reformed public sector accounting system could meet the EU's expectations.

This reform process led to the adoption of Government Order No. 74/2013 concerning public sector accounting. Budgetary institutions must continue to adhere to the Act on Accounting, though the new order introduced amendments to the act as too.

This new order set very impressive objectives. Among others, it aims to fulfil the increasing information needs of public entity management, a stronger cohesion with the Accounting Act, more emphasis on the adoption of accounting principles for budgetary institutions.

The new legislation allows only a year of transition - without any option for extension - for budgetary institutions to adopt new accounting systems.

The major reform lies in the separation of budgetary and financial accounting. Planning, accounting and reporting in budgetary accounting will continue to be based on cash flow. However, methodology for financial accounting sets out to represent assets in a unified structure and increase the reliability and validity of financial statements regarding assets. Furthermore, new legislations call for analysis on the effectiveness and efficiency of managing public entities and functions. These changes are both necessary and advantageous in terms of providing a sound framework for public financing.

Additional reforms introduced by the new legislation derive from the above mentioned key changes. Out of the additional changes the compilation of the Classified Balance Sheet stands out due to its significance. 31 December 2013 being the turning date, all accounts of the general ledger, prepared using previous accounting and registration logic, must be closed and amended with addition items as required by the new methodology. The compilation of the classified balance sheet poses a series of new accounting tasks including: the transfer of appropriate items, presentation and valuation of all accounts payable and liabilities, sorting of external monies, or the transfer of advance payments.

Public sector accounting executes a threefold registration function by recording the budgets of and the completion of revenues and outgoings as well as recording assets and liabilities. The government order introduced a unified chart of accounts and order of headings. Account classes of the general ledger have gained more significance, particularly Class 0, which covers all registration accounts. Assets and liabilities form integral parts of the accounting registration now. The fundamental proviso for completing any assets and liabilities is the accurate recording of assets and liabilities against which completion can be made.

Concerning completed items, the most important new element is the economic and functional recording of completion. Although this element was expected in the previous regime, either the economic or the functional recording was thwarted as a result of the cash flow approach and other technical solutions.

The new government order has also altered the structure of the balance sheet e.g. abolishing the activated value of experimental development. Although abandoning this item made sense, it might lead to information loss which could further result in certain institutions (with research functions) establishing a separate registration of such activities (incl. costs and revenues etc.). Concerning assets and liabilities, the accrual concept has been adopted. From now on, assets and liabilities of a certain year will be separated from those due in following years.

Significant changes have been instigated regarding the asset valuation. Salvage values are now limited to 25 million HUF. In addition, government financed institutions may use centrally determined accounting formulas for the valuation of fixed assets.

The content of financial reporting in the government sector has also altered. The yearly budgetary report can be compiled following two methodology, one is cash flow accounting while the other is accrual account. The report can be compiled following 4 different classifications: economic, functional and administrative classifications as well as classification according to government functions. The profit and loss statement has gained significance in the new budgetary reporting system. In addition, new reports must be prepared detailing costs and recovered costs in order to harmonise finances via meeting revenues earmarked for specific tasks with direct, own costs.

Overall, recent reforms of public sector accounting signify improvement on previous tradition. Although not enough time has passed since the adoption of the new legislation to provide enough ground for deep analysis, a few notes can be made using reference material and practical experience.

The transition to a new accounting practice is made more difficult for a number of institutions as the new legislation did not allow sufficient time for it adoption. Generally speaking, government financed institutions are not adequately prepared for a speedy transition. The previously practiced accounting logic cannot be altered in such a short period.

Despite the validity of accrual accounting, public institutions are now burdened with a dual accounting system resulting heavier workload and fears towards any changes.

Compliance with legislation requires that all necessary personnel and material provisions are available. Unfortunately, there is a shortage of accountants specialising in public sector financing. Furthermore, training practice in the public sector does not help the situation. Only six month after the adoption of legislation started public institutions providing specialist training for their employees, which was far too close to the start of preparing the classified balance sheet. On the material side of the problem, the concerned institutions could not get hold of the updated version of the Resources Programme on time for the work to commence.

The new reforms in the registration system do not necessarily lead to growing information supply and increased reliability. Compatibility among the different classifications runs into various problems. Additionally, the presentation of the profit and loss statement in the determined structure could be based on inaccurate and vague information.

The reforms have been vital even though they have dubious concrete results. Errors and shortcoming emerging in the transition period must be corrected.

3. Public sector accounting in an international comparison

In the followings we shall discuss the reforms of public sector accounting in Hungary in an international context i.e.: How do the above mentioned reforms relate to progress in the field on an international level? The discussion will follow the development of accounting principles.

The way from a traditional to a reformed accounting system could be discussed through the operational principles of accounting. Table 1 lists the general principles of accounting information systems.

Table 1. Operational principles of the information system

1. Empowerment	7. Foresight
2. Transparency	8. Sustainability
3. Openness	9. Integrity
4. Controllability	10. Sufficient detail
5. Financially sound	11. Validity
6. Performance	

Source: the Law of Accounting

The principle of empowerment or delegation implies that all responsibility for budgetary decisions should lie with the delegated agent. This principle was already a corner stone of the traditional budgetary policy.

Full transparency must be achieved in the public finance legislation as well as in the budgetary processes of government institution. The flow of public money should be easily monitored. This principle has gained sufficient significance as expectations towards an efficient management of deficient public moneys is increasing.

Open access to information on public finances are encouraged as a means to strengthen the community element of government policy and to present the key characteristics of the economy to the public. Social criticism concerning public sector finance also encouraged the government to improve transparency.

Increased controllability not only involves controls on adherence to regulations (lawfulness) but also performance and value for money audits evaluating the rationality and efficiency of managing government assets and finances.

Modern public sector finance policy and valid budgetary decisions must be built on financially sound ground which is one of the key corner stones of public management. Performance, sustainability and foresight are all new financing principles alien to the old, traditional approach.

Integrity implies that all elements of public sector financing and management must be fully scrutinised. Assets and liabilities of government institutions financed from non-government sources receive special attention just like assets and liabilities impacting public budgeting

and the management of government assets. The principle of sufficient detail supplements integrity in as far as it implies the classifications of public finance information into sub-categories of sufficient detail and content.

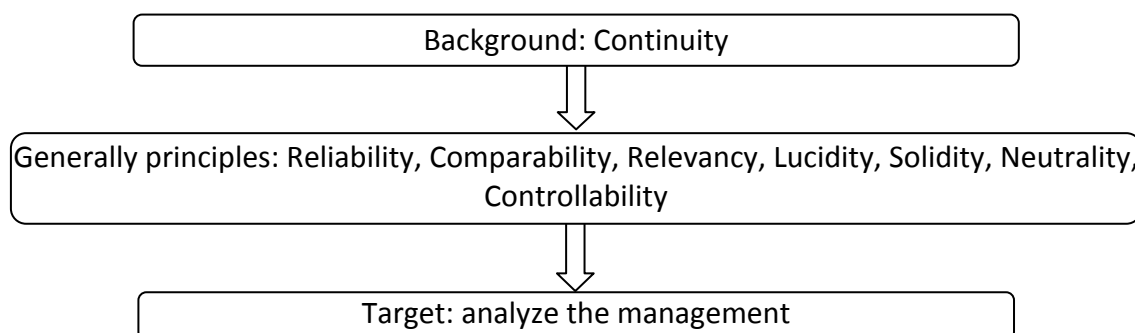
The principle of validity concerns on one hand the validity of information provided and also the increased content of public sector financing information. A valid picture of public sector finance management cannot be formed without performance assessment.

A change in the content of the information system's principles did affect the principles of public sector accounting. The introduction of public sector accounting standards (IPSAS) presents a good example.

IPSAS aim to prepare a unified financial statement system for public sector financing and management in order to provide sufficient and accurate information for all interested parties. The standards cover all area of accounting. Separate standards apply to accounting, evaluation, reporting and accessibility, publicity. The applicability of standards is not reduced to a single level of government but is relevant to all levels, central as well as municipal.

The majority of IPSAS were adapted from IAS, standards developed for the private sector. Hence most of the accounting principles of IPSAS come from IAS which can be divided into general principles and supplementary principles (See Figure 2).

Figure 2: IPSAS Principles



Source: original work based on Varga, 2009.

Figure 2 shows that the international accounting standard ignores the principle of providing a reliable and valid picture, which formed an elementary part of Hungarian accounting legislation.

According to the International Account Standard Board (IASB), the report will provide a reliable and valid picture of operations if during the preparation of the accounts all standards and other quality assurances are met. Quality assurances include reliability, comparability, relevance and clarity. US GAAP also highlights the significance of these standards with the only proviso that the understanding is the liability of the users. The operational principles of public sector financing and management are also relevant for public sector accounting.

General observations on international public sector accounting

Inevitably there is a significant variation among the accounting practices of European countries since each country has its own economic, political, social environment.

Each European country has taken steps towards accrual accounting. Parallel, the adoption of relevant accounting techniques has also started. The driving force behind accrual accounting is an ever increasing demand for economic related information. Besides budgetary control, performance assessment has also gained impetus.

There are many motives behind the adoption of accrual accounting including the reforming of public sector finance management, decentralisation and the changing attitude of managers.

On the other, there are issues hindering the smooth application of the new methodology such as lack of expertise, attachment to traditional budgetary techniques, opposition of concerned parties, insufficient IT support, non-compatibility with various element of government finance.

Countries that could overcome these obstacles made significantly more progress in accrual accounting. How fast and to what extent a country managed to transform its budgetary process also contributed to its overall success in accrual accounting compared to other European countries.

Different strategies have been developed in the adoption of accrual accounting. Although the duration of the transition period varies from country to country, it averaged 3 years.

How far a country relies on accounting standards shows a great diversity in Europe. Mostly Anglo-Saxon and a number of other Western European countries adopted full heartedly accounting standards. Other countries ignore these standards in their accounting legislation. However, all countries encourage the use of the IPSAS system to some extent.

Hungary should consider the international practice of public sector accounting. An analysis of the initial problems associated with the new accounting methodology emphasises a valid risk that the newly adopted legislation might not achieve the expected results. There is however the opportunity to intervene in the first stage of adoption.

4. Public accounting in the practice

The study has further target to present the spread of the management methods closely related to the standards in the Hungarian public sector. On behalf of this a typical public service, the water management will be presented.

Water management in accounting perspective

We would like to present the significance of the recent changes in the public accounting system through two main basic functions of the water management: the flood and inland waters protection and the management of state's property using by the directorates. This paper intends to reveal, how current changes in the legal regulation can influence the assessment of the quality of addressed basic functions on the local and national level as well. The reform may take effects many aspects of the operation, but the scope of this study is narrower we cannot introduce all changes. Therefore we will focus on the four main areas, all of which concern the above mentioned activities. These are the following:

- the opportunities inherent in the consolidation for the aim of providing the expected information of inhabitants and decision makers;
- the possibilities of measurement of performance and economic results according to the so-called statement about cost and returned cost;
- the effect of the reliable calculated depreciation on the efficiency, furthermore its influence on resource allocation in the scope of general functions and business activities;
- the impact of changes in the evaluation methods on the assessment of the real financial position.

In Hungary a significant improvement can be experienced regarding the consolidation method, but rules are still limited within the public area. (Ernst & Young, 2012) The government's right to set the rules of consolidation by decree is involved in the Act on CXCV 2011 on Public Finance (hereinafter: Public Finance Act), what has been entered into force on 31st of December in 2011. The government decree including the rules of consolidation was issued in January 2013 and it came into effect from 1st of January in 2014. This timelag presents all the necessity of time and adequate preparation of the changes. The Hungarian State Treasury (hereinafter: Treasury) is due to collect and provide sufficient information about the budget estimates and budget implementation. Actually the Treasury has been aggregating the information since 2000 in the scope of some subsectors of the state budget. According to the Government Decree 4/2013 (I.11.) on Specialities of the General Government Organizations Reporting and Public Accounting Rules the Treasury is required to compile the consolidated financial statement on the level of each subsector and for the completely state budget as well. The aggregation applies solely to some particular information, what are the following: balance sheet, profit and loss account, and statement about the implementation of budget. Despite of its importance the another parts of financial statement have not been consolidated.

In Hungary the development of the consolidation method works continuously. It consists of the following steps:

1. In the year of 2000 the consolidation was relevant solely to the national Social Security (SS) subsector and SS budgetary institutions. (According to Government Decree 249/2000. (XII.24.) on Specialities of the General Government Organizations Reporting and Public Accounting Rules) (hereinafter: Government Decree 249/2000. (XII.24.)) (Ernst & Young, 2012)

2. From 2009 the consolidation was relevant to a wider scope, which involved the central budgetary and governmental subsectors, furthermore SS and other funds. The aggregation had to cover the complete budget estimates and implementations on the basis of Government Decree 292/2009. (XII.19.)
3. The withdrawal period was from 1st of January in 2012 until 31st of December in 2013 there was no declaration regarding consolidation.
4. From 1st of January in 2014 there is completely consolidation concerning both subsectors and state budget as well. The legal changes entering into force from 1st of January in 2014 are relevant to the whole public sector, and their target is the realization of implementing unified public accounting policy in conformity with the 6th of IPSAS standard. (IPSAS Handbook, 2012)

The importance of the consolidation and transparency of the financial statements in the scope of water management resides in the calculation and national aggregation of the cost of the flood and inland waters protection. In the current practice the expenses incurring due to the protection are compensated ex-post by the state. This method requires wide range of data collections and supplying and owing to the cash flow approach and it is not suitable to identify the real costs. According to the relevant regulation the account for the cost of protection against water affairs shall be measured with the first cost (cost price) method in harmony with the law of accounting. Nevertheless there is a discrepancy in reference to cost concept defined by the law of accounting law and public accounting. It is a relevant problem, as historical cost is involved in the first cost (cost price). The regulation of accounting rules of the cost related to the water affairs use the terms "cost" and "expenses" as synonyms for each other. This reflects well, that according to cash flow approach these costs are not distinguishable. Thanks to the reform the solution of the above mentioned anomaly cannot be delayed in the future. And also it is very important to make clear whether the financing of the expenditures or the compensation of effectively incurring costs is preferable. In the last case the items without cash-flow will be compensated as well. The accrual accounting can contribute to useful information supplement in the case of ex-post funding as well. Hereby the difference between the compensated and real consumption of the resources can be calculated, which information is necessary and impressive information for local and other concerned people on upper level too.

From an economic point of view the accurate estimation of the cost of flood and inland waters protection has significant importance especially because of the soft budget constraint referring to this. Owing to this conception the expenditure target can be exceeded on the basis of the governmental approval decisions. This shall entail the setting priorities in the scope of both financing and protection consistently. The flavour of flood control is that the prompt reactions and decisions are crucial, so specific stand-by equipments and inventories are essential. The SWOT analysis has been accepted in the early 2014 as a suitable method for the risk management in the scope of flood control. The difficulties of the financial planning in this area are well-presented by the fact, that the appropriation reserved for disaster recovery in the state budget has not changed since 2011. The cost incurring due to the protection are financed ex-post by the state, what involve the risk of the existence of sunk costs. The way to the recognition of the reliable cost leads over the solving of the anomalies related to the accounting. The information about effective costs contribute to a more accurate budget planning, thus to the economic and careful

management. In our point of view in wider context the next step should be the consolidation of the statement about costs and returned costs. The measurement of the substantive costs for each general function of the state is the basis of proper and established resource-allocation. In the process of consolidation should pay distinguished attention to consequential corrections.

The statement about costs and returned costs is also part of the financial statement and the necessary information is provided by cash flow approach. It has the purpose to assess the results of the addressed functions, and according to this it uses the line items of the profit and loss account regarding both benefits and expenditures. The applied calculation method is very similar to the direct costing concept used in the business sector. In the public sector nowadays there is a very strong intention to realize the new business methods reflecting the compliance of the requirement of 3E. Essentially this derivation takes into account all of incurring cost and income concerning each task. As a result of that the cost and income per cost drivers and the balance of a particular activity can be identified. In the public sector similarly to the business sector the restriction of the concept has to be taken into account, namely the aggregation is limited. The activities classification according to the function classification structure and the matched bookkeeping supports the function focused approach. However there are some dysfunctions in the function classification structure, which prevents the clear sight and reliable information furnishing. The main groups of current system compress too many activities in one function compared to the complexity of those. Hereby the dimensions of this structure do not meet with the demand on information of the local decision makers, the inhabitants, and the government. The current concept is not able to identify the correct cost driver, since a particular function involves very different kind of activities, so that it cannot be featured by one index number correctly. The next station in the process of the development of the accrual based accounting should be the review of the function classification structure and adjust it to the required information. As the changes aim to improve accountability, furthermore transparency, efficiency and effectiveness in public administration, it is inconceivable without an appropriate framework of index numbers. This means also the basis of monitoring, which is one of the five interrelated components of the internal control.

One of the main characteristic of a water management directorate is that they operate with a very large amount of property, plant and equipment. These count about 90 to 95 percent of the balance sheet total. Accordingly the depreciation – what is actually potential cost – runs to high amount, so the preventive maintenance costs mean significant liability for the institutions. Owing to the straitened circumstances and reduced possibilities for innovations and renovations became the infrastructure increasingly outdated. The gross amount of the fully depreciated assets counts about 11 to 16 percent of the balance sheet total. Within this the proportion of the equipments and conveyances belonging to the indispensable precondition for the performance of tasks counts approximately 70 to 85 percent. Data express that the depreciation and so the commitment for the maintenance is necessary to be disclosed. Comparing these costs with the available financial resources the necessary incomings can be calculated, for which directorates need to raise funds by their own. At this point there some problems are arising associated with the calculation of price. As rates illustrate that the depreciation must play an important role in the operational cost, thus in the unite price of a particular activity. The knowledge about reasonable price of activities is crucial for appropriate resource allocation and tasks priority ranking, especially in the case of

resource scarcity. However the institutions of public sector are non-profit oriented the expectations from shareholders (specifically the inhabitants and the European Union) for the adoption of market approach and business management methods will be more and more powerful. Actually the public entities are required to improve their assets utilization ratio in order to reduce the specific costs and enhance quality of the provided public services.

The business activities are not preferred in the public sector. The reasons are obvious: without measurability and accountability there is no confidence whether it is remunerative or not. The following risk surfaces: business activities may take resources out of general function, what leads to conflict of interest. The disallowance or limitation of business activities dispossesses budgetary institutions from the possibility of partially self-financing and encumber the performing their maintenance commitments. If the business management methods seem to be ideal and are required to adopt by public sector the government ought to promote it by responsible legal and control environment. At this point it is worth to turn back to the opportunities provided by the statement about costs and returned costs again. The depreciation is included in the cost of a costs driver, what could help to the budgetary institutions to include it in the unite price of a particular service or product. Hence the return of the amortization will floe to the entity, moreover the estimation and planning become more accurate. Through this statement the decisions can be supported and the results of the activities can be presented by accurate calculation, what means a feedback and control at the same time.

The changes do not cause effects on the depreciation rate, the accumulated depreciation and the remainder depreciation of the assets installed before 1st of January in 2014. On the basis of these the accounting reforms are applicable on the basis of the public entities own decision. The concept does not solve the problem existing in this area for ages, thus the results probably come forward after more years. The headway lies in the revaluation of all used assets, but it means a great hiatus. Currently there is no information, whether the revaluation will be obligatory for water management directorates or not. The final decision about this question is expected at the end of the first or the beginning of the second quarter of 2014. From our opinion furthermore necessary actions ought to be the differentiated specification of depreciation rate for public sector and the more flexible application of valuation methods in line with the nature of activities. The depreciation rate in accordance with the real useful life is consistent with the 17th number of IPSAS. In Hungary the Government Decree 249/2000. (XII.24.) allowed for institutions till 2014 to adjust the depreciation rates to the real useful life of assets, but after the reforms this possibility is not available anymore. According to the current regulation instead of the promotion of the practical realization of these prescriptions, solely those depreciation rates are applicable, which are involved in the Act LXXXI of 1996 on Corporate Tax and Dividend Tax.

The historical cost and carrying amount of the assets play an important role to assess appropriate the financial position and performance. After the public accounting reforms of 2014 the historical cost does not include the non-deductible value added tax. That is a discrepancy between the public accounting rules and the general accounting law. This modification eliminates the distortion thanks to the taxes, hereby contributes to disclose the proper amount of depreciation. The amortization will be made independently from the changes in taxation, thus data become comparable over a period of time. Further changes are that carrying amount shall be recognised suitably to the purchasing price, what is more

narrow category than before. The appropriate amount of net assets requires the amendment of the rules concerning the residual value. According to the practice before 2014 all kind of assets depreciates fully, so their residual value at the end of useful life was zero. Due to the public accounting reforms the determination of residual value turned into essential in the cases of property, plant and equipment above cost of 25 million HUF (about 80.000 EUR), under that there is no possibility to determine the residual value. (Dömötörfy-Szankó, 2013) Especially thanks to the high level of invested assets the changes facilitate the proper assessment of the financial position and performance. By the way in Hungary more time needs to meet the 17th number of IPSAS requirement regarding the annual review of the residual value.

Within the assets the inventories are also very important for water management directorates, where the inventories appear almost solely in the form of materials and supplies to be consumed in the production process or in the rendering services. The inventories according to their nature are practically classified as follow:

- used for the general operation
- reserved for defensive purposes (stand-by materials and supplies)

These two categories also appear in the new public accounting separately. Consequently the consolidation has another unquestionable advantage beyond the previous. Information can be available on the national level about the stocks held for defensive purposes. This kind of inventories is analogous with the interchangeable inventories included in 12th number of IPSAS. For the completion of the tasks in connection with the flood control a certain amount of material and equipment is crucial. Actually these stocks are permanently engrossed current assets, what worsen the efficiency and effectiveness. This kind of inventories shows the following features: very slow turnover rate because of the conditioned consumption, the consumption implies the replacement obligations, low utilization rate, their impairment loss may run to high, significant demand on premises, their carrying costs are considerable, and the separated storage of them usually causes many problems. The carrying amount of the inventories is the historical cost less impairment loss adjusted by reversal of the impairment loss. Generally the stand-by inventories had been procured a long time ago and recognised in the statement as the historical cost of that time, what is now far away from their current market price or replacement cost. In the scope of these inventories a more accurate aspect is the recognition at the replacement cost in accordance with the 12th number of IPSAS. The present value calculation of the costs of flood and inland waters protection also requires the same method owing to the above mentioned features of the inventories and to the consistence with the ex-post funding system. Inventories bought and held for the ordinary course of activities have more favourable turnover rate. Thus the valuation method according to the corrected cost proves itself to be appropriate in this case, moreover it is the nearest approximation of the fair value. But there is such a specific type of inventory, what appears solely in the subsidiary ledger, and there is no information about their value. These are recognised as an expense at the date of purchase. This concept is harmonized with the IPSAS standards, because the activities of the water management directories are mostly service rendering, in which the consumed materials and supplies are accounted for expenses. But this category of inventory without value shall be amended. It involves such supplies, i.e. office furniture, which carry amounts are expected to be measured. The 12th

number of IPSAS enables to apply different cost formula for inventories with a different nature or use. Hungary did the first step to this distinction through division the inventories into the two mentioned groups. The orientation towards the specifications of IPSAS is discoverable from other aspects as well: in contrast with the Hungarian law of accounting the advances given for inventories will be recognised in the future as accounts receivable rather than inventories.

Last but not least we would like to mention a few words about the aggravating circumstances, which hinder the application of changes in practice. These are mostly thanks to the unpreparedness of information system. The surfaced difficulties show that the changes procedure was rather too fast and came into force without the proper arrangements. The preparation of the information system should have started at least one year before the reforms of legal regulation. In the meantime the users would have taste the program, and by means of their opinion and experiences the failures could have been corrected. The concept is now the same, but the available time for that is extremely short: no more than one month was during closing the accounts. This situation rings the possibility of some mistakes in itself.

Conclusions

The Hungarian public sector requires reform. One element of this should be the improvement of accounting system. It must not to be done take no notice of the characteristics of Hungarian public sector and international tendencies. The development conception can be defined according to the resultant of these two factors. This conception should be feasible and it can reach the anticipated optimal effects for local governments and for other level of public sector.

Unfortunately in Hungary we should not polemize about what is the best accounting method for public sector the cash-based or the accrual based accounting system. Surely this problem is embedded in a wider problem group; it is the efficiency of public sector. Within the scope of this such problems are waiting for solution as the unambiguous defining of state tasks, the optimal distribution of tasks among the state levels, the rational determination of circle of tasks and jurisdictions connection with a state level, the constitutional reform of public administration, the reform of management's regulation and the complex improvement of financial system of local governments. The handling of these problems has vital importance.

According to the international experience it is impossible to set an objective of full adoption of accrual based accounting in Hungarian public sector, because now preconditions do not exist. But this does not mean that there is no opportunity to the development of public sector, the international experience certify that the most appropriate field for adoption of accrual based accounting is the local government system, surely it is possible to test the new different accounting methods "on a small scale", and there is more possibility to change methods in case of need, and moreover the accumulated experience are expansible later to other level of public sector, too.

The reform has started in the end of 2013. There are some changes in the public accounting system. These elements of reforms tend to the application of accrual based accounting. If we examine the actual situation of the Hungarian public sector's organizations we can verify

that the process of accounting reform goes further very languidly. The actors of the public sector can not apply all new methods in the accounting system. They can fulfil all requirements which emerge from the side of the government. But the usage of the new settlement methods and other elements of accounting are very oppressive for the public sector. We are not optimistic that this reform could solve all problems in the accounting system. On the contrary we emphasize that hiatus will multiply in the area of Hungarian accounting system.

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FROM UNIDIMENSIONAL FORWARDS MULTIDIMENSIONAL POVERTY MEASUREMENT (MULTIDIMENSIONAL POVERTY INDEX ALBANIA M.P.I.)

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ABSTRACT

Albania has undergone deep social-economic changes during its long transition, which according to different periods of time and the nature of its indicators, are considered both positive and negative. Last decade has shown that the economic progress has been considerable and it has been present even during economic crises of other European countries. Unfortunately, compared with other European countries, our country is still ranked as the poorest, which means that this progress is not reflected with the same levels in the poverty reduction, well-being and sustainable development. Thus, real poverty measurements and its management is the core of actual and prospective development objectives in our country. The measurement and analysis of poverty, deprivation, and sustainable development are crucial to know what the figures show (being decomposable), to make evident all the factors determining this situation, to give the policymakers the right paths to right goals.

This study first of all focuses on multidimensional poverty index MPI discussing how and how many its dimensions and indicators exceed the limits of classical measurements of poverty, creates the possibilities of measuring and comparing multidimensional poverty. not only nationally, but regionally as well (Eastern Balkan). Second, this paper call at attention, Multidimensional Poverty Index MPI as an add value in efforts of poverty measurement, its information differs from those taken by unidimensional measurement. Multidimensional Poverty Index Albania helps to analyze the spectrum of poverty, understanding of sustainable development emergency, as well as it is a great help for reading poverty phenomenon on a three dimensional aspect and under the sub-meaning of 10 different indicators. Third this study offers a further comparative analyses of MPI Albania and Eastern Balkan countries Fourth it contrasts, all inclusive indexes are generated and applied, doesn't mean their conclusions are translated (converted) into all- inclusive policies as well. Indexes and techniques for poverty measurement in Albania are the same as those in other countries, but policies and results vary. Finally we argue the measures chosen to use in poverty measurement of course can lead or mislead towards the process of policy making due to the great practical relevance of measurement methodologies.

Keywords: poverty measurement, multidimensional poverty index (MPI), deprivation, incidence of poverty

JEL codes: D63, I32, O1, O57

Introduction

“Despite the substantial growth and a sizable reduction in poverty, Albania remains one of the poorest countries in Southeastern Europe”, World Bank.

How can it be decided if an individual in a given place, and time is poor or not? This is a wide discussion even in academic environment. The measurement way may be the most delicate point of discussion of poverty assessment. Despite this, we must not ignore the conceptual aspects of the problem analyses. It's worth mentioning the fact that the literature of debate on poverty starts with: “What is poverty, and who is poor?” and continues with: “which are the main factors that govern the poverty?” what is their comments thread? And does the used approach help to connect orientate of economic policies?”

Albania is a country which started using the free market in the beginning of 90's. For almost two decades, Albania has been successful in improving the process of doing business, agriculture in having progress during the last years, the financial system is developing, poverty is reduced, but there are a lot more battles to win to get rid of poverty. Migration and Emigration has always accompanied and country's transition (*World Bank 2007*). The World Bank's Reports (2007) show that this population movement is accompanied by the improvement of living conditions of the local population.

One of the biggest problems of the Albanian society is still low level of living conditions (chart 4). Evidences show a high percentage of food expenses by Albanian families. To be remembered, these expenses represent the basic needs of the man. This high percentage of expenses on food shows that the income is insufficient to cover other needs apart from the basic.

The scientific research on poverty in Albania are carried out mostly after 2002, proceed by the World Bank Reports. In 2007, a report on migration and poverty in Albania was published (*World Bank 2007*). It was made a deep analysis on the factors which influence the poverty, in that report.

On the other hand, the data for Albania leaves to much to deserve. The Survey on Measuring of standard of living (LSMS) are carried out for 2002, 2005, 2008 and 2012 by statistic institution (INSTAT). Their small number makes it almost impossible to use an empiric model to go deeper in the relationship between poverty and other micro or microeconomic indexes in chronological time. This is the reason why, with this study and research, we are giving a descriptive analyses aiming of contributing in literature and at further clarifying the poverty in Albania.

Literature Overview

Poverty may be, is one of the most challenging field for the researches. We can point out that there hasn't been a model or an almost acceptable approach for the poverty yet. There are many well – known authors who have given precious contributions of this field and it's worth mentioning her A.Smith, known as the father of discipline in economy , A.Sen , with a Nobel Prize in a Economy and being known as the welfare economist , and many others like S.Alkire and J.Foster , our recent researches who are made big steps in the poverty

conception and measurements. Nunes (2008), has made a literature overview concerning the instruments of poverty measurements. Orshansky (1965) was the first to bring the concept of the line of absolute poverty. Orshansky (1965) suggests the use of the approach to the line of absolute poverty, by deciding a point or level of income for the individual and for an 8 member family. All the individuals and families under this level, make what is called the part of population with the absolute poverty. The absolute poverty can be defined even as an impossibility to reach a minimum standard of living. This fact is consistent in time and space and is especially used in USA. Contrary to the approach to the absolute poverty, Townsend (1979) created the relatively approach for poverty measurements. Generally, relative poverty is measured as the percentage of population with less income compared to a fix income decided. The relative poverty can be identified as relative compared to some welfare measurements done for all the population. This method is mostly used by European Countries. Both methods are one dimensional and there has been a wide critic towards them, pointing out the necessity of including more dimensions in the analyses. (Nunes 2008)

It's a fact that the lack of the income doesn't completely explain the poverty phenomenon. (Sen 2009). Lately, more and more the fact of poverty assessment by an all-exclusive instrument is being emphasized. This becomes even more serious necessity once it is noticed that the income methods shows some drawbacks.

Firstly, the sample of consuming behavior may not be uniformed, thus the use of the poverty line based on income doesn't guarantee that somebody will achieve the minimum of its needs.

Secondly, different individuals may face different prices, thus reducing the accuracy of the line of poverty.

Thirdly, the ability of changing a certain amount of income in a substantial freedom varies according to age, gender, health, place, climate and disability conditions.

Fourthly, there are crucial services like water, health and education which are not offered by the market. Furthermore, the use of income method is not effective in verifying the internal distribution of the income.

Lastly, people who experience poverty describe their situation as a loss while the income is less. These limitations are pointed out by some authors, as Alkire and Santon, which make a summary of them. Contrary to the method of "dollar-per-day" measurement, the index of multi- dimensional poverty (MDP), is a method of indirect poverty measurement. Both these method complete each other. MDP identifies those individuals who fail to achieve those needs generally accepted as minimum and functional freedom.(a concept developed by Sen).

The basic study unit is the family, conditioned by the data. I would be better if we were individual oriented rather than family, because this would also show up the affect of gender in poverty. Its right to think that poverty affects one gender more than other.

MDP combines two aspects of poverty:

1. The expansion of poverty, shown as a percentage of poor people (H) and
2. The intensity of poor people, the average percentage of dimensions poor people are deprived of. (A)

Table one tends to clarify the composition of MPI (MDP) index. The base is laid on the fact that there are three main dimensions to be considered in measuring this index: health, education and standard of living. Each of these, weights equally, in the index, a third. On the other hand, these dimensions are represented by identified data.

Health, as a MPI dimension, is represented by nutrition index and child mortality. If it is noticed that a family or individual is badly fed, then the family is considered as deprived from the nutrition index. If it is noticed that a baby was dead in a family, than it is deprived from the child mortality index. Education is represented by the number of attending school. If no one in a family hasn't done at least 5 years of education and if there are children who don't attend school from one to eight year long, then the family is deprived from the corresponding index. It is agreed that the standard of living have to be measured by energy for cooking, hygiene water, electricity, the floor and the assets.

Table 1: The structure of Multi-Dimensional Poverty (MDP) in a 3 dimensions and ten indexes: - Reference: Alkire and Santos.

Dimension	Index (weigh)	Deprived if
Health (1/3)	Nutrition (1/6)	<i>A grown up/a child badly fed.</i>
	Infant/child mortality (1/6)	<i>A child dead in a family</i>
Education (1/3)	Years of attending school (1/6)	<i>None of family members has completed five years of education</i>
	School attendance (1/6)	<i>Any of scholar age children doesn't attend school from 1 to 8 years.</i>
MPI	Cooking energy (1/18)	<i>Family cooks with wood energy</i>
	Hygiene (1/18)	<i>The family hygiene is not improved or is improved but shared with other families</i>
	Water (1/18)	<i>The family doesn't access drinking water, or the drinking water is 30 minutes far away</i>
	Electricity (1/18)	<i>The family doesn't have electricity</i>
	Floor (1/18)	<i>The family has got a dirty sandy floor</i>
Standard of living (1/3)	Assets (1/18)	<i>The family doesn't own more than one of the assets like radio, television, telephone, bicycle, motorcycle or fridge and doesn't own a car or a lorry.</i>

Attending the steps created by Alkire and Foster , it is achieved to assess the multi-dimensional poverty. A special attention is given to deciding the exclusive limits to a given index. If a family is deprived in one of the dimensions, this means that this family is facing acute poverty. Acute poverty is that in which a family is deprived from some basic needs and rights within a dimension. When all the ten indexes are considered as deprived, than we to do with a multi-dimensional poverty. Here it is emphasized the difference between multi-dimensional poverty and one-dimensional poverty, where privation and poverty express each other. Thus, you may be deprived in one of the indexes but not poor; you may be poor but not deprived in any of the indexes . But how much should the limit be, which identify privation and poverty? This is related to the country where the study is carried out, the culture, social development and many other factors the well-being is related with.

The authors of this method of poverty measurement are based on Human Development Index (HDI). HDI is an index created in 1990 by Amartya Sen and it is used by UNDP in its reports until 2010. HDI takes into consideration three dimensions and four indexes: Health (life expectancy), education (the average years of education and coming years of it) and standard of living (national income per person). One of the differences between HDI and MPI is that the last tends to measure not based in general indexes of the income. MPI is wider inclusive, gives wider information and is more flexible for economic politics, because it shows which of the indexes is deprived. It looks like HDI has been ahead the MPI formulation.

Table2: HDI construction: three dimensions and four indexes

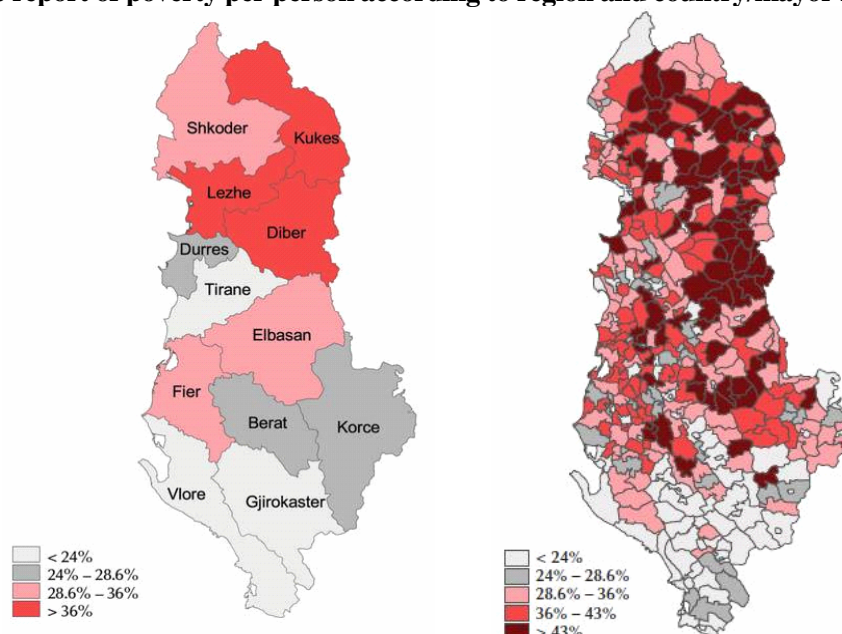
	Dimension	Index
HDI	Health	Life expectancy
	Education	Average years of education Expected years of education
	Standard of living	National income per person

THE EVIDENCE FOR ALBANIA

In this issue, we are bringing some evidence for the main poverty indexes for Albania. Through them you can create a clearer view on poverty tendencies.

The World Bank in 2004, aiming at helping politics, created and setup the distributive maps of poverty based on the data provided by INSTAT using the surveys of measurements of the standard of living (LSMS). Two of the three composed maps are shown in the following. It is clearly seen the concentration of poverty in north-east regions. It is interesting the position of Tirana region in the first and second map. In the first, Tirana is reported to have low levels of poverty per person. While in the second one, it is shown that they reach the most negative extremes.

Figure 1: The report of poverty per person according to region and country/mayor in Albania, 2004.



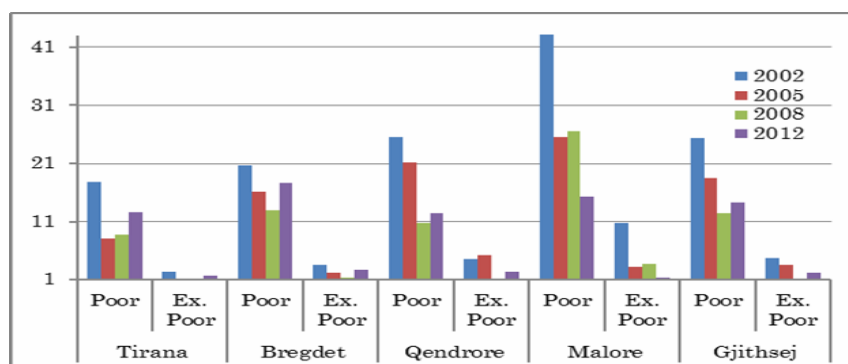
Source of information: World Bank

The following chart illustrates the development of poverty in years according to regions:

1. Tirana (the capital of country)
2. Seaside region (*Bregdeti*)
3. Central region (*Qendrore*),
4. Mountainous region (*Malore*) and
5. All or Total (*Gjithsej*).

In the chart are considered two indexes reported by the statistic institution: poor and extreme poor. In a quick view it is clearly shown that from 2002 to 2012 these two indexes have been reduced. In the first years, as shown in the figure the mountainous region reflects the highest values of these indexes. Concretely, in 2002 the poor index for this region is 44.5% of the population that lives there, which forms 18.6% more than in the central region (44.5%-25.6%). But, in 2002 the poor index in mountainous has performed a negative correlation in relation to other regions. It is the only zone where it is shown a further reduction of this index, reaching the level of 15.3% from 26.6% that was in 2008. This may have happened due to many reasons. Probably the movement of population towards urban zones may have had decisive affect in this index. As we mentioned above, in all the other zones expect the mountainous one, in 2012 this index is worsen. Apart from the migration of population, another reason may be the influence of the financial crisis of the recent years in Albania or our neighbors as well as the fragility of the Albania economy and deep budget limitations (financial help) for implementation of politics to sooth and fight poverty. The accuracy or not of these two hypotheses is left to be studied later. On the same tracks even the report of the World Bank is expressed (2007). Almost the same tendency is shown by extreme poor index, but in a more moderated values. It is disturbing the fact that the last year (2012) reflects a worse situation of the two indexes . This may serve as a signal for the policy makers which have to pre-consider a further worsening of the situation. Maybe one of the ways is the concentration in the pushing politics or stimulation of economy growth, which is in accordance with recommendations of World Bank. (2007). According to previous study the economy growth is the biggest contribution in smoothing the poverty in Albania. (World Bank 2007).

Figure 2: The graphic show of poverty percentage according to regions and years.

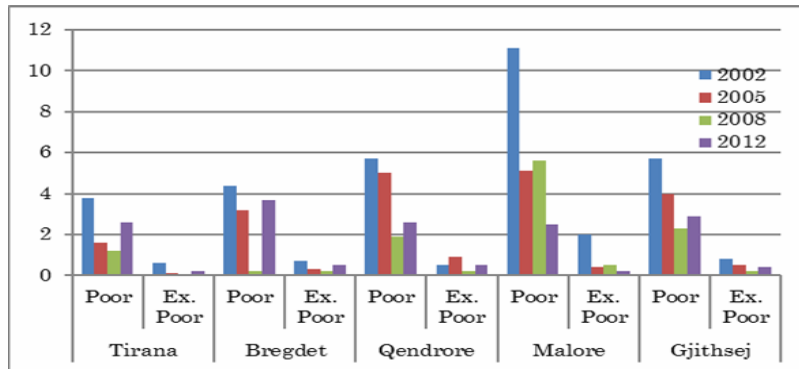


Source of information: INSTAT

But what has happened with the gap and hardness of poverty? To answer this question, we have shown two following charts. The index of poverty gap is illustrated in the chart for

regions or zones and years for two categories, poor and extremely poor. Generally, the poverty gap has been the same with poverty as a whole, which was illustrated in the previous chart. Let us focus on the seaside zone which has shown the worst and highest poverty gap compared with other zones in 2012. From an inconsiderable value in 2008 (0.2%) it has reached the value of 3.7 in 2012. It would be of high interest to study which are those factors which have determined such a behavior of poverty gap, but in this study we are not focused on this aspect.

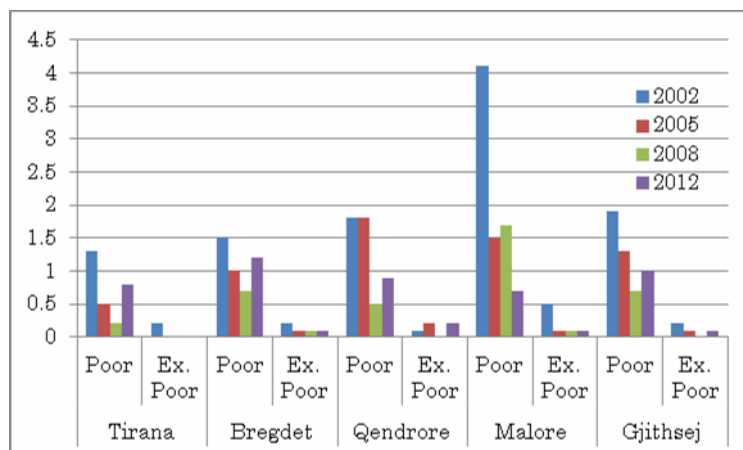
Figure 3: The poverty gap according zones and years.



Source of information: INSTAT

The roughness of poverty in Albania according to zones and years is illustrated in the following charts. Even this index corresponds with poverty as a whole and poverty gap as well, especially for the index poor. If we stop an analyze the central zone, the poor index , in the first two evidence(2002,2005), the poverty has been in the level of 1.8 followed by a fall of about 1.3 (= 1.8-0.5) in 2008 and resulting in the value of 0.9 in 2012. It is interesting the fact that for the seaside and mountainous zones the category extremely poor for 2005, 2008 and 2012 remain the same level of 0.1 and for Tirana is 0.

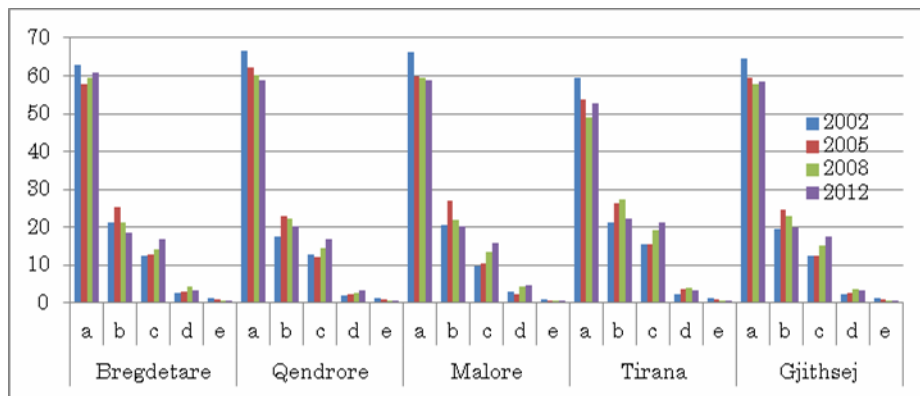
Figure 4: A poverty roughness according zones and years.



Source of information: INSTAT

A deeper view of development of poverty , based on the tradition methods of measuring it , can be taken from the real consumption per person. The following chart illustrates this index according to Albanian regions in four main moments: years 2002, 2005, 2008, 2012. It is disturbing the fact that most of the expenses for consumption are destined on food , which implies one of the basic needs to be realized. There is a slight reduction with the passing of years, but data expansion may give more information about the tendency of these indexes. In all regions the index of basic expenses has a clear tendency of growth, while expenses for long-term equipment are almost inconsiderable.

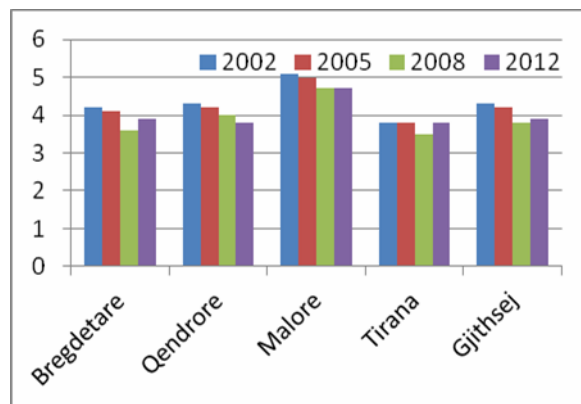
Figure 5: Percentages of total real consumption per person according to zones and years



Source of information: INSTAT

One of the indexes for MPI method is the number of members in a family. The following charts help us to create an idea about its behavior in different zones. The first place is run by mountainous zone with 5 members per family and with a slight tendency to be reduced. This may have an important role in poverty percentage, as a result with the roughness and its gap. Tirana’s region represents an average of 3.7 members per family, which is the lowest compared to other regions.

Figure 6: The average number of family members according to zones and years.



Source of information: INSTAT

ALBANIA IN M.P.I. “OPTIC”

It is obviously clear that the method of MPI poverty measurement, even though it is a recent approach, it will be the base of the development of the theory and implementation in the future. This is a natural assumption when we notice that the organizations focused on the poverty issue are using this approach (UNDP uses it in its reports since 2010). Based on the published report for Albania we have the following consideration for 2009.

Table 3: Summary of MPI report.

Issue	Value
MPI (Multi Dimensional Index of Poverty)	0.005
H (Distribution of Poverty)	1.4%
A (The average concentration among the poor)	37.7%
The percentage of population affected by poverty	7.4%
The percentage of population in rough poverty	0.1%

Source: Alkire, S.,A.Conconi & J.M.Roche.

Oxford Poverty & Human Development Initiative based on consideration and results of Alkire, Roche, Santos, & Seth report the main indexes of MPI for Albania. Thus, the percentage of population in rough poverty is considered to be 0.1%, the percentage of population affected by poverty is 7.4%, while the two components of MPI which are (H) and the average concentration between the poor (A) result in the level of 1.4% and 37.7% respectively. And, knowing that:

$$MPI = H \times A$$

$$MPI = 1.4\% \times 37.7\%$$

it is estimated even the value of multi- dimensional poverty index which is 0.005.

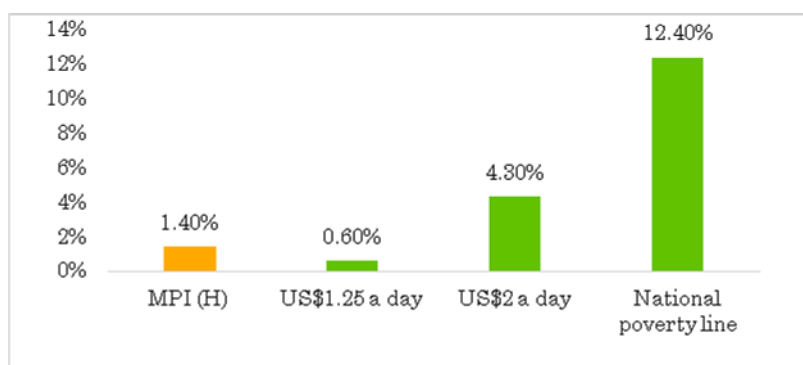
These figures can be interpreted:

- For the poverty distribution (H=1.4%): 1.4% of the population is poor according to MPI (they are deprived from at least 33.33% of the weigh index, according to the definition):
- For the average concentration among the poor (A=37.7%): those who are poor according to MPI suffer from deprivation in the level of 37.7% of indexes, as an average;
- The MPI Value is a figure which helps us to give a position to our country compared to others. The lower this figure the multi – dimensional poverty is.

The results brought by MPI are better understood if they are compared with other applicative methods. So, if we showed in a chart the poverty distribution (H) and the poverty lines we would have the following figures. This gives us the view which helps us to understand the difference between the methods used for poverty measurements. If we base on the poverty line method with 1.25 dollar per day, the poverty in Albania is 0.6%.

Expressed differently, this means that 0.6% of the population lives with less than 1.26 American dollar per day. The poverty according to poverty line in the level of 2 dollar per day is naturally higher than that of 1.25 dollar per day, 4.3% or 4.3% of the population lives with less than 2 dollar per day. The national line of poverty is reported 12.4%, which is much higher than two previous lines. The report of poverty per person according to MPI (H) results to be 1.4% and this is higher than the value of poverty line in 1.25 dollar per day and lower than that of 2 dollar per day ($US\$1.25 \text{ a day} < H < US\2 a day). The last one is one of the finding of MPI method, where the value of multi-dimensional poverty shows that in Albania there are fewer poor than those expressed by National Lines of Poverty and the poverty line in 2 dollar per day. The difference between them is quite obvious.

Figure 7 : The comparison of poverty values according to different measurements



Source of information: Alkire, Conconi & Roche

The pie chart gives us information of how is poverty in Albania composed according to MPI index. This means that we can understand which the major factors of poverty are or which the poverty origin is. For example, the value 26 of school attendance by children shows that 26% of poor population and deprived in each index suffers from not school attendance as the biggest cause of poverty. If we join the value of school years (6.1%) with that of school attendance by scholar age children (26%) than we have the value which corresponds the measure of education (32%) and implies that 32% of poor population has a problem with education as a cause of poverty. Furthermore, the measure of health reaches the value of 44.9% (24,3%+20.7%). The standard of living makes up the rest value of 23%. From this we noticed that health makes the biggest part or we can say that health is the biggest factor as a cause multi-dimensional poverty in Albania. To sum up, the index of school attendance by children is the biggest cause of poverty, while health is the measure which forms and causes the biggest part of the poverty. Electricity index is the only one which has the value of 0%. So, there is no poverty caused by electricity.

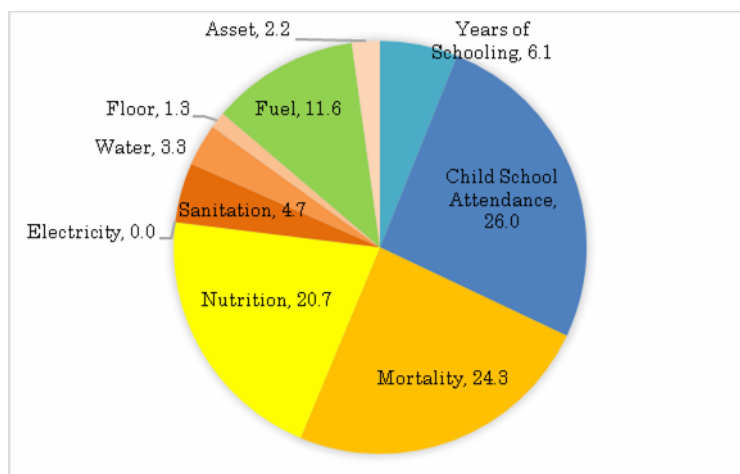


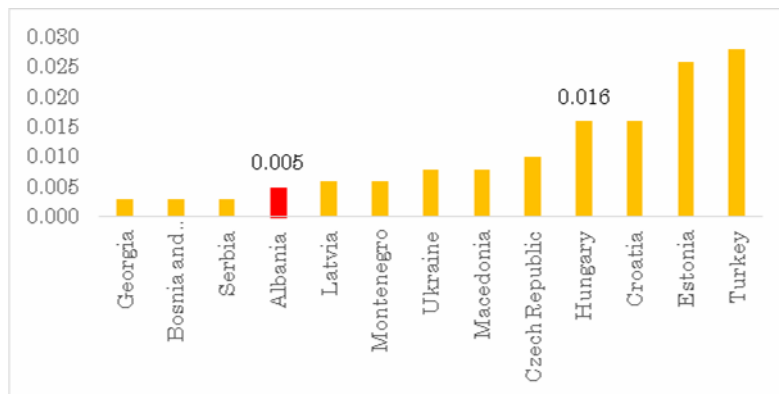
Figure 8: Distribution in percentage of poverty according to indexes.

Sources of information: Alkire, Conconi & Roche

One the advantage of MPI method is that is creates the orientation of politics exactly where the poverty arises. If we stop and analyze the MPI composition in indexes we will understand that despite the fact which is the origin of poverty, it may be necessary to concentrate only on one factor and not spend energy and efforts on factors which may not have urgent need to be improved. Thus, in Albanian case according to MPI the efforts of policy makers facing the poverty should be focused on the measure of health making the biggest part in MPI. On the other hand, if we are further interested , the school attendance index by scholar age children has the highest value of depriving cases , a value which helps us to put it first in the “struggle” against the phenomena of the school abundance. This helps even the government agency clarifying where the problem is. This index is followed by that of nutrition , having a high level of deprivation in population. Still clearer , the economic politics related to struggle against poverty there is no necessary to focus on electricity index because it is reported to be a non-deprived index in Albania.

Now let us focus on the analyses of MPI in region. Firstly the ranking. Based on the found data by the Oxford University, we can rank countries under development with low level income , where Albania is positioned better than countries like Check Republic , Hungary and Croatia.

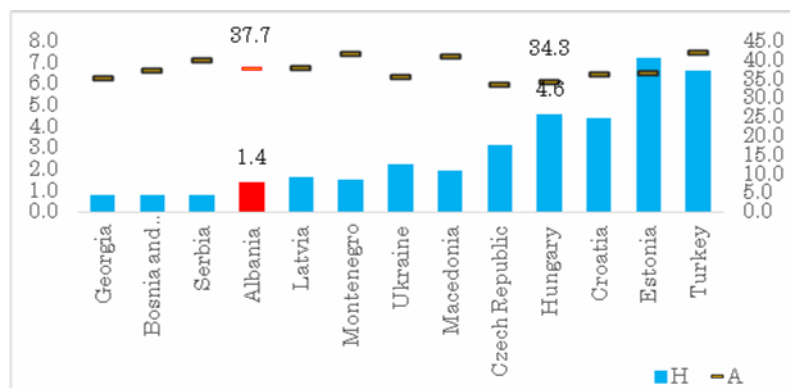
Figure 9: Ranking of several regional countries according to MPI



Source of information: Alkire, Concon & Roche.

What happens with ranking based on poverty distribution and its intensity? As far as poverty distribution is concerned (H), there isn't much difference compared with ranking based on MPI. Albania has got a low level of this measure when we compare it with chosen countries. Concerning the poverty concentration, the rank has got some differences where Albania passes to countries with higher poverty.

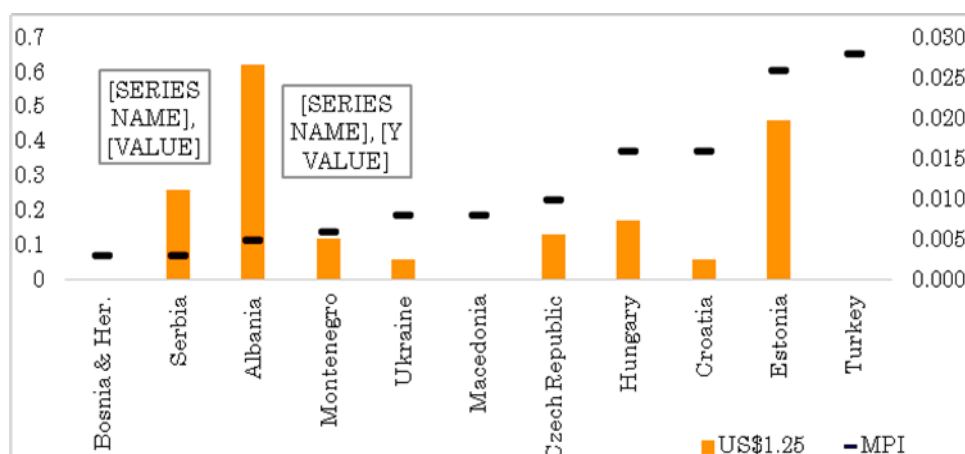
Figure 10: Ranking of some regional countries according poverty shown by H (Distribution) and A(intensity)



Source of information: Alkire, Concon & Roche.

The illustration of ranking according to MPI and poverty line in 1.25 dollar per day helps us understand how assessments of these two poverty measurements differ. If we refer to poverty line measurement, Albania is the poorest country among others with a value in a level 0.6. But, MPI poverty assessment classifies it much better, 0.005. At this point, many governments are skeptic with figure of MPI. But on the other hand, the assessment of poverty only by income has got its own drawbacks. Anyway, the clash between these two measures is because of MPI considers ten indexes and measures them as quality variable thus widening the poverty body.

Figure 11: Ranking of some regional countries according to MPI (right side) and poverty line in 1.25 dollar per day (left side).



Source of information: Alkire, Concon & Roche.

Let's come back again to the composition of MPI, but this time according to the countries analyzed. Let us try to understand that the poverty origin varies from one economy to another. Exactly this is one of the undisputable advantages of multi-dimensional method, where the governments are presented with the profile of the poverty origin of their own country and from here on they achieve to orientate their policies in accordance to the urgency rank. So, if for Albania the most problematic index is school attendance by scholar age children, in other countries this index may be not. Concretely, Bosnia and Herzegovina suffers from bad nutrition and than is followed by years of education. Serbia and Macedonia suffer more from nutrition and it's followed by school attendance. And so on and so forth.

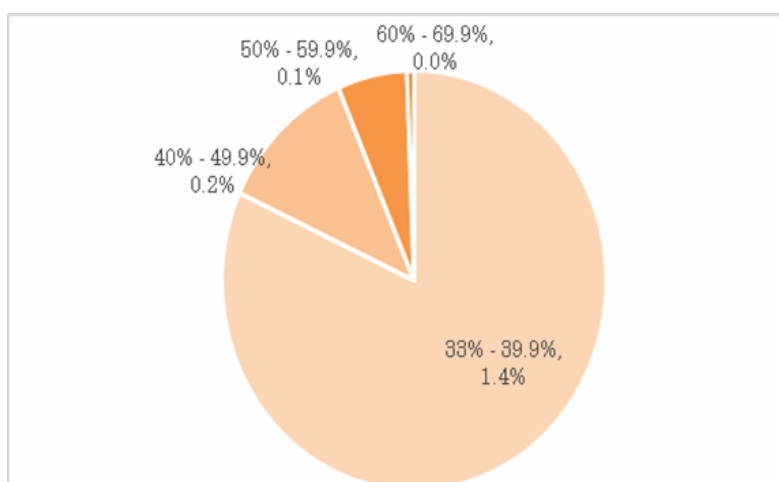
Table 4: the contribution of MPI elements on poverty

Country	MPI	Contribution of each measure in poverty			Education Health Living Standard (10 indicators)									
		Education	Health	Living Standards	Years of /Education	School Attendance	Mortality (each age)	Nutrition	Electric Power	Hygiene	Water	Floor	Energy for cooking	Property
Bosnia and Herzegovina	0.003	29.2	<u>51.8</u>	19.0	19.8	9.4		<u>51.8</u>	1.2	2.7	1.4	0.8	8.6	4.3
Serbia	0.003	30.5	<u>40.1</u>	29.4	21.3	9.2		<u>40.1</u>	1.1	3.9	1.8	5.8	11.0	5.7
Albania	0.005	32.0	<u>44.9</u>	23.0	6.1	<u>26.0</u>	24.3	20.7	0.0	4.7	3.3	1.3	11.6	2.2
Montenegro	0.006	37.5	<u>47.6</u>	14.9	17.5	20.0		<u>47.6</u>	0.4	3.2	1.9	0.4	8.0	1.0
Ukraine	0.008	4.7	<u>91.1</u>	4.2	1.2	3.5		<u>91.1</u>	0.1	1.0	0.4	0.2	1.8	0.7
Macedonia	0.008	59.9*	12.8	27.3	28.9	<u>30.9</u>	10.5	2.4	1.1	5.5	2.6	4.6	10.3	3.3
Czech Republic	0.010	0.0	<u>99.9</u>	0.1	0.0			<u>99.9</u>	0.0	0.0	0.1	0.0	0.0	0.1
Hungary	0.016	1.8	<u>95.6</u>	2.7	1.8			<u>95.6</u>	0.0	0.0	0.0	2.0	0.0	0.7
Croatia	0.016	45.0	<u>46.7</u>	8.3	45.0			<u>46.7</u>	0.0	1.0	0.3	0.2	4.3	2.4
Estonia	0.026	<u>91.2</u>	1.2	7.6	<u>91.2</u>		0.0	1.2	0.0	1.2	0.6	0.0	5.1	0.8
Turkey	0.028	<u>42.3</u>	38.4	19.2	9.1	<u>33.2</u>	30.0	8.4	0.0	7.8	4.9	3.3		3.2

Source of information: Alkire, Concon & Roche.

Concerning the poverty intensity among multi-dimensional poor, we have to mention that its interpretation is closely related to the fact that a family, a 100% deprived at poverty indexes faces a bigger poverty intensity than a family 40% deprived. Based on this logic, the poverty intensity analysis is built. Let us concentrate in the following chart which is a part of report for Albania. The identified part 33%-39.9% forms that part of population which suffers 39.9% of the poverty indexes. This is the biggest part of multi-dimensional poverty in Albania. According to MPI 1.4% is the percentage of poor population with this intensity, or 0.2% which represents the percentage of people who are deprived in 40% of poverty indexes.

Figure 12: Illustration of poverty intensity analyses



Source of information: Alkire, Conconi & Roche

Discussions

Poverty and struggle against it, is one of the most delicate issues of policies related with social well being of a country. Undoubtedly, it is an important part of debates by policy makers, decision makers, economists and academics. According to World Bank Reports, Albania is one of the poorest countries of the south-east European Region. The definition of poverty is closely related with the method used to measure it. As we proved above, poverty according to INSTAT measurements, use by LSMS – one-dimensional, is to much different from the result given by multi-dimensional poverty index (MPI). This difference confuses even policy makers. Which is more accurate? MPI is more suitable measure. It integrates a multi-dimensional analysis, identifies which of the included factors as an index influences on the poverty, by presenting with the poverty profile correspondently and this orientates the policies against it. Of course, as a relatively new method, this needs a further consolidation especially the chosen of suitable indexes for representing the respectively concepts. The founders of this method are of the opinion that the discussion about the right operation of some concepts in variables can be open meaning thus the further perfection of MPI method. Also, considerations are being given to include even other aspects of social character. A problematic issue is the problem of finding and collecting the data. For example, due to the lack of data in Albanian case, the infancy mortality is measured with mortality for every age, bringing a different information from the theoretic one.

For the Albanian case, MPI shows the level 0.005 which is a lower level among countries under development and with poor income. The index of health is reported more problematic than two other indexes, while that of school attendance is the most deprived index. These findings are not uniform among poor countries. And now we come to the conclusion that many authors have previously emphasized: poverty is caused and has a different nature for different countries, even inside the country.

If we can show a consideration, after reading the meaning of MPI figures, the policies with school attendance focus would be an urgent need in response to poverty, as well as health focus.

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THE INFLUENCE OF THE ECONOMIC CRISIS ON THE IMPLEMENTATION OF HUNGARIAN WASTE LEGISLATION

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ABSTRACT

Hungarian environmental policy has made significant progress in the past 25 years. In environmental protection and nature conservation several decades' lag had to be made up in a relatively short time. This could be successful due to the accession to the European Union in 2004. Our lag was the most significant in modern environmental infrastructure and environmental technology development. Large-scale industrial development forced by political considerations during the communist era was a major source of environmental pollution, and environmental investments and remediation fell short due to the lack of resources. As a result, some areas of the country became considerably polluted. The improper treatment of the waste and the pollution caused by it resulted in a catastrophic environmental situation by the end of the 1980s. Another problem was the lack of modern environmental policy and legislation. This was of course closely related to the lack of financing, because it is impossible to apply strict regulations without sufficient resources. The political pressure of the EU-accession extorted the transformation of the Hungarian environmental policy from 1990. In the course of the legal harmonization the legislative background of environmental protection was created in line with the directives of the EU. It was a long and slow process, and the EU-compliant environmental regulations has been established by 2002. The modernization of the regulation had not eliminated the shortage of resources. Because of the lack of adequate financing we were not able to meet the strict requirements set by the new legislation. Fortunately, the European Union not only imposes certain requirements, but also provides professional assistance and financial support to achieve the strategic goals. Right after the change of the political system in Hungary some EU funding was opened to us, resulting in investments in environmental protection infrastructure development. Thus, we could reduce the gap in 10 years after the accession in 2004. Since then the development of environmental policy and environmental legislation has been continuous. The last significant change was made in waste management, the new Waste Act of 2013. The financial crisis of 2008-2009 has made a major impact on European and Hungarian economy. In my research I examined these unfavourable macroeconomic conditions: how and to what extent they influenced the implementation of the new national waste management regulations.

Key words: environmental policies, governmental policies, air pollution

JEL codes: K32, Q28, Q53

Introduction

Hungarian environmental policy has made significant progress over the past 25 years. The country's lag of the earlier decades had to be worked off in a relatively short time in the field of the environmental protection and nature conservation. This success has been one of the results of the accession of Hungary to the European Union.

The main reason of the lag was the lack of modern environmental infrastructure and the deployment of environmental technology. The large-scale industrial development of the communist regime forced by political considerations was the major source of environmental pollution. The environmental investments and the required environmental remediation interventions failed due to the lack of financing resources. As a result, some regions of the country had been considerably polluted by the time of the political system change in 1989. In particular, the pollution caused by the waste and its improper treatment had resulted in a near catastrophic environmental situation by the end of the 80's.

Besides the insufficient financing resources another reason of the Hungarian environmental problems was the lack of modern environmental policy and legislation. The importance of environmental pollution prevention and the remedy of environmental damage had not been realized. Of course, the two reasons, the lack of money and the missing policy are closely related to each other, resulting in high risk and severe pollution.

The political pressure of the EU accession forced the transformation of Hungarian environmental policy, beginning in 1990. The reform of the legal background of environmental protection, the making up for the missing laws and regulations have been accomplished in the framework of the harmonization of the European and the Hungarian legal systems on the basis of the EU directives.

It was a slow and long process, and as a result the Euro-compliant Hungarian environmental regulations have been established by 2002. The minimum of the expected EU requirements were met. But derogation was required in many areas, for example in waste canalization and waste water treatment.

The modernization of the regulation had not eliminated the shortage of resources. Due to lack of funds Hungary was not able to meet the stringent requirements set by the new legislation.

Fortunately, the European Union does not only impose requirements for the accession countries, but helps to achieve the strategic goals with significant professional assistance and different financing funds. After the change of the political system some EU funds have been opened, resulting in investments in infrastructure developments in the field of environmental protection. As a result, Hungary has managed to reduce the gap significantly after the accession in 2004, in 10 years. The development of environmental policy and environmental regulation has been continuous. The last significant change was made in the field of waste management, the new Waste Act became effective 1st, January, 2013.

The 2008-09 financial crisis has had a major impact on the European and Hungarian economy. In my research, using the tools and methodology of implementation research, I examined to what extent these unfavorable macroeconomic conditions hampered and influenced the implementation of the new national waste management regulations.

I. Policy and Implementation

1. Policy and implementation in general

Policy (Public Policy): Revelation of a goal and the means used to achieve the goal (public statement). (Gornitzka 1999)

Policy is not equal to the intervention / reform / innovation (action to change the system): "the policy could be will, action and inaction." (Hogwood, Gunn 1984)

Policy implementation: include the actions of public and private actors/groups that take place in order to achieve the targets of the policy decision. (Van Meter, Van Horn 1974) .

Implementation research: an investigation by scientific instruments and methods, that how much is realized from the policy initiated by the government. (Fullan, Pomfret 1997)

Implementation research on environmental protection: examines the implementation of the initiated environmental policies (regulation) – as a subsystem – by the theoretical modeling and empirical research method.

2 A brief review of implementation research

The basic book of the implementation research Sabatier, Mazmanian (1979):

The Conditions of Effective Implementation

The defined factors affecting the success of the implementation of the following:

- Clear and consistent objectives
- The proposed change rate of the system
- Appropriate causal theory underlying the reform
- Adequacy of financial resources
- Actors commitment
- Social and economic conditions

3. The analytical framework of policy implementation

The implementation of policies can be examined by a number of approaches and instruments. In the analytical framework the following approaches are possible:

- The implementation success/failure
- The actors of the implementation, the behavior of the players, their impact on implementation
- The implementation context
- The levels and the complexity of the implementation
- The implementation process
- The policy

3.1. Success Factors

Starting point: There are commonly accepted influencing factors.

Critical variables (Brynard 2005):

- The content of the policy
- The context: organizational-institutional context, but which also shape the wider context
- Commitment: the attitude of those who responsible for implementation on all levels (regime-level, street-level), is there any "fixer?" (Bardach 1977)
- The sector capacity: structural, functional and cultural ability for the implementation of the governmental targets
- Clients and coalitions: interest groups, opinion leaders behaviour
- Communication
- Other considerations:
 - Clarity of goals v. "Acceptable mix of outcomes"
 - Impact of changes in the socio-economic context
 - Implementation capacity and absorption capacity
 - Ambiguity - conflict matrix → 4 types of implementations,
 - Four critical factors (Matland)
 - Controllable/uncontrollable, linked to the policy makers/implementers

3.2. The implementation actors, their behavior, their influencet on the implementation

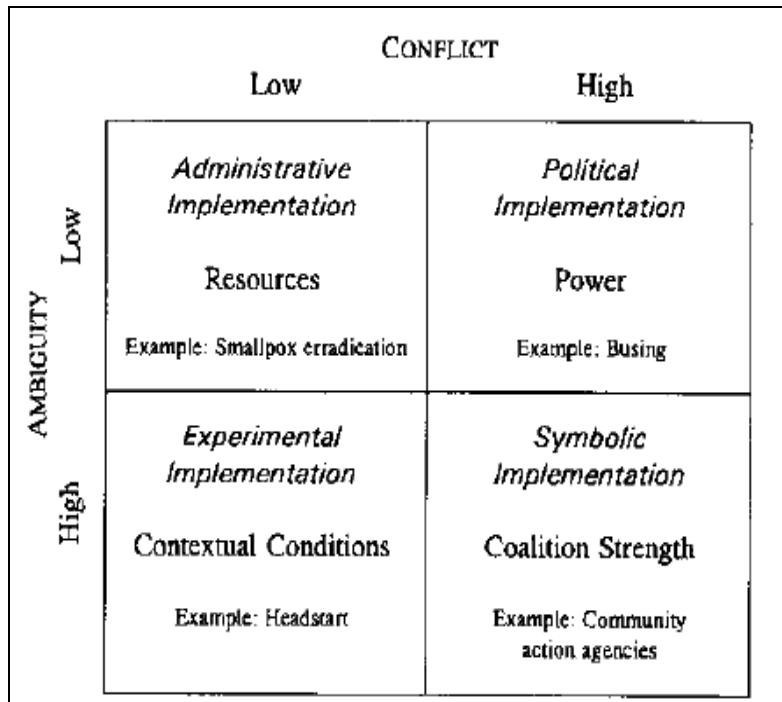
Starting point: the actors of the implementation process are generally not individuals, but usually form coalitions, interest alliances. Sabatier (1998) established the "Coalition Support Framework" (Advocacy Coalition Framework) model, which graphically shows the possible effects of the actors of the implementation in the process of implementation.

Additional considerations:

- Slip/torsion (Pressman, Wildawsky)
- The relationship between policy makers and implementers (Farrar et al.)
- Degree of implementers freedom
- The role of street-level bureaucrats

3.3. Ambiguity and conflict (Source: Matland 1995:130)

Matland focused to the relatiship of ambiguity and the conflicts in the policies in his investigations. His matrix determined four main types of impelementation that have different basic characteristic.



- **Administrative implementation:** the most important guiding principles are the resources
- **Political implementation:** the main guiding principle is the power (an actor or a coalition, who is able to force the other players to accept its own perspectives)
- **Experimental implementation:** the key guiding principles are the contextual conditions
- **Symbolic implementation:** the most important guiding principle is the coalition forces

3.4. The context of the implementation

Starting point: the method of governance – which consider the relationship of the government and the environmental protection – designates the possibilities and scope of the actors during implementation.

Kiindulópont: A kormányzási mód – amely meghatározza a kormányzat és a környezetvédelem viszonyát – az implementáció során kijelöli a szereplők lehetőségeit, mozgásterét

	Sovereign, Rationality-Bounded State	Institutional State	Corporate-Pluralist State	Supermarket State
Environmental protection	Tool of secondary political and social objectives	Protection of environmental and nature values, divided responsibility	Monopoly power and control (competing and legitimate centres of authority and control)	Follow the requirement of the different interest groups (Resource market)
State-environment relationship	Only the necessary actions (The rest of budget principle)	The state is only one actor of the environmental protection	Strict control and punishment	Environmental protection in market circumstances
The method of change	Slow, the result is significant pollution	Possible fast changes (It depends on the available resources)	Depends on interests and powers of the interest groups	Fast and effective if the activities are profitable

(Own work based on Gornitzka 1999)

Machine Implementation	Game Implementation	Transaction Implementation	Evolutionary Implementation
Developed clear plan behind a legitimate decision-making power	Bargaining and exchange overshadows the plans and policies, characterized by irrationality	Based on the negotiation between the policy and its environment	The policy makers 'influence only' the action potential

(Own work based on Warwick 1982)

Additional considerations may include:

- The role of the macro-environment
- Initial and desired level of development (McKinsey)

3.5. The implementation levels

Starting point: the environmental implementation is a multi-level process.

Levels:

- supranational level (World organizations, EU);
- national level ;
- regional level (regions, cities);
- organizational, institutional level (state, local government and business organizations);
- the levels in the organizations (departments);
- individual level

Note: The policy transfer from one level to the next is not clear and not one-way (Brynard 2005)

Environmental policy implementation: interactions of actors at different levels

3.6. Content and purpose of the policy

Lowi distinguishes four types of public policy (Lowi 1972):

- Distributive (directed to allocation of resources)
- Regulative (target control)
- Redistribution (redistribution of resources, aimed at changing the distribution)
- Constructive (reorganization, creation, development).

II. The Hungarian environmental policies

After the transition (1989) in the Hungarian environmental interventions were clearly recognisable the distributive, regulative, redistributive and constructive elements. In the majority of cases these characteristics were present simultaneously. This should generate conflicts that primarily could be connected to the redistribution (redistribution of resources) and, secondly to the allocation (some people get it and some do not), as both connected to

the loss of the status quo, the field of power conversion, the reorganization of positions. The constructive and regulative interventions are almost always associated with the (re)distributions too, so also carry the conflicts involved.

Prior to the change of regime, can not talk about the merits of environmental policies. The environmental regulation is displayed but there is no effective policy.

1 Environmental regulation in Hungary

Ten years before the EU accession the Hungarian environmental regulation was significantly behind the developed countries of the world. During the legal alignment period the country started catching up to the EU requirements and developed the appropriate environmental regulations. At the moment of the accession, with the exception of derogation areas, domestic regulations have been complied with EU norms.

1.1. Legislation before the transition (-1989)

During the period of socialism had only been regulating a few environmental areas that were traditionally considered important and where there were formed very significant and dangerous pollution. These areas were as follows:

- Water quality protection, wastewater treatment (1960)
- Air quality management (1970)
- Noise and vibration (1978)
- Hazardous waste treatment (1981)

1.2. The legal alignment process (1990-2003)

Under political pressure to join the EU initiated a comprehensive review and reform of environmental regulation. This took place in the context of the creation and regulation of a number of important areas of environmental law, which had been left out of the legislative process earlier.

- Environmental Protection Act (1995)
- Waste Act (2000)

1.3. Regulation after 2004

After the EU accession, the primary task was to meet the requirements of new environmental legal system, compliance with and enforcement of the rules much stricter than before. To reach this goal significant environmental infrastructure improvements were needed, which was significantly supported during the transitional period longer prior the date of accession to the EU. Sewage and wastewater investments and modern waste management facilities have been built, substantial elimination of pollution, large-scale remediation of contaminated sites took place. The end of the derogation period the regulation and the conditions tightened further and further. The most significant change has

occurred in the waste management legislation, which came into force a year ago. This was one of the most modern and one of the world's most stringent regulation .

- New waste law (January 2013th 01)

2. The policy and implementation before the transition

During the period of socialism, the environmental protection was not a priority, the ideology and the propaganda sharply divorced from reality, at the level of deeds and actions the environmental protection as a stand-alone policy was practically non-existent.

2.1. Environmental protection during the period of socialism

The Cold War period was characterized as a cutthroat competition between the socialist and capitalist countries. The socialist countries wanted to overcome at all costs by strong industrialization, agriculture thus began a complete overhaul ("chemical processing"), which resulted a significant pollution (water and air pollution). In the end some industrialized regions of the country had been completely polluted.

2.2. Environmental regulations in the period of socialism

A politikai rendszer vezetése, a termelési eredmények bővületében nem akart tudomást venni a környezeti károkról és ártalmakról, követő szabályozást (kényszer szabályozás) alkalmaztak, amikor már tarthatatlanná vált a helyzet és kialakultak a tényleges környezeti károk és ártalmak, csak akkor és csak utólag avatkoztak be.

For the political leadership the important was only the production results, they did not want to ignore the environmental damage and hazards, the „follower rules principal” (enforcement regulation) was used. It meant: when became catastrophic situation and developed the actual environmental damage and harm, if and only in that case took place the governmental intervention.

2.3. The implementation characterization

The legislation of the dictatorship could be characterized by irresponsibility (lack of social responsibility), the ideological goals overrode all common sense and rational aspects. The collective irresponsibility (Context: The Sovereign, rationally-bounded state) resulted extreme environmental degradation. Regulation of certain areas were needed after a while, because of the serious pollution and harm. These were „political” type implementation of regulations (implementation by power). The policy making and the legislation process happened without the involvement of the different interest groups of the society and the law and rules enforced by power tools.

3. The policy and implementation during the legal alignment period

The EU environmental policy is the most advanced environmental legislation in the world (The highest quality environmental protection: The Netherlands, EU). The IPPC: Integrated Pollution Prevention and Control principle summarizes the principles, methods, and goals of the modern environmental management and the sustainable development. Detailed regulations are the guidelines (directives) for different subject areas. The EU directives have mandatory application in the development of the member states national legislation.

3.1. Harmonization of the environmental legal system

After the change of regime in Hungary in 1989 the EU accession treaty were signed soon and started the preparation for the accession. Under political pressure to accession to the EU started the alignment (legal harmonization), in which a priority area was the environmental protection. The legislative process was characterized as the „follow up” (enforcement) regulation. The domestic legal system - following a comprehensive review - was needed to convert according the EU policies, and directives.

3.2. The characterization of the implementation

Political types of implementations (necessity) occurred, because the accession criteria had to be fulfilled on time. For the social groups involved in the justification: The EU is all about ! We are emergency, when you want the accession the conditions had to be met. But in the given the situation we go only as long as to had to. (lack of money, derogation) !

4. The policy and implementation after the EU accession

4.1. The national environmental policy after accession

After the accession in 2004 the domestic environmental policy was characterized by duality and remains the same in the present day. The environment is still not a priority (not strategic area), but the EU's environmental policy directives are mandatory. As a result, still following the rules (enforcement regulation).

4.2. The domestic environmental regulation after 2004

The period after the accession of Hungary to the EU, the domestic environmental regulation was characterized the compliance with the mandatory content of EU policies (IPCC, guidelines, directives, etc.). In this frame some major legislative changes, tightening had been occurred in the beginning (2010). In addition to the environmental targets appeared other policy objectives for waste management regulations in the past few years.

- Modification of Environmental Act
- Modification of Waste Act (2013)

4.3. The characterization of the implementation

Still have political (power) type of implementation (Context: more or less between the Institutional and Corporate-pluralist state), therefore social or formal consensus can not be possible. Reason: because we still have all of the EU !

III. The implementation of new waste legislation

By the detailed analysis of the new waste law entered into force the 1st of January 2013, I'd like to present a good example of the problems of domestic environmental policy implementations.

1 The new waste management legislation features

The Waste Act and the connecting other rules and regulations contain essentially environmental targets, but significantly appear other objectives in the policy, which of expected future effects are difficult to be calculated.

1.1. Environmental goals

The new legislation is highly advanced and environmentally progressive, and consequently much stricter and much more expensive for the waste producers as the previous legislation. The most important environmental professional objectives of the law are:

- Pollution exclusion
- Promote the selective waste collection and recovery
- Reduction of waste dumping (land filling)
- Strict administrative (record keeping, reporting) and verification system
- Ensuring professional background (certification)
- Ensuring financial background (just on principle)

1.2 . Political (real) points

By the most strict regulation the real goal is the transformation of the existing domestic waste market, the displacement of the foreign-owned service companies from the Hungarian market. The professional environmental goal, which is intended to help ensure the financial background can not be achieved in practice.

1.3. Effects of the new regulation

In addition to a significant increase in the costs of public services, loss of income (reducing overhead), significant operational problems, and the financial difficulties are the expected influences of the new regulation.

2. The implementation of waste legislation

During the research of the implementation process I examined the preparation phase of the regulation (policy) and the experiences of the implementation since the regulation came into force 1st of January 2013 until now.

2.1. Conflicts and disputes concerning the preparation period

The preparation phase of the regulation (policy) could be characterized as a protracted legislative process, after several formal (non-substantive) rounds of negotiations, despite serious objections, in virtually unchanged form have been adopted by the parliament (2/3rd political dominance in possession).

2.2. Significant modifications have been already made within six months

There is no clear, consistent professional content, because there wasn't any substantive consultation with stakeholders (professional bodies). In addition the EU principles are damaged and constitutional concerns (equality, neutrality of competition, ignoring the market economy rules, forbidden state intervention) have also been raised.

2.3. Caused by the increase in cost and overhead reduction malfunctions occur en masse

The most serious consequence is the significant deterioration in financial conditions, which may cause malfunctions in a significant part of the public service, in some cases leads to the impossibility of public services, the consequences can be handled only by state intervention. (Disaster Management Authority) .

3. The characterization of the implementation

3.1. Content and purpose of the policy

In the new waste management legislation are simultaneously present the distributive, regulative, redistributive and constructive elements. The new regulation led to the loss of the status quo, the conversion of the field of power and the reorganization of the positions. Hence the major conflicts. The regulative and constructive interventions associated with resource (re)distributions that have significant consequences are the emergence of conflicts.

3.2. Ambiguity and conflicts

The rules (policy) are characterized by a high level of inconsistency and significant conflicts. The foreign – owned private companies excluded from the domestic market, while causes financial difficulties to the remaining domestic-owned public service companies. The implementation of the policy is essentially a political implementation: the guiding principle is the power, political and legal constraints.

3.3. The context of the implementation

The starting point of the context is mode of governance - which defines the relationship between the government and the environment - during implementation selects the participants scope and options.

According the definition of Gornitzka the transition between the „Institutional state” and the „Corportate-Pluralis State” (Gornitzka 1999) could be the type of governance that characterizes the context of implementations of the examined policy and regulation. In this context is perhaps more dominant the „institutional” nature.

The type of implementation context according Warwick this is a „Machine” implementation (a well defined clear plan, behind the legitimate decision-making power) (Warwick 1982). The mutual relationships of the implementation of the Hungarian waste management system can be characerized by that formula.

4 The assessment of the implementation and the expected effects

4.1. Analysis of Success Factors

The success factors are:

- The clear and consistent objectives are missing (not known)
- Rate of change (unknown, outcome of the changes are uncertain)
- The underlying of the causal theory of proper reform (elimination of the waste pollution)
- Adequacy of financial resources (uncertain, but there is any money)
- Actors commitment (unknown, more negative)
- Social and economic conditions (non-compliant)

The success factors of the implementation with few exceptions predict the failure of the hole process. It is already established that the risk of probable harmful consequences is extremely high.

4.2. Expected impacts

The total failure without changes and corrections is inevitable within a short period. There are political constraints in this situation because of the elections in 2014. The system must be maintained ont he same way until the end of 2014. Possible temporary solution could be to the end of 2014 the state intervention (compensation, special assistance and supports, disaster management authority intervention).

5. The effects of 2008-9 financial crisis

The 2008-09 financial crisis indirectly has had a major impact in Europe and within the Hungarian economy. After the outbreak of U.S. mortgage crisis emerged in 2008, the financial crisis caused a significant setback on the real economy over the world.

5.1. The general effects of the crisis

Economic growth fell back in a few months and by the end of 2009 Europe 's economy had been in recession (4.2 % decrease). The GDP data showed (Hungary: 6.3 % decrease) significant reduction without exception, the mass of firms were in difficult situation, unemployment had risen significantly (Hungary: from 7.7 % up to 10%. or more). The household income and thus their consumption is also reduced, which further exacerbated the already declining economic performance. The HUF exchange rate from 250 HUF/ € has risen close to 300, sometimes to over 300.

In order to treat the major crisis governmental intervention had taken place in the banking sector (crisis management). The positive effects have occurred in the short term, but in the medium term, because of the risen governmental debt, also raised new problems. (The individual governments to cover the costs of the bank saving interventions used new debts.)

In the case of weaker economies in South and Central Eastern European countries the crisis phenomena have proved to be far more serious and taken for a longer time. The Hungarian economy had been in recession until 2012, and GDP has been started to grow again only in the second half of 2013. During the reporting period the unemployment rate were significantly higher than 10% , but decreased again below to 10% by the end of 2013. The investments, purchasing power and consumption steadily decreased in parallel (in 2009: 7.6 %) and it has changed only in recent months. (Belyó 2011)

5.2. The crisis effects on the waste management policy of Hungary

General condition of the Hungarian economy and the deteriorating social situation of the population was severely affected to the public service providers. The increasing amount of outstandings and the proportion of bad debts significantly worsened the financial position of public service companies in the waste management sector. For this situation the companies have responded by cutting back the necessary renovations and improvements, which can result malfunctions in the medium term. Cost reduction due to financial constraint problems, increased the risk of direct environmental pollution. (If you fall short to prevent and eliminate pollution due to lack of funding measures.)

The crisis developed by the lack of funds made it difficult to make effective cooperation in the implementation of the new waste management regulations (policy) principles for stakeholders.

Legislators (government actors) ignored the expected financial difficulties during the implementation, which were greatly exacerbated by the effects of the crisis. Due to the malfunctioning, the regulation content problems are significantly due to the unfavourable economic environment. Therefore, we can say that the crisis significantly complicates the domestic waste policy implementation.

Summary

Hungarian waste management policy and the related environmental legislation may well be an interesting case study of implementation research. Except a few professional areas it did not measure up to the principles of an effective and successful implementation. With few exceptions the success factors determined by scientific theory and empirical research were not present. There was a huge discrepancy on one hand between the environmental requirements and the terms of financing (public overhead reduction), and on the other hand between the EU regulatory principles and its policies (neutral competitiveness, forbidden governmental intervention).

In addition to the above problems the decision makers ignored the forecasted financial difficulties caused by the financial crisis during the implementation. The regulation content problems are significantly due to the unfavourable economic environment. Therefore, we can say that the crisis considerably complicated the Hungarian waste policy implementation. and increases the risk of the malfunctioning of the public sector in the field of waste management.

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NATIONAL PERSPECTIVE Session – part 2

REGULATORY REFORM TO REDUCE ADMINISTRATIVE BARRIERS TO BUSINESS IN ALBANIA

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ABSTRACT

Well-functioning regulatory system is an essential component of modern society. In societies where the rules works well, strengthen governance, promote prosperity and stability. A good regulatory system provides a stable environment for business by reducing transaction costs, providing security and encouraging healthy competition, and increasing international competition, investment, growth and employment.

After the 1990s the governments of many countries of the world supported their economic development and reducing poverty and expanding with reforms acceleration to improve the business climate through regulatory policies and reducing administrative barriers. Improving the environment in this period became the norm for developing countries seeking sustainable growth and development. The inability of large hamper growth and addressed mainly to macroeconomic levels, both through extensive legal reforms and regulatory ones.

However, extensive reforms are difficult to implement and support. Successful reform requires overcoming personal interests in public and private sectors, overcoming the fear of change, complexities of the uncertainties of change in dynamic environments, economic and social.

Development of comprehensive regulatory reform strategy, offers good opportunities for donor coordination: planning and support, as well as pursuing a comprehensive approach to aid, rather than supporting activities and fragmented interventions. The existence of a clear strategy, comprehensive regulatory reform also helps donors by facilitating the provision of budget support and technical assistance in a systematic and continuous long term periods. In this situation was included also Albania, which introduced for the first time in the list of countries assessed by the World Bank study regarding facilities for doing business, so in Doing Business 2004.

Key words: Regulatory policy, administrative barriers, transaction costs, regulatory reform, regulatory impact assessment, capacity building, procedures.

Introduction

Reforming the business environment is a broad agenda, but at its core is regulatory reform, particularly for small enterprises that are disproportionately harmed by regulatory costs, barriers to entry, risks and uncertainties, and associated costs of corruption.

Economic transition requires massive legal change. Such legal change goes beyond policies and formal instruments, since the role and style of regulation in society is deeply embedded in traditions, capabilities, interests and the organizing of power. Far reaching legal change, called "regulatory reform" stretches from the collection of existing legal instruments into the institutions, processes and capacities of government, and even further, into the institutions of the rule of law, and the changing relationship between the state, market and society.

Much development work is focused on adjustments to the legal system to support new economic and democratic needs. But such work is very slow. The challenge is finding ways to shift the complex system of instruments and behaviours to support of rapid economic growth needed to produce ambitious poverty reduction promised and growth welfare. The experience has told that there are always time lags between market change and legal change, the task is to shorten the lag so that legal system "catch up" with market needs.

The high degree of difficulty of the problem makes that reformers either under validate or fear of it. No single approach to the displacement of this welter of rules, institutions and interests, would be enough. Experience shows that:

First, stable regulatory reform should be part of a broader program, supported by macroeconomic, microeconomic, and governance changes.

Secondly, there are no magic rules that tell us that these reforms should be included in a sustainable program of action, which starts immediately and focus in the results. It should enjoy political commitment, adopting a set of tools proven in other countries that face similarly problems, and invests in institutional capacity and human resources.

1. Development history of Regulatory Reform, literature review.

Studies have been recently focused about how regulatory reforms scale are being developed in different countries and how these experiences can be used in the design of reforms in other countries. Increasingly, studies are examining the plan of the political economy of reform and are trying to tie the design of reform processes and instruments.

There is no ideal model for the "right" regulator system. The exact role that markets and governments can play varies from country to country and from sector to sector.

Regulation of business existed in the ancient period. It is understood that these regulation have been more developed in the area that today we call business, but in that period *were* called trade. At that time there have standardized weights and measures, where the information coming from *antiquity* gold may have operated as an international currency and

as a key element of regulation. Also the use of national currencies as an exchange instrument has been a strong reason to promote regulation.

In China, a national currency system existed and paper currency was invented. Sophisticated law existed in Ancient Rome. In the European Early Middle Ages, law, standardisation and the power of the after the decline of Rome, but regulation existed in the form of norms, customs and privileges; this regulation was aided by the unified Christian identity and a sense of honour in regard to contracts⁴².

Beginning in the late 19th and 20th century, much of regulation in the United States of America was administered and enforced by regulatory agencies. At the federal level, one the earliest institutions was the Interstate Commerce Commission, which had its roots in earlier state-based regulatory commissions and agencies.

In the 1930, lawmakers believed that unregulated business often led to injustice and inefficiency. In the 1960 and 1970 concern shifted to regulatory capture, which led to extremely detailed laws.

The idea of regulatory capture has controlled discussions of economic regulation and regulatory reform for more than two generation. Its origin comes immediately after World War II as "capture thesis" tht dominated the closing decades of the 20th century, the basic definitions of which are quite clear and already accepted. Indeed one of the most surprising things about the genealogy is the extraordinary degree of consensus about regulatory capture across a broad spectrum of economists, historian, and scholars of law, politics, and public administration.

The capture thesis first originated not in law and economics but in the fields of political science and public administration. For the most part early formulation of capture theory were mildly reformist in orientation-usually concluding with call for something like increased judicial review or enhanced executive supervision or a higher level of administrative formality in regulatory practice in order to reign-in or counter-balance industry influence.⁴³

According to Stigler "regulation is acquired by the industry and is designed and operated primarily for its benefits."⁴⁴

"Regulation itself was invariably controlled by leaders of the regulated industry, and directed toward ends they deemed acceptable or desirable."⁴⁵

The theory of "regulatory capture" as a form of deregulation, finished as a short sighted theory that stood behind it.⁴⁶

Obviously the study of regulation is not something new. It is rooted in economic and political science, legal, public and management disciplines that means going back a century or more.

⁴² www.wikipedia.com

⁴³ Theodore J. Lowi (1969), "The End of Liberalism ", f 14.

⁴⁴ George J. Stigler(1971), "The Theory of Economic Regulation," *Bell Journal of Economics and Management Science* 2: f 21.

⁴⁵ Gabriel Kolko (1963), "The Triumph of Conservatism: A Reinterpretation of American History", f. 2-3.

⁴⁶ William J. Novak (1985), "A Revisionist History of Regulatory Capture", f. 29.

Theories of regulation have merged in different ways in the practice of regulatory reform. As a result, the concept of regulatory reform has assumed several meanings over the last 30 years.

Since the 1960, the economists have studied the microeconomics of regulatory intervention in markets. Theories based on concepts such as market and government failure and transaction costs tried to define the effects of regulation in specific situations.

Normative and positive theories of regulations based on concepts of private interest and public interest tried to explain how the regulation is used in the political economy, and to predict the form and pace of regulatory reform. The modern school of law and economics applied neoclassical ideas to the analysis of legal problems.⁴⁷

Meantime modern regulation began in the age of industrialization in response to sometimes spectacular market failure.

According to Stiglitz, the concept of market failure remains a powerful framework to think about regulation in many contexts. In his essay Stiglitz identifies a series of failures of the contemporary market irrationality and the spread of justice. He relied on his extensive experience as a public official, argues that..."robust regulatory governance, the implementation of well-conceived, can effectively compensate these market limitation."⁴⁸

Market failure theory encompasses a powerful set of ideas, and it will inevitably remain a pillar of any modern approach to regulation. But it should not be the only-nor perhaps even the principal-intellectual foundation for a new era of regulatory engagement.

Since the 1960 influential new research on government failure has helped to drive the movement for deregulation and privatization. Yet even as the study of government failure was flourishing, some very different ideas were sprouting in the social sciences with profound implications for our understanding of human behavior and the role of government.⁴⁹

Some of these ideas, particularly from the field of behavioral economics, have begun to nudge their way into discussions of regulatory purpose, design, and implementation. Yet even here, the process is far from complete; and many other exciting new lines of research-on everything from social cooperation to co-regulation - have hardly been incorporated at all.

During the 1980s often it is said that we live in an age of deregulation and that the state has been forced to retreat to reduce burdens on businesses. Under these statements is the belief that a decade of more of deregulation has reduced state intervention in markets.⁵⁰ To be blunt, this is largely a myth, and one that interferes with efforts to improve the effectiveness of the state in protecting public interests.

However it belongs to the past, because in 2000 American Scott Jacobs, father of "Regulatory Reform" will declare that: Far from living in an age of deregulation, we live in

⁴⁷ Scott Jacobs & Peter Ladegaard (2009), "Regulatory Governance in Developing Countries", f. 4.

⁴⁸ Joseph Stiglitz (1985), "Credit Markets and the Control of Capital", kap I, f.147.

⁴⁹ David Moss & John Cisternino (2009), "New Prospective on Regulation", f. 7.

⁵⁰ Derregullimi – ose e thënë ndryshe liberalizimii rregulloreve/ rregullimeve,

the golden age of regulation.⁵¹ From environmental protection to consumer protection, safety and health, labour standards, and social justice rules such as equal opportunity, no government activity in OECD countries has grown faster since 1980 than government regulatory functions.

Even during the administrations of Reagan and Thatcher - the quintessential "deregulation" crusades - the quantity of regulations measured in number of rules and their length increased in both the United States and the United Kingdom. And regulatory constraints are becoming more stringent. Regulatory standards have never been higher in the developed countries than they are today. International standards are increasing rapidly. That is not to say that they are keeping up with new risks and technological changes, but that is another argument entirely.

The number and scope of government (domestic and international) regulations have increased so rapidly in almost all OECD countries that the term "regulatory inflation" was coined by the OECD in the early 1990s, which means that multiple rules are therefore redundant. In fact, the level of regulation is increasing so quickly that governments cannot possibly enforce all rules, nor can citizens and businesses comply. Regulatory compliance is probably declining as regulatory inflation continues.

In the economic sphere, too, regulation is increasing. The essential difference is that new market regulations tend to be pro-competitive, replacing more costly and less effective forms of government intervention, such as state ownership. It might be surprising that, in the United Kingdom, regulation grew fastest in the 1980s, the decade of privatisation. This is because large new regulatory regimes and institutions were established as the state changed its role from owner to regulator.

Prime Minister Thatcher was the biggest regulator in UK history, because she introduced the biggest market liberalization in UK history. The UK "Big Bang" in many respects codified what had already been going on in practice, and moreover tightened up regulation in many respects.⁵²

The deregulation myth arose because liberalization in international capital markets and privatization in a few key infrastructure sectors such as telecommunications and to a lesser extent energy and transport released powerful new market forces, which became a symbol for generalized government retreat, though governments were actually building many new regulatory programmes and institutions.

The idea that market liberalisation and deregulation are synonyms is misconceived, and when put naively into practice has led to regulatory gaps, market failures such as dominance, and consumer abuses such as safety hazards. For that reason, the deregulation myth is dangerous.

It is easy to dispose of another myth. The state is not withering away in the face of markets. If anything, the average size of the governments in the OECD area, measured in government revenues as a percentage of GDP, increased slightly from the mid-1980s to the mid-1990s. This is perhaps a natural consequence of the growing role of the state in insuring

⁵¹ Scott Jacobs (1999), "The second Generation of Regulatory Reform", f 23.

⁵² The OECD (1997), "Report on Regulatory Reform", f. 43.

citizens against risks as dynamic markets increase insecurity and of welfare effects of aging societies.⁵³

A third myth, too, deserves deflating. It is often said that globalization is driving market liberalization at the national level. The popular story is that governments are doing just fine on their own, but are being forced into unwanted and harmful reforms by international pressures.

In reality, most reform is driven by purely domestic needs: stubborn levels of structural unemployment, lagging growth rates, diversion of fiscal resources into propping up loss-making state-owned enterprises, and consumer demands for innovations like mobile phones and cheaper services and products.⁵⁴

Likewise, most benefits of reforms are enjoyed by domestic consumers and producers. It is for domestic reasons that supply-side reforms to stimulate competition and reduce regulatory inefficiencies have become central to effective economic policy.⁵⁵

The real policy challenge today is not resistance against a ruthless programme of deregulation driven by markets. The challenge is to manage the quality, transparency, and effectiveness of the burgeoning regulatory state to ensure that the new kinds of regulations and institutions contribute to social and economic progress. The real problem may not be the size of the state (as suggested by those who focus on deregulation or regulation as a test of effectiveness), but the effectiveness of the state itself. In some important areas, such as capital movements and investments, governments have lost substantial control of market decisions. For other reasons, regulatory tools are losing relevance to markets (as factors of production become more mobile and global, and as product cycles shorten) and to civil societies (as societies become more diverse, informed, and oriented toward choice). These forces - weighted against increasing regulatory interventions - must cause us to question traditional methods of state action, and look for new ways to harness markets in the social interest.

“The notion that big intervention of the state associated with economic efficiency, is corrected. The level of intervention cannot be as important as its quality”.⁵⁶ La Porta used institutions as binding element of government. For a better governance better institutions are needed. The economic crises of last decades has shows the importance of state institutions and its necessity control. The set up of the institutions of reform is a precondition to its positive results and implementation of the regulatory agenda.

Today many studies in different fields of economy show that “There are two reasonable explanations to have effective regulatory institutions, *an economic and a politic one*.”

Economic logic is to ask how effectively corrected market failure and how to develop instruments and institutions to correct it.

⁵³ Scott Jacobs (2000), “The Golden Age of Regulation”, f. 11.

⁵⁴ A side effect of liberalisation is that it has allowed national resources are used to support social program. Privatisation in the United Kingdom has transformed many state-owned enterprise, the enterprise exhausted in the state budget to tax-paying enterprise.

⁵⁵ Scott Jacobs 2000), “The Golden Age of Regulation, f. 12.

⁵⁶ La Porta et al (1998), “The Quality of Governement”, f. 16.

Politic logic asks if and how the politic should delegate the power to independent institutions such as regulatory structure and commissions. Both approaches are complementary and have much in common.⁵⁷

According to Cesar Cordoves the four core functions of an oversight body that should be assigned for a successful reform are: 1. Co-ordination and supervision, where government has the purpose to implement and monitor a regulatory policy through setting up the procedures and machinery to ensure the quality of new or existing regulations.

Main instrument are RIA Regulatory Impact Assessment, administrative simplification and standard cost model (SCM). 2. Challenge and scrutiny, first based on an independent assessment on the quality of a regulation (*i.e.*, RIA, SCM calculations) The oversight body advises the government and seeks support from other ministries for its view about the quality of a draft with (but sometimes without) approval from the drafting regulator.

A *second* and rarer implementation of the challenge function is to give special powers to the oversight body to enforce quality criteria or a specific programme.

3. A third function of an oversight body is to assist regulators in improving the quality of their regulations. Key support tasks include the publication and dissemination of extensive written guidance and manuals. As well conducting training on regulatory quality issues has been an important way to support regulators in complying with new disciplines, and to raise awareness and promote a cultural change among regulators and regulatees. Training programmes are organised into three types:

- a) High level briefing on the framework for best practice regulation requirements;
- b) General training on RIA and use of the Business Cost Calculator (BCC), and a comprehensive seminar series on preparing RIAs, using the BCC and undertaking cost-benefit analysis.
- c) Third level have been engaged in delivering specific expertise to regulators in the context of their development of particular regulations through mechanisms such as a "help desk" which provides expert input directly, or through the ability to fund the employment of outside experts to complete specific tasks.

4. The fourth core function consists in the advocacy function can be internal to the administration, as well as external. Institutions have a mandate to recommend quality regulation through specific deregulation/ reregulation initiatives to ministries, regulators or agencies.⁵⁸

Again, this crisis has exposed a regulatory failure: regulators failed to prevent the exploitation of poor and poorly educated borrowers by lenders. These people were not able to ascertain well the risks associated with various lending provisions, such as variable-rate mortgages with negative amortization, in a period in which interest rates were at a historically low level. The lenders should, of course, have been able to do a better job of risk assessment, but because of another set of market failures, they did not. The result is a

⁵⁷ I. Bartle & P Vass (2007), "Independent economic regulation: A reassessment of its role in sustainable development", *Utilities Policy*, f, 15, 261-269.

⁵⁸ Cordova-Novion, C. & S. Jacobzone (2011), "Strengthening the Institutional Setting for Regulatory Reform: The Experience from OECD Countries", f. 12.

massive social and economic disaster: people are losing their homes and their life savings, and our economy is facing a meltdown.

By its nature, a regulation restricts an individual or firm from doing what it otherwise would have done. Those whose behaviour is so restricted may complain about, say, their loss of profits and potential adverse effects on innovation. But the purpose of government intervention is to address potential consequences that go beyond the parties directly involved, in situations in which private profit is not a good measure of social impact.

“The design of regulatory structures and systems has to take into account:

a) Asymmetries of information, since the regulator is often at an international disadvantage relative to the regulated; b) moral hazard, since there often problems in ensuring that a regulator’s behavior is consistent with social welfare (for example he is not beholden to those whom he is supposed to be regulating); c) human fallibility, since mistakes are inevitable, and we need to minimize the costs of such mistakes. Well-designed regulation takes into account the limitations of implementation and enforcement. While no regulatory system is perfect, economics with well-designed regulations can perform far better than those with inadequate regulation. Regulation can both enhance markets and protect those who might otherwise suffer in unregulated markets.⁵⁹

In the last decade regulation as an instrument to achieve economic and social targets, has increased dramatically. The element that leads regulations is the private behaviour regulation. This type of arrangement became a fundamental tool of government in the management of complex societies and various thereby allowing competing interests to be balanced.

In short, regulation is necessary because social and private costs and benefits, and hence incentives, are misaligned. Such misalignment leads to problems not only in the short run but also in the long run. Incentives to innovate are distorted.

In recent assessments of the European Commission “better regulation remains an important instrument contributing to the policy for strengthening competitiveness and supporting sustainable growth and employment.”⁶⁰

Regulatory reform started at 70s is not a single effort, but a dynamic, long-term effort, and a multidisciplinary process. Since the beginning it showed that it would be enduring and perhaps forever. In the field of business it took a fast developing, particularly in Eastern European Countries, due to the opening of markets.

Since the 1980s ...governments have adopted the term as part of an effort to improve service to the public, but on the other side regulation is considered as a tool to reduce administrative barriers and to provide a more structured environment and a friendly policy to investors.⁶¹

⁵⁹ Joseph Stiglitz (2009), “New Perspectives on Regulation”, f. 12- 21.

⁶⁰ European Commission (2010), “Better Regulation”, f. 29.

⁶¹ Frank Sader (2000), “Do One stop shops” Work?

In general every government, trying to reduce bureaucracy, by means of implementing cost-effective administrative arrangements and removing administrative barriers in many areas of activity.

Administrative barriers issues are resulting very problematic after the year 2007 Attention has focused to reducing administrative barriers on trade, investment and venture. Many developing countries gave the priority to removing bureaucracy. In this sense, the removal of barriers is only one part of a number of policies designed to increase performance and productivity, and thus can not be treated as a separate issue, or particular issue.⁶²

In this literature review the question that arises is how this reform, already launched in Albania, has helped to improve the business climate, namely by simplifying administrative barriers, which at the beginning of 2005 had become unaffordable by business.

What's the contribution of reform instruments such as one stop shops or guillotine to reduce administrative barriers in Albania and how they are implemented, based on theoretical definitions and experiences in many countries?

2. Red-type concept/administrative barriers, reducing and their measurement

Business regulation has been on the international agenda for several years but they a large part of the countries seeking to develop successful reforms remain so even today. Most governments wish to create an environment that will strengthen development and ensure the growth of a competitive business sector. Good competitiveness requires good framework conditions and a focus on the regulatory environment.

Nowadays business barriers considered:

- Dynamic development and complexity of advanced societies creating an ongoing need for new regulation
- Lack of effective voices on the part of the business community
- Vested interests in maintaining laws within the business community
- Conflicting policy goals
- Reducing "red tape" for businesses which is not core business for lawmakers
- Lack of clear responsibilities on the part of public authorities
- Lack of coordination between public authorities
- Time pressure in the law process.

This list of barriers shows that there are significant obstacles on the path towards better business regulation and fewer administrative burdens. Recognition of the existence of these barriers is a first step on the way to alleviating the "red tape" problem.

Creating an effective organizational framework is imperative in the effort to reduce administrative burdens. Dedicated institutions with sufficient resources and efficient instruments are necessary to change the conduct of government institutions, and convince officials that the improvement of business regulation and the reduction of administrative

⁶² OECD Report (2006), "Cutting Red Type: National Strategies for Administrative Simplification", f 108.

burdens is an important consideration in the law preparatory work. Organizational structure and incentives are closely connected, since the creation of effective organizations to improve business regulation and reduce administrative burdens is not in itself a guarantee that action will take place. It needs to be followed by strategies and incentives to effectively engage the relevant government institutions (line ministries, departments, etc.) in the efforts concerning better business regulation.

The motto "Less paper = less work" is the fundamental objective of this new concept of Regulatory Reform. Red-type is a priority of the political agenda. Business and citizens complain that they spend more time and devote significant resources to activities such as filling out forms required to obtain a permit or license, business information reporting, notifications of changes etc.

Red type is costly, not only for the time and money spent on applications filling, but also in the context of reducing the productivity and innovation in business. Particularly for small business this is a burden and simultaneously discourages the people who want to start a new business. These effects are more expensive in global markets, where the efficiency of internal regulations and administrative environment can affect business competitiveness.⁶³

Many governments are now embedding programmes to cut red tape within their overall regulatory quality systems. In the past, administrative simplification was often undertaken on an ad hoc or sectoral basis. This contributes the most significant innovation of recent years: a break with the past. Strategies to simplify regulations focus on two dimensions:

1. Examining the administrative burden that will be introduced by new regulations before they are implemented, and
2. Reforming existing burdensome regulations.

Although the majority of countries still put greater emphasis on reviewing existing regulations than on reforming them, there is a trend towards examining new legislation or regulation before it is introduced to try to minimise any new administrative burdens. This is mainly done during the Regulatory Impact Assessment (RIA) process – an exercise to determine the likely effect of any new regulation before it is implemented.

While the focus of RIAs is not specifically on reducing administrative burdens, they do assist in stemming the tide of new burdensome regulation. RIAs ensure that regulatory proposals or existing regulatory arrangements are subject to a transparent, publicly accountable and rigorous analysis to determine if they are proportional means of meeting regulatory objectives.⁶⁴

Some countries have also introduced special procedural measures to assess the impact of regulation on small and medium enterprises (SMEs) in particular, including the assessment of alternatives that might accomplish the stated objectives while minimising the impact on small businesses. Measuring the burden of regulatory procedures tends to be on business, often with special consideration for small and medium sized businesses, but there has also been a trend towards measuring and reducing the burdens imposed on others, including private citizens and the not-for-profit sector.

⁶³ OECD Report (2003), "From Red Tape to Smart Tape, Administrative Simplification in OECD Countries", f167.

⁶⁴ OECD Report (2006), "Cutting Red Tape: National Strategies from Administrative Simplification", f 108

In many cases, measuring systems are based on the Standard Cost Model (SCM) developed in the Netherlands, which has been introduced or adapted by a number of other countries. The strength of the model is not only its high level of detail in the measurement of administrative costs, but also the fact that the numbers obtained are consistent across policy areas. Moreover, the model allows governments to set numerical targets for burden reduction and to measure progress towards these targets over time.

2.1. What tools can help in cutting red type/reducing administrative burdens?

There are tools that governments can use to cut through red tape, and to ensure that they manage their requests for information and regulatory requirements in a way that minimises the time and resources needed to comply by those affected by the regulations. Such tools or mechanisms not only help ensure that governments can fulfil their aim to cut red tape; they also improve the transparency and accountability of administrative regulations. *The basic tools* used for administrative simplification, such as one-stop shops and process re-engineering, have remained effective

A. Konceptti mbi One Stop Shop-in dhe format e tij.

The term one-stop shop (OSS) originated in the United States in the late 1920s. One-stop shops are single interfaces for business start-ups and have become popular in many economies.

OSS has been since the 1920s⁶⁵, mainly in retail trade. OSS has been a popular idea, but difficult in practice. "By the 1980s, governments have adopted the term as part of an effort to improve service to the public, who had undergone a metamorphosis from simple user or recipient of public services, to clients who were entitled to expect the same standard of service they could expect from a retailer. But on the other hand is considered as a tool to facilitate administrative barriers and to provide a more structured environment and a policy friendly to investors'.⁶⁶

Types of OSS have been different in different countries. The first model was the model "a door" (one door), which means looking to create a one-stop shop, first instincts are often to bring together representatives of various government agencies in one place. This approach is often described as a "door" or "one roof". This model can be relatively easy to implement. Ease is a fact that normally does not require any changes in legislation or ministerial responsibilities. What this model includes it is effective cooperation between different ministries and agencies.

Model window. If, by going through "a door", the customer finds no counterpart some, but only one (or several, from which he can go to each of them), this is a different kind of organization: an approach "a window" or "table". Advantage of an approach "window" is that the officer is authorized to accept documents for government bodies. It follows that the

⁶⁵ Giant Martin (1920), "One-Stop Shopping Solution, Convenience-it's a beautiful thing!", f 41,

⁶⁶ Frank Sader (2000), "Do One stop shops" Work? Washington, D.C.: Foreign Investment Advisory Service (FIAS), f 27

applicant should normally only deal with one person and do not have to go to the tax office or meet with a tax official, or to any other office.

One more stop? In some cases, such as the Enterprise Center Formalities (CFE) established in France, has created a new organization to coordinate the functions of registration. This avoids the need for major restructuring of the primary bodies responsible for registration. "In terms of administrative activity, it can be considered as "one more stop", because it adds a new function, without any corresponding reduction elsewhere. This means that it includes an increase in the cost of administrative functions and reduces deadlines only to the extent that it allows functions to set or return back provides a one stop shop making you flatter other agencies to speed up their operations. On the other hand, from the standpoint of the applicant still has the advantage of being able to deal with a single organization".⁶⁷

However one-stop-shop (OSS) is one of several government institutional substitutes often adopted to circumvent or to speed up existing procedures where they are not functional.

In practice all governments that tried to implement this form of OSS, encountered considerable resistance to various government agencies responsible for various administrative procedures. Most important was that ministries and other agencies feared that the creation of the OSS such an act would result in limiting their authority and mandate, which would quickly lead to intense ground battles within the government bureaucracy. Issue becomes more important if such an OSS is politically feasible, so if a single agency should actually be given that much authority and power. Therefore the government usually stays away from placing such a structure, OSS, in the strict sense. Instead it tends to rely on a form coordinating mechanism where various authorities maintain their mandates and responsibilities of existing.⁶⁸

Concept One-stop shops became popular in 1980 as a tool to encourage investment, often as a substitute for investment promotion agencies. The basic idea is that an investor would only need to be in contact with a single entity to obtain all necessary documents in a process of effective and coordinated, rather than go through a maze of different governmental bodies. So one-stop-shop provides a place where businesses and citizens can obtain all the information necessary for their questions, or can perform various transactions, such as complete an application.

OSS concept further hiked in 2008 where three were key elements: i) OSS communications services to investors, which is mainly related to communication channels (media, radio, television, newspapers, magazines); ii) Facilities for the purchase of land for investment projects, and iii) OSS coordination with line ministries.

B. Guillotine and basic concept

Giving Guillotines concept takes a special importance for two reasons: The first has to do with the clarification of the concept of guillotine, that despite the underlying is the word

⁶⁷ Investment Climate Advisory Service/ World Bank Group (2010), "How Many Shops in One-Stop Shop" A Review of Recent

Developments in Business Registration, f.4.

⁶⁸ Andrew Stone (2006), "Establishing a Successful One Stop Shop: The case of Egypt", f.5.

elimination, removal or cutting, it has not to do with the concept of a guillotine, human eliminating, used for the first time in 1793 in France in the period the monarchy. This phenomenon has given that term negative sense. Second, to make more informed than that which will be discussed below, is the regulatory guillotine as economic concept and directly relates to regulatory reform.

"Regulatory Guillotine⁶⁹" is not something new. It was used in some variants in the past 20 years."First successful pioneering used the guillotine has been the Swedish government in 1980, which was faced with regulatory confusion caused by a century of accumulated rules. So basically it was a legal reform. In 1990 it was used by Mexico and in the late 1990s was implemented in South Korea, including the reform of the financial crisis.⁷⁰

Guillotine is an innovative instrument of reform that is designed to overcome the difficulties imposed by extensive reforms and regulatory support and accelerate reforms of the business environment in the future.

In 2000, Jacobs and Associates Inc...assesses experiences and develops a more systematic strategy guillotine mainly for countries in rapid economic transition towards market moving. In the period 2003-2007 the guillotine was applied successfully in Ukraine, Moldova, Kenya, Croatia and Bosnia. The guillotine process is based on three strategies:⁷¹

- A *political strategy* that sustains vigorous top-down political support from the prime minister and key ministers, and builds public support for radical reform affecting many stakeholders;
- A *legal strategy* to create an over-arching legal framework that enhances legal security and transparency, rather than creating legal chaos;
- An *administrative strategy* to carry out a highly structured "top-down" review process with clear filters and incentives for reform.

There are strong reasons why the guillotine has become essential in the field of reforms. Many countries that have made progress in improving the regulatory environment for business recognize that, despite their efforts, the economy continues to suffer from high-cost and high-risk regulatory environments that deter investors. Entrepreneurs and international indicators agree that that there is still much progress to be made in making many national economies an attractive place to do business. Meanwhile, competition for markets and for foreign direct investment is intensifying throughout the world.

The guillotine eliminates and simplifies many regulations in a short period at low cost, while strengthening the government's ability to focus on regulations needed to protect health, safety, and the environment. If the guillotine is successful, the costs and risks of doing business in the national economy will be visibly reduced, improving competitiveness, investment, and job creation.⁷²

⁶⁹ Koncepti "Gjotinë Rregullatore" është markë tregtare e Jacobs & Associates Inc.

⁷⁰ Scots Jacobs, Jacobs & Associates, & Irina Astrakan (2006), "Effective and Sustainable Regulatory Reform: The regulatory Guillotine in Three Transition and Developing Countries", f.18.

⁷¹ Scott Jacobs (2005), "The Regulatory Guillotine Strategy" Preparing the Business Environment in Croatia for Competitiveness in Europe", f. 10.

⁷² S. Jacobs/ Jacobs and Associates (2008), "The Regulatory Guillotine; A National Commitment to Better Regulation", f 2.

Regulatory Guillotine is a quick way of achievement, approaches that can deliver short-term results. This combination of simplicity and speed, and the results achieved to date, provide a relatively promising premise for reform, and for the use of her achievements as a basis for further reforms. Regulatory Guillotine is a simple and fast testing tool.⁷³

The regulatory guillotine is a *flexible* method but is specifically designed through a precise sequence to produce good results even where resistance is high. Essentially, it is a means of rapidly reviewing a large number of regulations, and eliminating those that are no longer needed. It counts the regulations that exist, and then reviews them against clear criteria, using an orderly and transparent process built on extensive stakeholder input.⁷⁴

The regulatory guillotine is intended for those situations where governments are moving rapidly through transition process from state-led growth to market-led growth. It is based on the view that the regulatory reform is vast and systematic, and that isolated and marginal reforms must be replaced by board-scale and systematic reforms that extend across the public sectors. It is expressly designed to:

- Reverse incentives in the reform process, and so overcome some of the barriers that have slowed or blocked board-based regulatory reform in the past. These barriers include high political and administrative costs, intense and passive insider resistance to change, and lack of planning on how to sustain change into the future. It is designed to reduce the costs of reform within a political and legislative system that is already overburdened with difficult reforms;
- Create a sustainable process for the future quality control and legal security, mainly by establishing a quality checklist and review process and creating a comprehensive and central regulatory registry with positive security;
- Create the institutional infrastructure for continuous and effective regulatory reform implementation, including establishment of mechanisms of interministerial coordination and cooperation, strengthening the engines of reform, and building core capacities for regulatory analysis.

A rapidly spreading regulatory reform tool is the Regulatory Guillotine, a reform strategy used by OECD countries in the 1990s, and extensively refined, and systematized by Jacobs and Associates to speed up regulatory simplification and highlights the positive sides:

1. Produces rapid results (4-18 month) in cutting hundreds or thousand regulations and reducing regulatory costs on business;
2. Improves management of regulation by producing of comprehensive map that can be used to create an electronic registry;
3. Increases reform capacities by reducing the politically and administrative costs of reform and eroding the capacities of insiders to block change;
4. Creates the political economy and organization for continuing “better regulation” reforms;
5. Stimulates public participation and the support of active private partners for reform that are useful in sustain momentum for “better regulation” tools such as RIA.

⁷³ Scott Jacobs/World Bank (2006), “Business Licensing Reform: A Toolkit for the Development Practitioners”, f17.

⁷⁴ Scott Jacobs & Cesar Cordova, Jacobs and Associates (2008), “Regulatory Guillotine Flyer, a National Commitment to Better Regulation”, f 12.

With these results we can say that the guillotine enhances the credibility of the reform strategy and the potential for further reforms, more aggressive in the future. Guillotine process has not always a complete success. He has weakness that the government should decide on its plan to correct in the next stage of reform.

Guillotine review requires about 4-6 months preparatory and it requires about 10-12 months to be completed depends on the number and complexity of the instruments under review. Guillotine is designed to work quickly and must be completed within 18 months.

So guillotine is only one step in the long process of preparing the administrative arrangements to use wisely.

C. Process re-engineering

Process re-engineering, as its name implies, refers to simplifying an administrative process, such as applying for a licence, and is principally used in cutting red tape for business.

What has changed in recent years is the increasing use of technology in cutting red tape. One-stop shops, whether for filling out a tax form or applying for a business licence, are increasingly offered online rather than in a physical office, for example. This raises issues of co-ordination among ministries and government agencies. E-government services may be increasingly linked in future to provide a “whole-of-government” access point.

Many of the tools and programmes developed in different countries have focused on reducing administrative burdens imposed by the central government. But there has also been an increasing trend towards considering the burdens imposed by lower levels of government and to adapting and using the simplification tools that have been developed and tested at the central government level at lower levels as well.

The focus is not entirely on the use of electronic methods of achieving burden reduction, however. Process re-engineering, including the simplification of licensing procedures, continues to play an important role in reducing administrative burdens but more could be done to reduce burdens imposed by lower levels.

3. Achievements of the national registration centre

NRC is the only institution responsible for business registration in Albania. It serves as one single window where all processes of business registration are carried out, including the registration fees for the effect of national and local (municipal) level, social and health insurance and labor Inspectorate.

Currently, the institution develops its activity in 31 offices across the territory of the Republic of Albania. NRC operates on the basis of an integrated electronic system that performs data link between all service windows NRC headquarters in Tirana. It is created in accordance with standards and best practices for electronic business registration with the support of the Millennium Challenge Agreement for Albania.⁷⁵ Today, through the new system of registration to NRC, the business has possible to register within 24 hours and only via an

⁷⁵ NRC Report for METE 2010, page 2.

application form, which costs only 100 ALL, provided that the law 9723 dated 03.05.2007 "On the National Registration".

On this basis, starting businesses registered for the period 2008 were registered 17,773 businesses, 2009 were registered 13,240 businesses, and for 9 month period of 2010 were registered 12,891 start-up businesses.

This system is able to arrange the data in the correct way and give the opportunity to inform group of interested in real time regarding the status of their application. Full computerization of existing data according to court records archives makes it possible:

1. Giving the extracts of data registry on the electronic way.
2. Minimizes time delivery service and the time to review the application of registration specialist.
3. Enables simplification and standardization of business registration procedures

Also, the NRC has failed to meet the commercial register in electronic form by throwing all the existing data of the subjects being realized this goal in a short time. Publication and dissemination of data and supporting documents to enable the protection of third parties, is one of the main principles of the NRC. This publication has increased transparency and confidence on the part of the procedures offered by NRC. NRC has created opportunities for businesses to submit balance sheets in an electronic format which has bilateral impacted directly and is also in favor of subjects and the work of the NRC. Implementation of electronic data system is intertwined with the NRC's achievements since its creation has led to increasing transparency and reducing corruption in the context of Albania's objectives in this field.

As a result of the implementation of NRC electronic system performs on real-time all changes and deregistration that companies make.

Changes and deregistration for the period 2008 till 2010 were: in 2008 were changed 13,763 businesses and 3,597 were deregistered, in 2009 were changed 15,775 businesses and 5,449 were deregistered in 2010 were changed 14,040 businesses and 3,056 were deregistered.

The Albanian Government immediately after the approval of NRC law proceeded with the approval of law no. 9880 "On electronic signature "that took place on 25.02.2008 and the law on Bankruptcy on May 2009, which further facilitated the work of the NRC. Referring Doing Business Report of World Bank 2011, Albania has improved also 4 other places in the rankings, which except 5 features (simplification of formalities in recording, recognition and improvement of procedures on line, removal or reduction of post registration procedures, establishment or improvement of OSS, as well as removal or reduction of minimum capital requirement) described in this report, has influenced the improvement of tax payment system⁷⁶. In fact the reforms undertaken by Albanian Government to improve the business climate have affected especially in improving the image of Albania in the eyes of foreign investors.

⁷⁶ Doing Business/World Bank 2009/2011, page 19

3.1. What are the achievements of the NLC today?

National Licensing Center (NLC) - has today, 10 wickets in Tirana and other cities. Based on law no. 10081 dated 23 February 2009 "On establishment of the National Centre of Licenses and Permits in the Republic of Albania", opened the way for reforming the licensing system as discussed in Albania. With the introduction of this law it was reduced the number of licenses and permits from 200 to 64 categories and sub-categories only, 46 of which are issued by the National Licensing Centre.

Even the center, as the NRC has basically one-stop service shop (with one stop only), which constitutes one of the essential issues of deregulation system in Albania. NLC offers shortened procedure, rapid and transparent, reducing the costs associated with the process of licensing which costs 100 lek for businesses, thereby removing most of the administrative barriers, reducing the degree of informality and in this way has significantly improved the business climate in Albania. This was achieved with the operation of the center starting from June 9, 2009.

According to the aforementioned law licenses, permits and authorizations in Albania are divided into three main groups. In the first group entered the permits and licenses issued by the NLC in collaboration with other institutions, in the second group included only given licenses by the NLC. Licenses/permits of group 1 and 2 are examined and approved by the NLC. Legal deadlines for their adoption are respectively no longer than 2 and 4 days. The third group includes licenses/permits that require the approval of other government institutions. Legal terms for this group rang from 10 and 90 days.

Survey to monitor the performance of the NLC in the period April-November 2010, conducted by Partners Albania, Center for Change and Conflict Management, with the support of "Threshold Programme of the Millennium Challenge Corporation" for Albania II, it was proven that and an increasing number of businesses are using large counters NLC regional districts for their licensing needs. While over 95 % of respondents stated that licensing procedures with a stop are "very clear" or "obvious". (Page 5) 84 % of respondents stated that the application for a permit / license new is "easy" or "very easy". Approximately 70 % of respondents consider it "very easy" to get a response from NLC staff and that they were "satisfied" or "very satisfied" when asked about the general experience with the NLC. 34 % of respondents were using the website to NLC to obtain information on licensing. 84 % of respondents who need a license / permit before the foundation NLC accept that NLC has significantly reduced the time and effort to get a license / permit in Albania.

The license of the third group remains increasingly difficult due to the complexity it presents. So by 12 % of respondents have visited NLC three or more times to get a license and a third group that 6 % of them find it difficult or very difficult" to apply for a license / permit group third.

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THE CONSEQUENCES OF THE GLOBAL CRISIS OF 2008 ON ROMANIA

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ABSTRACT

Within the global economy of nowadays, related to some unprecedented interdependencies between the world countries, between the individuals and organizations, the global crisis launched in 2008 on the American economy (as matter of fact, the moment of launching was the last quarter of 2007), has been extended really fast, even if not of the same intensity, on the entire world. The hypothesis of launching the crisis, meaning the so-named “high depression”, towards the end of the last century, was especially known by governments, central banks or various governmental agencies; many studies have invoked this hypothesis, even explicitly (Röpke, 1936; Schumpeter, 1939; Mitchell, 1954; Friedman, 1987; Samuelson, 2001 etc.), where the economic cycles were unanimous accepted as part of the capitalist economies dynamics (Juglar, 1862; Kondratieff, 1925; Kuznets, 1930; Schumpeter, 1939 etc.). “The only surprise related to the economic crisis of 2008, according to Stiglitz, was the fact of surprising so many people”; this time, the crisis was launched on the immovables market in the banking sector, which financed this market, since almost two thirds of the American economy has started to be addicted to the immovables (the construction of buildings, the endowments, purchasing and mortgages on consumption etc.).

As regards the analysis of crisis over the European Union member states, and separately over the main states included within the Euro Region context, “the pattern” of current global crisis appearance has been significantly different for the countries in the Central and Eastern Europe. For some countries of this part of Europe (as Poland, Romania, Hungary and Bulgaria etc.), one might carry out an estimation about the comparative impact induced by the global crisis, and as result, consequences relatively proximate from one country to another; they adhered lately to European Union, and are not yet part of the Euro Region. Although, the presumption invoked should be regarded carefully, since the impact of the global crisis was significantly different to the countries placed in this region of Europe. These countries have felt and managed in a relatively different way “the shock” induced by the global crisis, from one case to another. The same effects of the crisis have been rebounded in a more severely way over another countries, such as Japan or India, and relatively moderate over some countries, such as China, Russia or South Korea.

Keywords: Global crisis; macroeconomic indicators; unemployment; external trade; public debt; budgetary deficit.

JEL codes: A1, E3, F5, H6.

Introduction

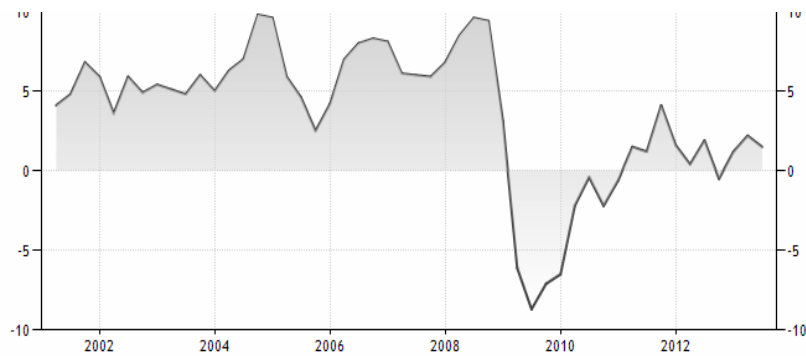
As in other countries of the region, Romania has been vulnerable along the economic crisis that was launched in 2008 in USA. One should mention that the GDP progress expressed in absolute terms in Romania has indicated an increase as comparing to 1990; during the interval 1990-2000, the year rate of the GDP was oscillating, but starting with 2001 and up to 2008, an ascending trend could be seen, as regards the economic growth in Romania (in 2008, when the crisis was in progress of strong appearance, in USA and other occidental countries, Romania registered almost 8% of the growth rate of GDP). In order to understand the moment when the global crisis was felt within the Romania's economy context (as well as the intensity wherewith this was subsequently behaved), one should take into account that the government and the banks have encouraged the access to credits and the purchasing on the immovables market, at least until 2008; the easy access to credits has encouraged the aggregate consumption, but even the tendency towards the unsafe speculations, as happened over the wide world. In other words, starting with 1990 and until 2008, the immovables market of Romania has registered a relatively ascending rhythm; in an absolute similar way with the situation of other countries, the hypothesis of a collapse of prices within the immovables will not enter in the individuals or organizations calculus at the moment 2007-2008.⁷⁷ Moreover, 2008 signified the elections time for Romania, and the executive authority preferred (perfectly comparative to the government-citizens relationship from the occidental countries at the same moment) to transmit some messages, extremely optimistic, towards the people, as regards the Romanian economy perspectives. The reality that followed within the crisis in 2009 and up to present of our country has definitely contradicted the optimism manifested in 2008 by the government and other institutions; the economic and social costs of this "discrepancy" occurred in almost one year as regards the accepting the idea of economic crisis will be able to be evaluated more rigorously by the historians.

Effects of the economic crisis

The distortion of the economic activity signifies one of the first effects that can be noticed, effects induced by the economic crisis over the Romanian economy since 2009 (the impact was tuned by almost one year, in terms of "forcing" the economic growth by the government, which was visibly not sustainable, as happened in other countries). During 2009-2011, the year rate of GDP growth was reduced beneath the level of the general trend, which obviously indicates the existence of the economic depression. Although there are no tendencies of economic refreshment, the estimations for the following two years will not suggest the significant improvement of the Romania's situation; contrariwise, it is estimated that the growth rate of GDP, although positive, will continue to be reduced at least until 2015.⁷⁸ The progress of the year growth rate of GDP in Romania is emphasized in graphic no.1.

⁷⁷ Lybeck Johan A., *A Global History of Financial Crash of 2007-10*; translation from Romanian of *Istoria globală a crizei financiare (2007-2010)*, Polirom, 2012, pp. 106-107

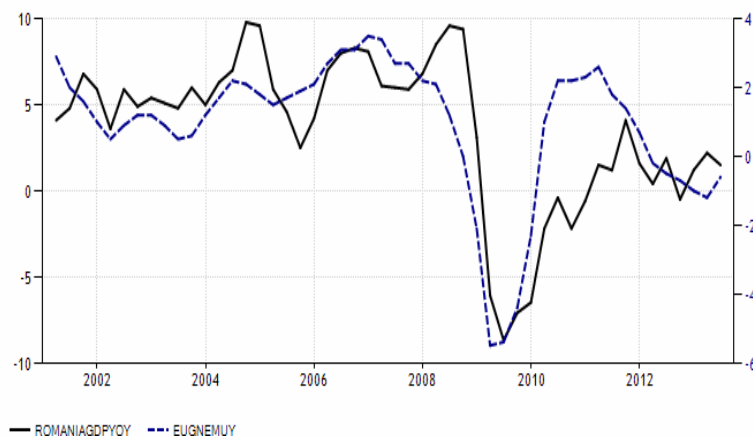
⁷⁸ <http://www.tradingeconomics.com/romania/forecast>

Graphic no. 1. The progress of the GDP growth rate in Romania, during 2000-2013 (%)

Source: www.tradingeconomics.com

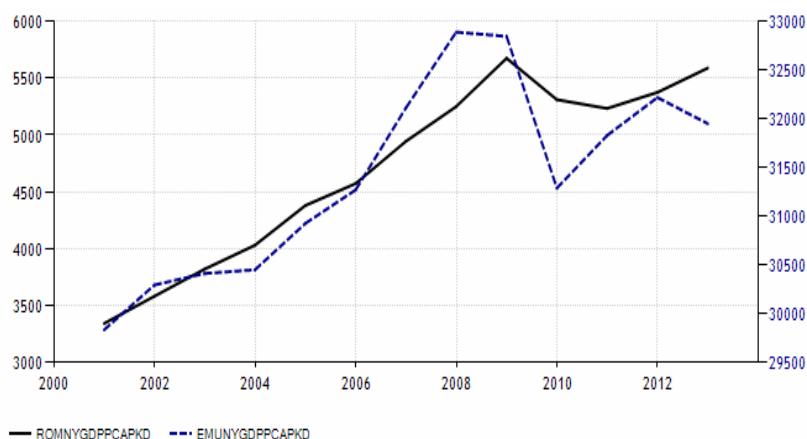
The economic activity distortion was generated by the reduction of industrial manufacturing and the processing industry. According to the National Bank of Romania estimations, the notable contribution to such trend was known within the agricultural sector, fact that illustrates the existence of a strong correlation between the internal economic growth and the agricultural production in Romania. Regarded from the requirements point of view, the temporization of economic growth was also intensified by the reduction of investments requirement and the net exports (as result of reducing the requirements aggregated on the international market). The demand on consumption goods was situated on an easily ascending trend, being supported by both the governmental sector and the private sector, as well; as regards the requirements on the long lasting products, it was limited by the process of financial disintermediation, as well by the tendency of intensifying the predisposition towards saving.⁷⁹

The trends occurred within the economy of Romania have followed a relatively comparative trend with those registered by the economy within the Euro Region, as can be seen by the following graphics (the year rate on GDP growth and the average growth rate of GDP per capita; the second indicator illustrates a ratio of almost 1:10 between Romania and the average of the Euro Region).

Graphic no. 2. The progress of the GDP growth rate in Romania comparative to Euro Region 2000-2013 (%)

Source: www.tradingeconomics.com

⁷⁹ ***Year Report 2011, 2012, National Bank of Romania, www.bnro.ro

Graphic no. 3. The progress of the GDP growth rate per capita in Romania comparative to Euro Region. 2000-2013 (USD)*

* Note: The values mentioned on the vertical left axis correspond to the GDP per capita in Romania (between 3000 and 6000 USD); the values in the right side correspond to the Euro Region (between 30.000 and 33.000 USD).

Source: www.tradingeconomics.com

The indicators invoked in graphics no.2 and no.3 will be taken into account, since they emphasize by de facto that once becoming member of the European Union (2007), the Romanian economy has followed closely the trend of the macroeconomic indicators within the Euro Region, even if Romania hasn't adopted the Euro currency. A series of questions, such as "Which are the real perspectives for Romania, in order to manage simultaneously the economic crisis, wherewith this is confronted, and to manage a potential process of adhesion to the Euro Region, as well?"; "It is preferably for Romania to postpone the adhesion to the Euro Region, by taking into account the hypothesis, according to which Romania can be better protected, if it would not be addicted to BCE?"; "Can Romania stake on a financial external support, quite significant in order to manage more easily the effects of the global crisis?"

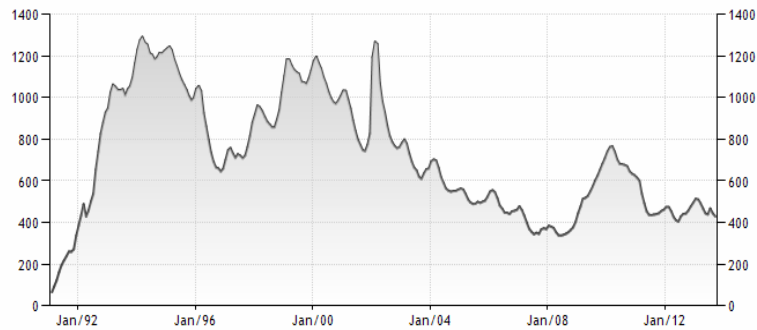
Any attempt on formulating an answer to so many questions, on the above mentioned type, should take into account the current realities of the Romanian economy, and that the total debt of government reported to GDP is still on a low level (In Romania, the percentage is almost 40% of GDP, as comparing to Italy, Portugal or Greece, countries where the indicator has exceeded the value of 100%; Annex no.1), as well as *the fact according to which the surpassing of an economic crisis will remain essentially addicted to the government actions and the behavior of the organizations or individuals from any country that is confronted with such a disequilibrium*).

Finally, in order to describe concisely the current state of the Romanian economy, within the crisis context, we included in our analysis a radio-graphing as regards the unemployment, the external trade, the public debt, the budgetary deficit and the inflation rate.

The unemployment has started to grow simultaneously with the propagation of the crisis effects; although, the recent progress has confirmed a trend of recovering; but, though the number of people employed has followed an ascending trend, the modest economic growth proves to be unable "to absorb" from the labor force excess, already existing at the level of

Romanian economy (situation emphasized in graphic no.4). According to the estimations of the World Bank, this ascending trend will be maintained in the following years in Romania as well, on extremely pride-less limits.

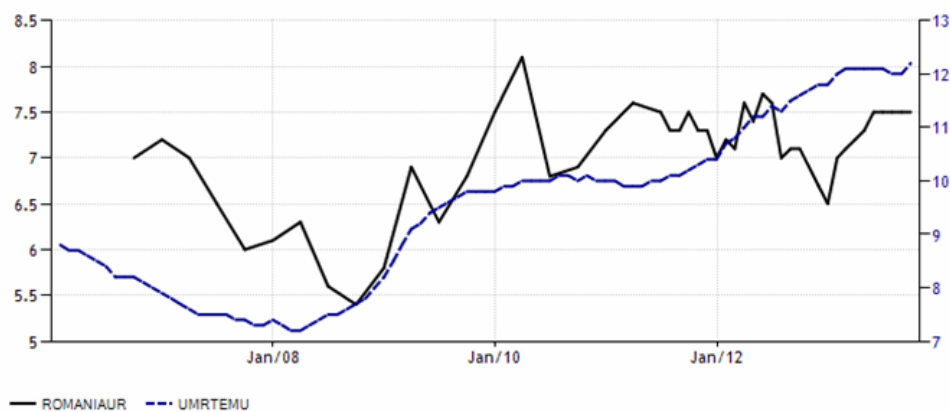
Graphic no. 4. The progress of unemployment during 2000-2013 (thousands of people)



Source: www.tradingeconomics.com

In contradistinction to other indicators that emphasize the economy's status, as regards the unemployment in Romania, this has registered a relatively more favorable trend as comparing to the Euro Region (almost 7-8% the year rate, towards 10-12% in the Euro Region), fact that can indicate a tendency of economic recovering, more pronounced in Romania, rather than in countries included within the Euro Region.

Graphic no. 5. Progress of the unemployment rate in Romania as comparing to the Euro Region. 2006-2013 (%)

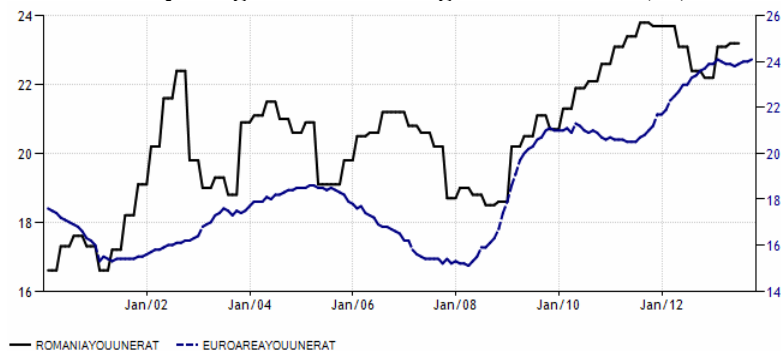


Source: www.tradingeconomics.com

Notwithstanding, an easy comparative analysis of the yearly growth trend related to the number of unemployed actually "hides" so many different structural behaviours in Romania towards the Euro Region, concerning this indicator. During the times of economic crisis, one of the classes more affected by the unemployment growth are represented by the young people; the statistic data indicates a very pronounced trend in this direction, at the Romania's level, as comparing to Euro Region. More precisely, as mentioned before, for the most of occidental countries, and for the Euro Region, the unemployment has affected in a

different way the structure of the working people; the evaluations have shown that “the most affected” by the crisis were the young people and the emigrants⁸⁰. For some countries included within the Euro Region (Spain and Portugal, for instance), the official rate of the unemployment was about 25%, but this rate was reflected every year in extremely different ways on social groups; for some periods, one of four young persons was not able to be employed (as previously mentioned).⁸¹ The structural analysis of the unemployment in Romania emphasizes that such phenomenon had extremely negative results within the active people structure (even if the unemployment rate in our country has remained under 10% every year); more precisely, the unemployment has affected Romania, and especially the young people, being on their start on the labour market, fact that brings severe signs on questioning, related to the future of an entire generation. Graphic no.6 illustrates the statistical data that support our previous affirmations.

Graphic no. 6. Progress of the unemployment rate over the young people in Romania, as comparing to the Euro Region. 2000-2013 (%)



Source: www.tradingeconomics.com

The distortion of the external trade in Romania was caused by lowering the easily growing trend of exports on one hand, as result of reducing the demand on the Romanian products outlet, and by the imports restraint, on the other hand. The trade balance was maintained in deficit, but its contribution on the current account deficit was more reduced.⁸²

The deficit of the strengthen general budget of Romania was reduced in the last years, after reaching a significantly maximum in 2010 (9%), but the value was estimated at 2.9%⁸³ in 2013, fact that would mean that Romania aimed on respecting the nominal convergence criteria, which established the maximum level of the public debt, for countries that aim to adopt the Euro currency, as well as on register within the general trend noticed at the Euro region level.

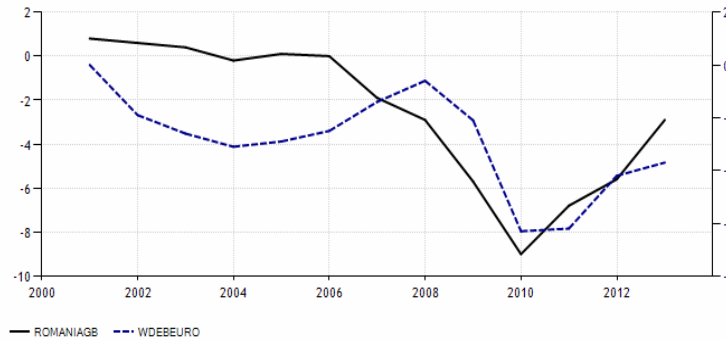
⁸⁰ Keeley B, Love P., *From Crises to Recovery. The Causes, Course and Consequences of the Great Recession*, OECD Insights, 2010

⁸¹ Keeley B, Love P., *From Crises to Recovery. The Causes, Course and Consequences of the Great Recession*, OECD Insights, 2010

⁸² ****Raport Anual 2011, 2012*, Banca Națională a României, www.bnro.ro

⁸³ www.tradingeconomics.com

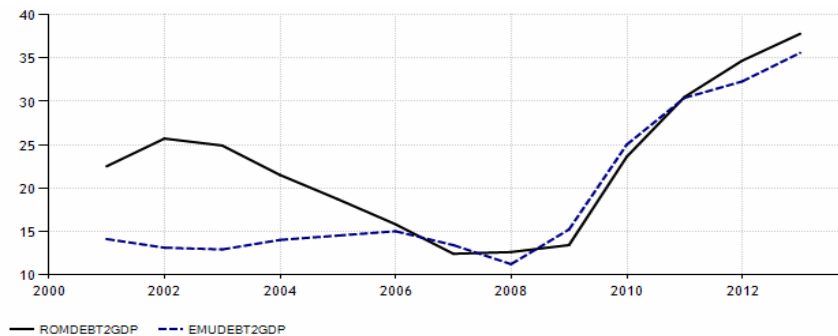
Graphic no. 7. Progress of the budgetary deficit in Romania as comparing to the Euro Region. 2000-2013 (% din PIB)



Source: www.tradingeconomics.com

Another criterion established for the evaluation of public finances sustainability, within the perspective of integrating one country within the Euro Region consists in *the weight of the public debt of GDP*, (maximum 60%); this indicator was deteriorated constantly after 2008, but maintaining on levels lower than other countries included within the Euro Region, as previously mentioned (Graphic no.8, Annex 1).

Graphic no. 8. Progress of the public debt level in Romania as comparing to the Euro Region. 2000-2013 (% din PIB)



Source: www.tradingeconomics.com

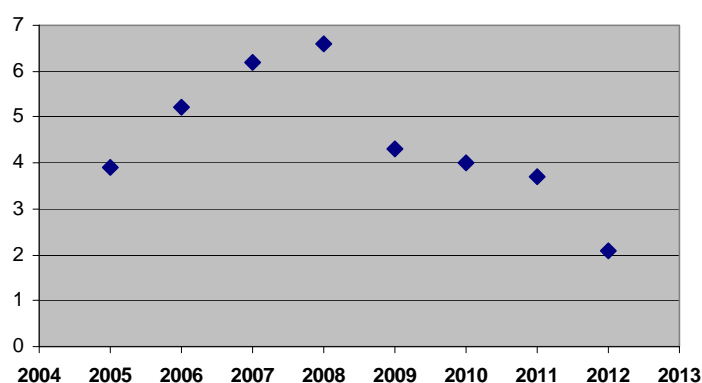
As regards the inflation rate, the situation in Romania followed about a descending trend in 2006, and up to present, with easy year oscillations; one might say that after Romania's adhesion to European Union, the inflationist trends in our economy were lower, approaching by the trend registered at the Euro region level (this happened after starting with 1992, the Romanian economy has had a strong inflation trend during almost a decade).⁸⁴

Finally, related directly to the current realities of the Romanian economy, we will forwards invoke in a concisely way the problems of emigration, within the context of the capitalist economies dynamics. There is no unitary point of view as regards this topic, but more often, the estimations have shown that the countries that accept the emigrants are especially beneficiating and more advantaged by the global competition, as comparing to the

⁸⁴ <http://www.tradingeconomics.com/romania/inflation-cpi>

emigration countries (the issuing countries). This fact took place since the countries that accept emigrants (for instance, USA or Canada) are usually the beneficiary of a high qualified year labor force flow and/or aimed towards economic sectors of hard labor (understanding here that persons that emigrate were trained by the countries that accept emigrants). Although, if we include in our analysis the two well-known economies as models of development within the after-war period (on one hand USA, which receives yearly almost 400.000 emigrants and Japan, for which the legal migration is almost null, on the other hand), one can establish that we cannot identify any direct relationship between the migration phenomenon and the equation of developing a country; and, USA and Japan have always been competitive within the world economy, being equally affected by the current global crisis. As regards Romania, the estimations have shown that the phenomenon of emigration, especially for the young people, has reached a severe level, and the beneficiaries are represented usually by the countries that accept the labor force from our country (most often, such labor force was high qualified in the origin country). On the other hand, the emigrants coming from Romania, similar to the same “specific social group”, were more affected by the unemployment and by the negative effects of the global crisis in 2008, as the OECD⁸⁵ studies reveal. Regarding from the Romanian economy perspective, and analyzing the involvements associated to the migrations phenomenon, one might notice the positive effect of the volume of amounts issued by the labour force that left Romania, in order to work abroad (estimating that a part of these commitments were intended to the productive consumption, by the nature of some immovable investments, by the financial assets acquisitions etc.; moreover, these funds have partially supported the year equilibrium of the external payments balance etc.). Graphic no.9 illustrates the progress of Romanians relegation abroad, indicator that emphasizes quite well the negative effects of the global crisis and over this social group (since the number of these relegations was reduced by about one third after launching the crisis of 2008).

Graphic no.9. Progress of Romanians relegations from abroad (milliards of Euro)



Source: National Bank of Romania

Taking into account the consequences of the most known economic crisis, one can appreciate that in Romania as well, the current economic crisis has followed “the general

⁸⁵ Keeley B, Love P., *From Crises to Recovery. The Causes, Course and Consequences of the Great Recession*, OECD Insights, 2010

pattern”, the trends emphasized within the Romanian economy, by following the tendencies that marked both the European economy, especially the Euro Region, as well as the world economy, per assembly.

Conclusion

The problems related to the occurrence, behaviour and mechanisms of managing the economic crisis has always been a major topic of interest in the entire economic theory, starting with Adam Smith and up to present, even if initially, the theory took into account the economic equilibrium and the cyclic movement of the capitalist economies. Among other conclusions that are imposed, one should also emphasize the idea known in the economic theory, according to which, the cyclic or sinuous movement over the evolution in time of the developed economy or in progress of development can be regarded as a natural movement, no matter the causes or forces that induced it.

ACKNOWLEDGMENT

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***Raport Anual 2011, 2012, Banca Națională a României, www.bnro.ro

Annex no.1

Governmental total debt of some countries during the following period of timen2008-2011

YEAR Country	2008	2009	2010	2011	2013 (estimated)
ROMANIA	12,6	13,4	23,6	30,5	37,8
AUSTRALIA	18,3	24,1	29,3	30,6	
AUSTRIA	66,2	71,4	74	75	
BELGIUM	84,8	89,3	88	91	
SWEDEN	42	42,1	38,7	38,3	
UKRAINE	13,8	24,9	29,9	27,4	
CANADA	44,2	52,6	52,7	52,5	
NEW ZEELAND	37	45,9	49,1	63,9	
GREAT BRITAIN	57,2	73	86,6	101,2	
DENMARK	31,6	40	43,5	50,6	
FRANCE	73,3	84,9	89,1	93,7	
GERMANY	43,1	47,6	55,6	55,6	
GREECE	121,3	136,9	129,2	106,5	157
PORTUGAL	78,9	91,1	94,6	92,5	124
HUNGARY	73,9	82,8	82,7	81,6	
SPAIN	34,2	46,7	48,5	55,2	84
ITALY	107,2	119,1	117,7	110,9	127
POLAND	45	47,1	50,9	54,8	55
JAPAN	153,1	166,8	174,8	189,1	
USA	55,5	67,7	76,8	81,8	101,6
CHINA	19,6	17	17,7	33,5	

THE NATIONAL WELFARE CAPITAL: POST-CRISIS MODEL OF SUSTAINABLE INNOVATION AND PROSPERITY-ORIENTED INCREMENT CLUSTER POLICY

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ABSTRACT

The theoretical and practical aspects of the national welfare capital increasing cluster policy new model are considered in the article in the context of contemporary socio-economic development focus on innovation. Achieved welfare level and the national economy subjects' innovation activity level close linkages on the base of the organizations innovation activity level and Russian Federation quality of life parameters' dynamics analysis are shown. The innovation-reproductive and rent-generating function of national welfare is exposed, necessity and real ways of national welfare innovative potential look-ahead analytical estimates methodology and tools' revision in a context of globalization trends are offered, complex analysis of the results of system parametric indication of the strategy of national welfare development in the innovation economic growth interests on the author's set of instruments ground is conducted.

Key words: National welfare, innovation as a new form of combining industrial, intellectual and social resources; innovation rent; cluster policy model; national economy subjects' innovation activity; expertly-analytical set of tools.

Introduction

The purpose of this paper is to base the necessity and to offer the real ways of national welfare as the integrated innovation-oriented economic development resource methodology and set of instruments revision; to expose the economic content as well as conditions, principles and factors of new national welfare model (which the innovative economic subjects interests coordinates) forming and its role in innovation economic growth valuing. The main research peculiarity is the first time complex approach using which multilateral system national welfare as the integrated innovation-oriented economic development resource from socioeconomic dynamics view indication allows.

Author's approach novelty consists firstly in the theoretical basing of the heuristic necessity of four-sector national welfare model as the innovation-oriented development social-resource component into the state innovation economic trends management system integration. Regularity that the higher national welfare resources into the innovation economic growth factors conversion level the economic subjects innovative activity level growth promotes is exposed and empirically verified.

1. Intermediate results of stages of research

In a context of the modern economic development model the essence of national welfare is expressed in new aspects – it becomes not only the accumulated re-iterative reproduction process result, but also is converted into the integrated innovation-oriented economic growth resource-factor. This conversion is connected with world and national economic systems movement towards innovative «knowledge economy», competition gravity center transference to the science, education, innovative activity sphere, non-material actives role in economic reproduction process increasing.

The resource-provided countries have the export-raw model of economy. Their development may be characterized in comparison with other countries by the rough, spasmodic rate, mainly caused by considerable raw materials prices and economic instability. Such development is inevitably accompanied by the problems which brake economic modernization and its social and innovative orientation. On the contrary, the development of the countries which realize the policy of human capital quality, national well-being, high technologies increment provides advantages in world socioeconomic evolution, raises competitiveness of national «intellectual» economy.

The obvious cyclic nonlinearity of the national economies innovative-focused development dynamic trends which is originally indicated by the national welfare accumulation – consumption relation is opened: accumulated national welfare becomes depleted during the period of stagnation, low rates of economic dynamics (as the result of its part mobilization for economic growth objectives), and, on the contrary, collects and creates the integrated basis of a long-term economy rising trend at the cost of the increasing add-on national income during the lifting period of high growth rates. It is substantiated that sizeable accumulated national welfare rate in highly developed countries creates the definite innovation-oriented economic growth «stability stock», which decreases the depth of the depression in crisis [1, p. 145-150].

The national welfare innovative potential look-ahead analytical estimates modelling tools have to be based, due to the aforementioned facts, upon evolutionary-cyclical, informational-innovative paradigm of the economic development theory and upon resource analysis, in accordance with which national welfare in the post industrial society plays the role of an integrated resource for the innovative economic trends. One witnesses not only a different nature of the input of national welfare into the reproduction process, but its various composition, i.e. apart from traditional material elements, which have cost measurement (revenue level, volume and structure of the personal consumption fund etc.), greater importance is attributed to its social elements – level and quality of education of the population, level of its health, housing conditions, degree of security within the society, quality of the social-ecologic habitat, social capital, social-economic mentality, condition of general and spiritual culture in the society, set of the symbolic benefits etc., which do not have market cost and, often, which have the nature of social benefits, i.e. they create general social conditions for fulfilment of a person, for creative freedom (fig. 1).

*The structure and the functional properties of the national welfare
as an integrated resource of the innovative-oriented economic development*

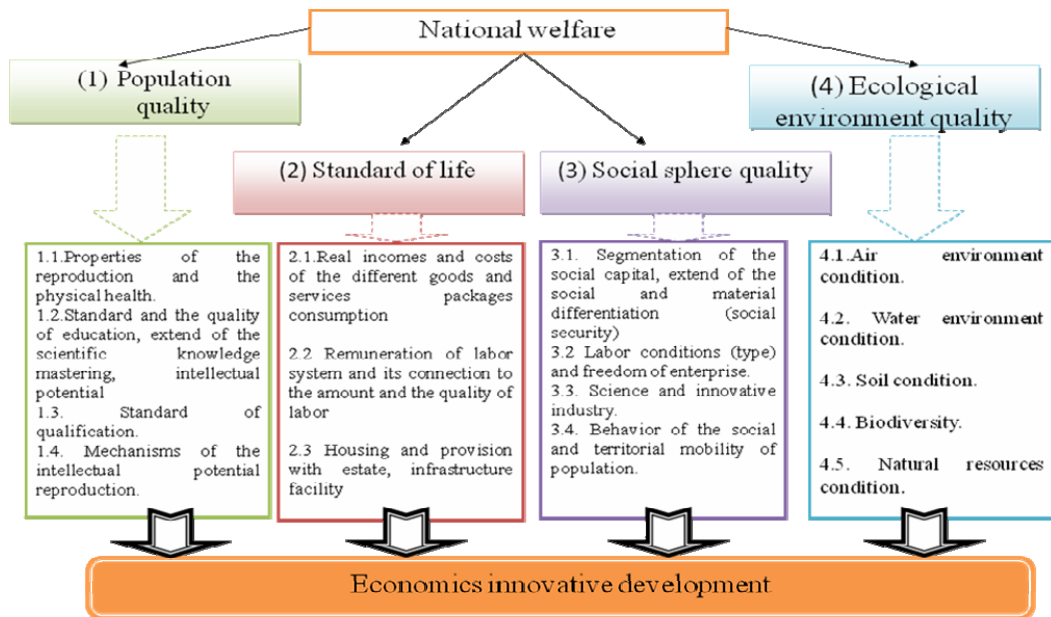


Figure 1 – The structure and the functional properties of the national welfare

The national economy subjects' innovation activity and the quality of life characteristics dynamics analysis revealed a strong correlation between them (table 1), what was the rationale for the quality of life management four-sector model development. The set of instruments integrates the analytical procedures of the quality of life innovative potential complex estimation in the space of the quality of population, material standards of living, the quality of the social and ecological spheres global coordinates as well as the innovative strategies of economic policy forming on the basis of the innovative effect evaluation. The distinguished four national welfare components just define the basic vectors of its accumulation at an initial reproduction stage. They form the potential of innovative economic dynamics rates increasing on the basis of national welfare resources converting into innovative economic growth factors.

The elaborated set of implements allows to analyze efficiency of the existing national welfare resource structure, to expose its limiting components and to form on this basis a strategy for a long-term economic policy, aimed at development of institutions, which increase national welfare resources competitiveness and the level of their conversion into productive sources of innovative economic growth.

A distinctive feature and advantage of the elaborated model set of implements is the possibility to use it in order to accumulate analytical information regarding the results and parameters of economic, social, ecologic strategies related to accumulation and increment of the national welfare resources with the view of achieving a higher national economic dynamics and to thus provide (as opposed to the traditional implements) a more adequate evaluation of the mechanisms used in the state economic policies related to support of the innovation-oriented economic development trends (fig. 2) [2, P. 98].

Table 1 – The pair correlation matrix of achieved national welfare level indicators and the level of economic units' innovative activity

Indicators	Plant facilities' innovative activity level	GDP _{PPP} per capita	Average life expectancy	Gini coefficient	Ecological sustainability index
Plant facilities' innovative activity level	1	0,442	0,393	-0,671	0,324
GDP _{PPP} per capita	0,442	1	0,585	-0,466	0,249
Average life expectancy	0,393	0,585	1	-0,346	0,241
Gini coefficient	-0,671	-0,466	-0,346	1	-0,227
Ecological sustainability index	0,324	0,249	0,241	-0,227	1

The first module implementation results which were revealed by the linear multiple regression model constructing showed that taking into account the Gini Index (monetary income differentiation indicator) and the Environmental Performance Index Human Development Index (GDI) changes the countries' quality of life estimates (fig. 3).

Diagnostics effected on the basis of the set of implements with regard to the national welfare as an integrated resource of innovation-oriented economic development of Russia state-of-the-art within the global coordinates framework (fig. 4) and integral innovative effect of its increment showed that due to realized innovative welfare management strategies (including strategies of a higher level/quality of education and lower sickness rate of the population, higher buying power of its monetary income per person and lower level of poverty, development of the social infrastructure, higher social-territorial mobility and level/conditions of employment of the population, development of smaller business and greater freedom of entrepreneurs, creation of a dynamic information infrastructure and better access to technologies and science etc.), the indicators of the Russian economy subjects may be increased approximately by 1.5 times mostly by means of better social sphere quality [3, p. 34].

The innovative effect due to national welfare increment and its transformation into innovative economy resources indicators: level of economic subjects' innovative activities, level of conversion of national welfare into innovative growth competitive factors, innovative rent capitalization level are the key parameters which characterize the proportions between accumulation and consumption of the national welfare resources state policy.

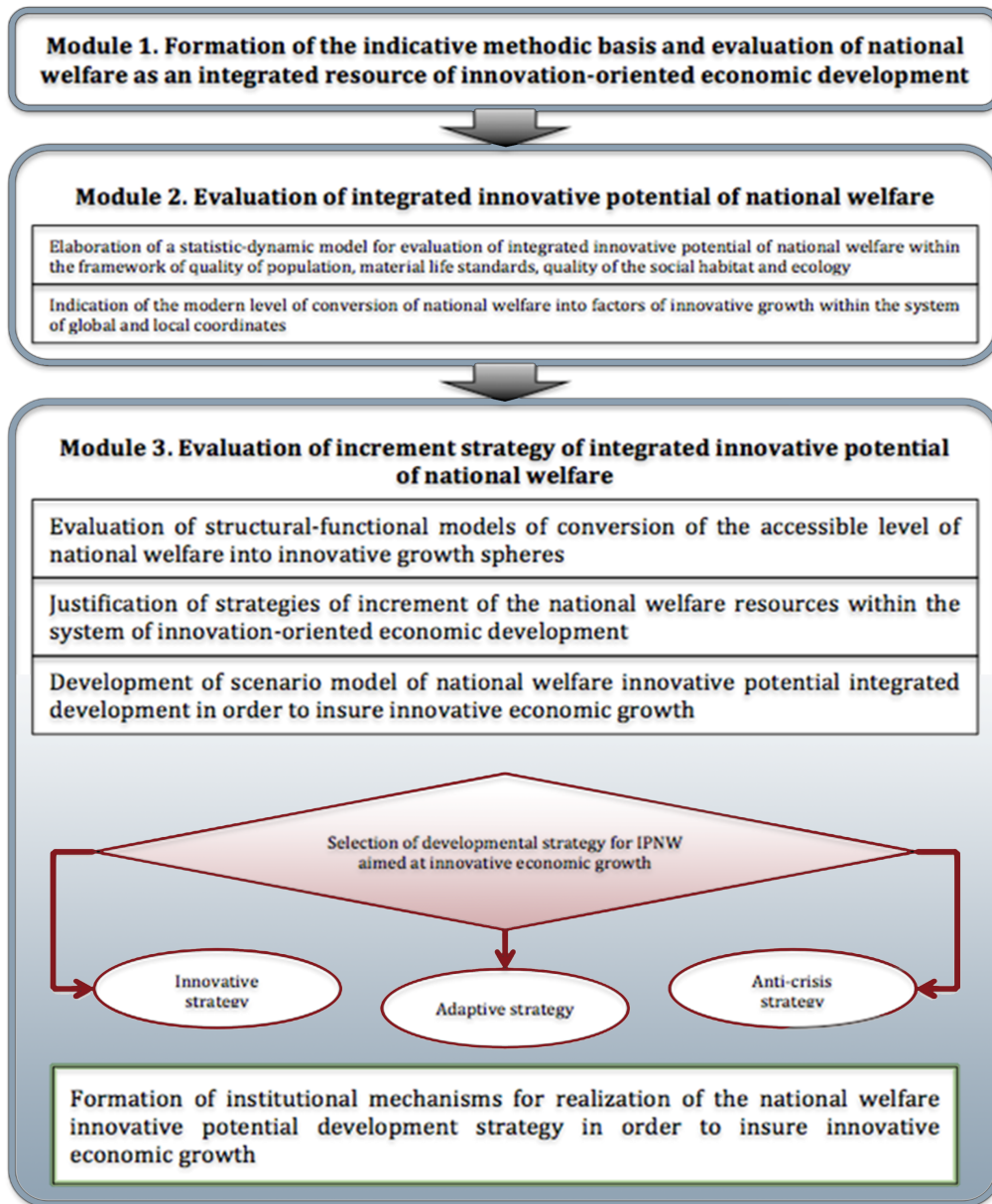


Figure 2 – Model set of implements for national welfare’ innovative potential increment state strategy analytical evaluation

The quotients, calculated (with regard to Russia) with the view of proposed structural model empiric verification and reflecting the dependence between the dynamics of the innovative activity of the economic subjects parameters and the parameters of the national welfare resources (average expected lifetime, GDP_{PPP} per person, Gini index and ecologic stability index) showed that, within the integrated effect indicator among the four basic components of national welfare, greater importance is held by the social sphere resources which reflects the priority of social, socially-advantageous benefits – social capital accumulation sources reproduction.

These sources are characterized by such important properties from the point of view of the innovative growth as: positive network effects and their higher marginal utility in the course of their use; therefore, the level of the national welfare resources into factor sources of

innovative growth conversion greatly depends upon the state of the social sphere – the elasticity quotient was 1.724 and the correlation quotient was 0.671, then, following the order of lower dependence one has the ecologic habitat quality – accordingly 0.463 and 0.324, quality of the population – 0.137 and 0.393 and the material life standards – 0.057 and 0.442.

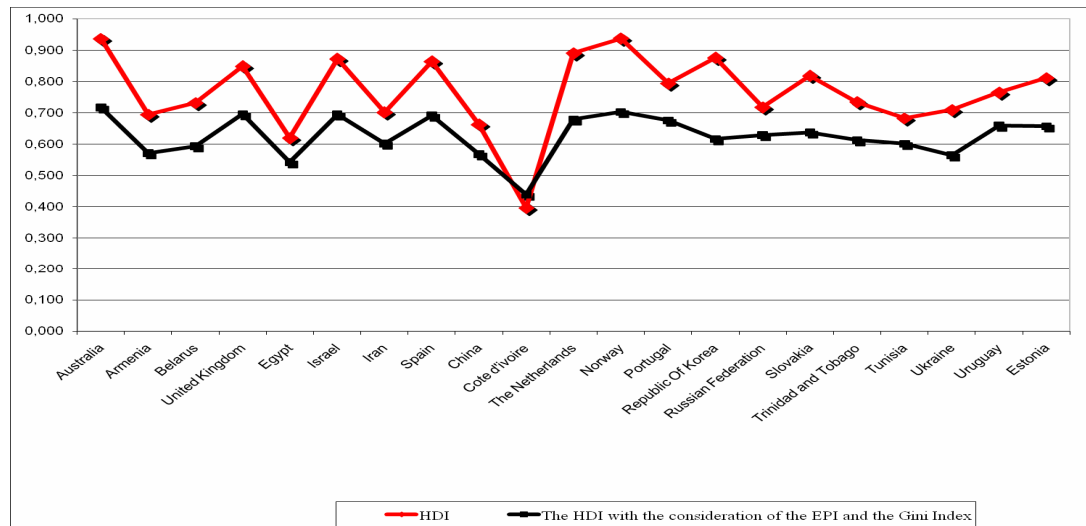


Figure 3 – Adjusted and traditional national welfare indicators in some countries

In the course of interregional comparison of the conditions and existing limits for realizing the policy of state national welfare resources reproductive proportions between accumulation and consumption optimization, one detected a domineering correlation between the economic subjects innovative activity indicator and indicators of the achieved level of conversion. The calculations effected by the author according to special methods showed, in particular, the following typology of dependence of the features of the economic subjects innovative activity on the parameters of domineering kinds of national welfare resources (social sphere resources) into innovative growth factors conversion which determine the priorities of the long-term state economic policy: for an economy, which is characterized by a low, medium, high fully realized dependence of the features of the economic subjects innovative activity upon the parameters of the social sphere resources conversion, priority belongs, therefore, to the strategy of developing social infrastructure and higher level/quality of employment of the population, strategies of developing smaller business and greater freedom of entrepreneurs, strategies of easier access to scientific achievements and to new technologies, information infrastructure development (figure 5).

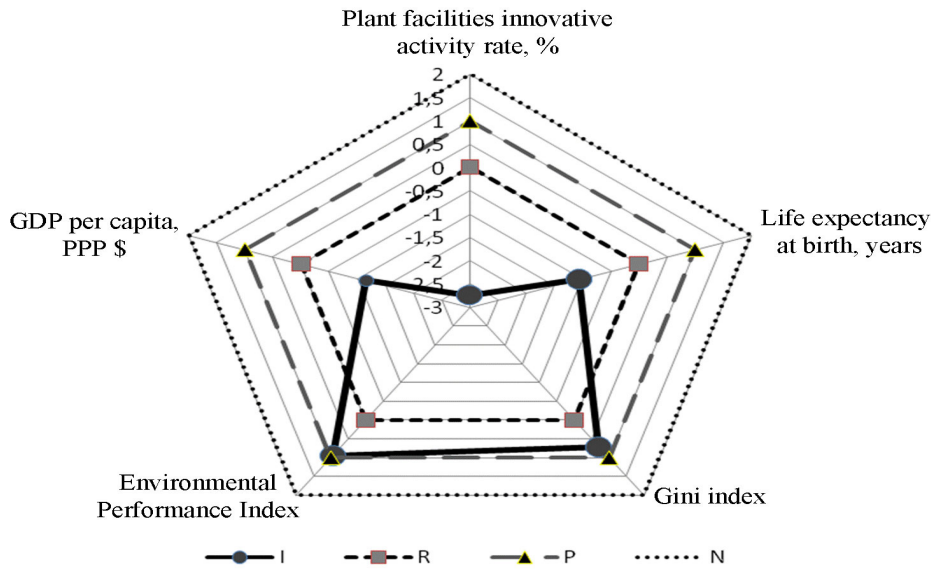


Figure 4 – National Welfare as the Russian Economic Development Integrated Resource State-of-the-art Estimation⁸⁶

The detected innovative effects indicate the priorities of the social-economic policy, in which the main role belongs to investments into the innovative national welfare resources: housing conditions, social and information infrastructure, science, education, healthcare, culture etc.

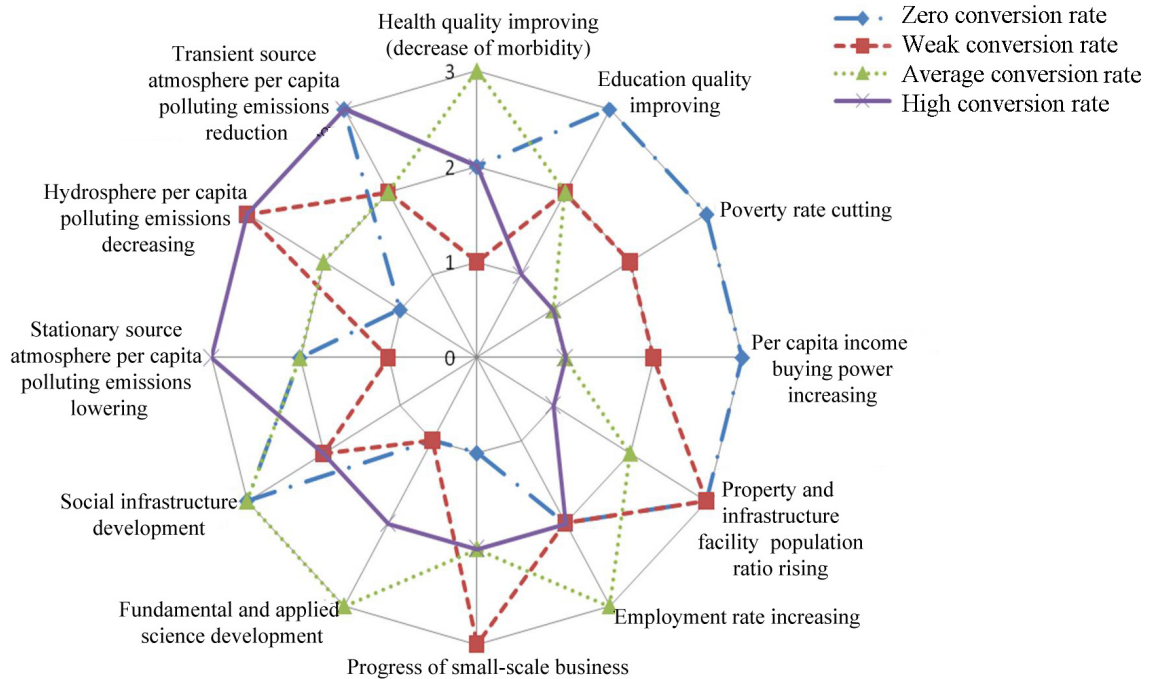


Figure 5 – Spatial strategic «developmental crystal» of Russian national welfare in the innovative growth interests

⁸⁶ Composed according to the author’s set of instruments approbation results.

2. Conclusions

The obtained results show that due to social conditions, factors and motives of behavior more important role, social capital resources greater importance, it is necessary to elaborate a harmonized systematic program of innovation-oriented long-term economic policy modernization and to create a favourable social-economic climate in the country on the basis of the existing national welfare.

In the present situation efficient mechanisms of balanced innovation-oriented economic development may be formed only on the basis of the state, civil society and business integrated efforts in order to achieve consistent expansion and rectification of opportunities for the representatives of different social, professional and territorial population groups via reproduction of the national welfare resources as a social benefit. This has to be reflected in the system of innovation-oriented long-term social economic development strategic management.

The national welfare resources will be realized in an efficient way within the framework of an innovative economy, only if there is a stable need for them from the reproductive process. The strategic task is to bring about long-term correlation of the national welfare resources demand and supply in the innovative development of the economy. The developed theoretical analytical tool allows to evaluate not only efficiency of accumulation and usage of the national welfare resources, moreover, it makes possible to determine the innovative effect due to a higher level of their conversion into the sources of innovative growth.

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NATIONAL INNOVATION SYSTEMS AND ECONOMIC CATCH UP: LESSONS FROM RECENT EXPERIENCES

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ABSTRACT

The last twenty years showed dramatic change in the working of Innovation systems of low and middle-income countries. In Europe newcomers has known an impressive catch up process, which leads to a convergence process inside the EU, with important differences in the National Innovations systems. Eastern Asian countries, mainly Korea and Taiwan, experienced an even more impressive catch up process, which allows them to reach the group of High-income countries. On the contrary, other middle-income countries remains blocked in a “middle-income trap”. The success of the strategy of the former countries lies in their ability to develop short cycle technologies, which enable them to create and localize their own knowledge base. Another way to improve the efficiency of the Innovation Systems of emerging countries is to promote user innovation, which will bend technology to the satisfaction of their needs. That requires the development of technological and social capabilities that will allow these countries to upgrade their innovation performance.

Keywords: Economics of innovation, Economics of knowledge, Technological Diffusion, Convergence and catch-up process.

JEL Code: O140 O47

1. Introduction

Eastern and Southern Europe Emerging Economies, including Turkey and Maghreb countries, have experienced recently a catch up process towards more advanced economies, mainly grounded on the adoption and adaptation of prevailing techniques used in these economies. From this point of view the European Union experience, with its progressive enlargement to Southern, then Central and Eastern gives an insightful experience field. The technological catch up process that occurs during last 20 years has been widely documented in the different European Innovation Surveys (CIS1 to 4) and in the European Innovation Scoreboard (Innometrics, 2011). They showed how the latecomers in the European Union increased they Innovation Performance with low investment in R&D and more generally in Knowledge industries. Now other countries outside the Europeans Union are following the same way.

During the same period, emerging Asians countries knows a parallel impressive catch process, especially South Korea (Lee, 2013), in developing their manufacturing capacities. More precisely, these countries succeeded by implementing industrial policies that allows them to upgrade their competitiveness from low to middle, then upper middle and even high income countries in a relatively short period. On the contrary, other developing countries,

after beginning their catch up process in joining the group of the middle income countries group, failed to continue this process and know a stagnation of their GDP growth, falling down into the « middle income trap » (Lee, 2013). This trap lies in their specialization in low technological level industries, and in their inability to upgrade their specialization in more advanced technologies.

The aim of this paper is to address this issue from the point of view of Eastern and Southern Europe emerging economies. These economies are at a crossroad, with new opportunities coming from the proximity of the most advanced European countries, but also with the risk of falling down in the “Middle-Income Trap”. From a general standpoint they should develop and promote their own National Innovation Systems, as they already did it. But as this paper will try to prove, they should take account of two specific points that will interfere with their policy design.

First, lessons have to be taken from the experience of the former catch up countries, in designing their industrial policy (Lee, 2013). This industrial policy has promoted short cycle technologies that allow them to improve dramatically their international specialization in a short time. The adoption of these technologies is crucially linked to the accessibility of these countries to a foreign knowledge base, and of their ability to appropriate it.

A second important point is linked to the development of User Innovation, or Innovation by users (Gault and Von Hippel, 2009) that is a major source of Innovation Product and Process. As the process of technological diffusion is becoming more complex, it concerns not only its producers, but also its users (Von Hippel, 2005). That means innovation process needs to promote innovation users, who have the ability to modify an existing product or process, or to create a new use for it. This kind of innovation has been encouraged by the development of the Information and communication technologies, the most prominent example of this development being the experience of Free Open Source Software (FOSS), in advanced like in developing countries. While this kind of innovation appeared for a first time in the more advanced countries, it is a challenge that the middle-income countries will have to cope with. It is an important way to appropriate new technologies that these countries should promote, in order to adapt technologies. Promoting them is an important stake, as they will help to promote adapted technologies and leapfrogging innovation strategy.

The paper will in a first step present the European Experience in the field of Innovation, and detail the catch-up process that has been experienced over the last Twenty years, and the different factors that influenced it. In a second point, a comparison will be made with the experience of other catch-up process, more precisely of other middle-income countries, from South America and East Asia. The question of the “Middle-income trap” and of the way to escape it will be discussed. Lastly the issue of the development of Innovation users will be addressed.

2. The dynamics of Innovation and Technological catch up: some recent results

Countries from Eastern and Southern Europe has recently known a catch up process, that let them become upper middle- and for some high-income countries, but with different performances of their national Innovation systems.

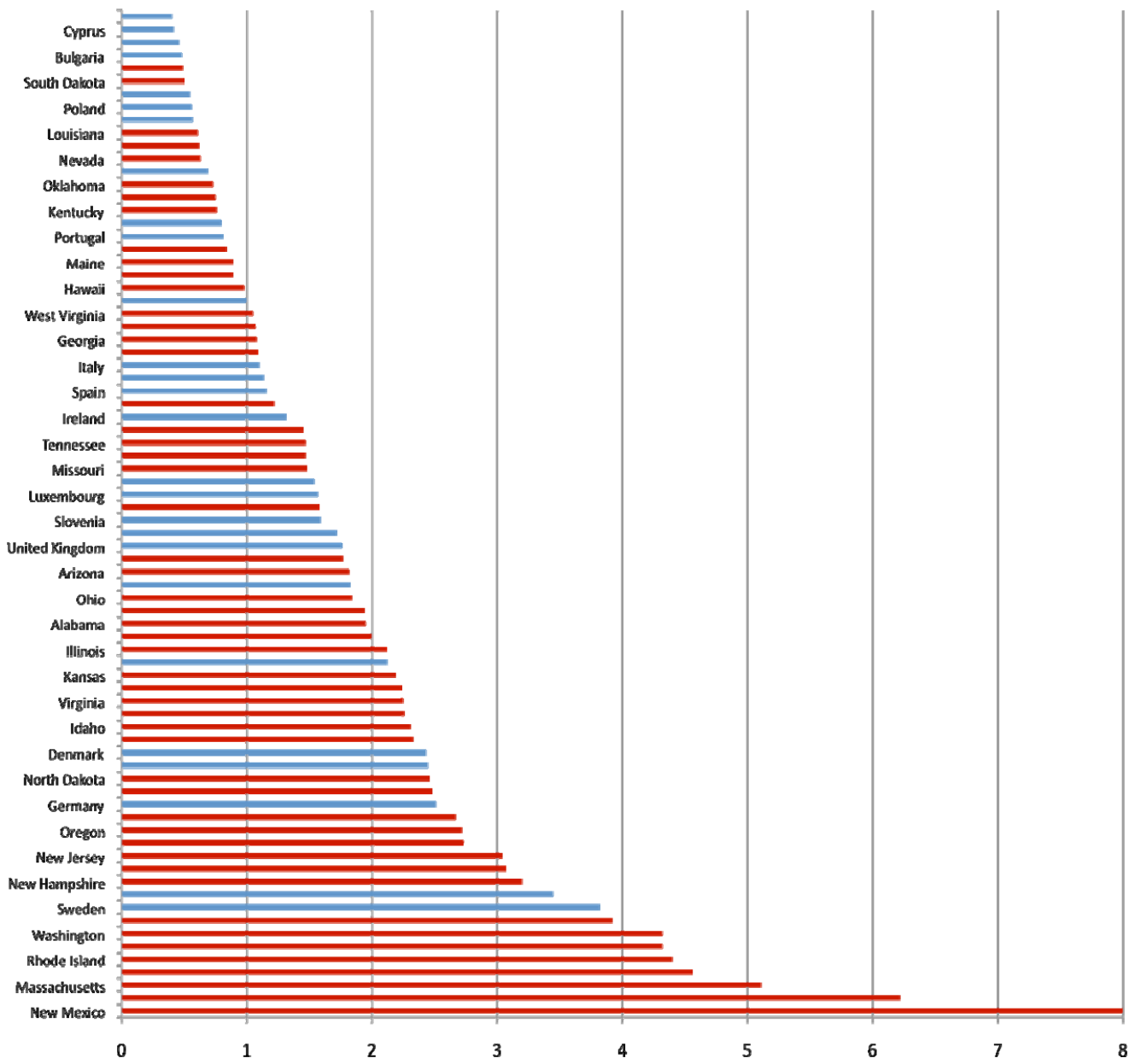
2.1 The European Experience: a fast convergence process, with large disparities in Innovation performance

Over the past thirty years the European Union experienced an exceptional historical convergence process which concerned at first the Southern European countries, and after the Central and Oriental European countries. From this point of view the Lisboa Strategy aiming a ratio of 3% of the GDP devoted to R&D by 2010 was doomed to fail since the first millennium decade saw the integration of low RD level countries, lower than 0,5% of their GDP, which exert a negative effect on the aggregated data.

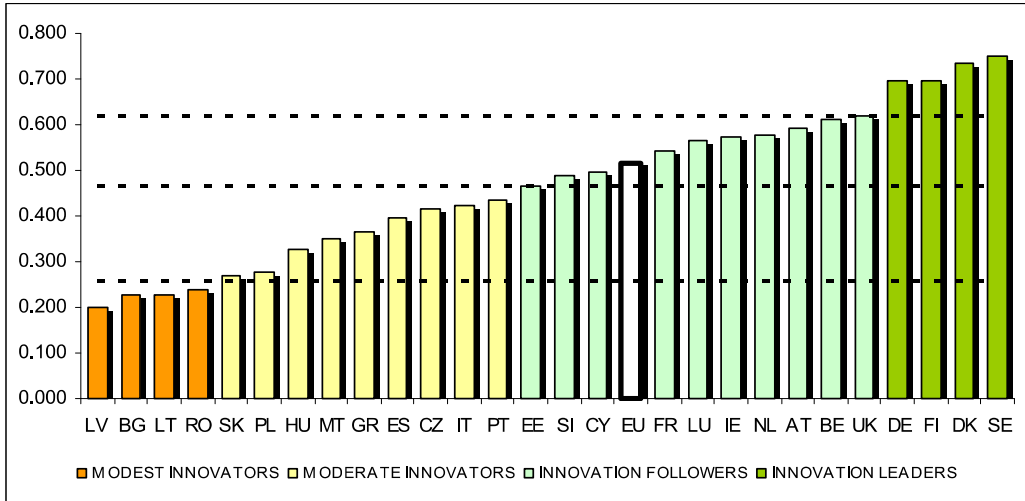
Comparing Europe to more homogeneous countries like Japan or USA is, from this point of view, nonsensical. The alleged R&D gap is decreasing when the European States performance in this field is detailed. It has been done by Van Pottelsberghe, who compared the R&D performance between the European and the American Federal states: if some “high tech” American federal states obtained far better result than the European ones, the ranking between the two geographical areas is quite mixed, for example the Scandinavian countries appear in the top group of this ranking. (Van Pottelsberghe, 2008). On the contrary, latecomers in the European Union, which shows very low level of R&D spending, are close in this field to some rural

The large disparities between European countries innovation performance are confirmed by the four CIS studies over the last ten years, and the European Innovation Scoreboard, now Innovation Union Scoreboard (IUS, Innometrics, 2011, see box 1). This Scoreboard ranks the European countries according to an index of Innovation Performance, build up from 29 indicators, in four main categories: innovation enablers, firm activities and innovation output, lead to a clustering in four groups, namely the innovation leaders, (dark green), the innovation followers (light green), the moderate innovators (yellow) and the modest innovators (previously catch up countries, orange). As it could be guess, this ranking is close, but not similar to that of R&D intensity. For example, Germany, with a R&D intensity close to that of France, belongs to the group of Innovation leaders, while France appears in a lower position in the innovation follower group. On the bottom of the innovation performance index it can be seen that some newcomers in the Europe Union are ranked in a better position that their R&D intensity let guess.

Figure 1 R&D intensity of US Federal States (2004) and EU Members States (2006)



Source: Van Pottelberghe, 2008

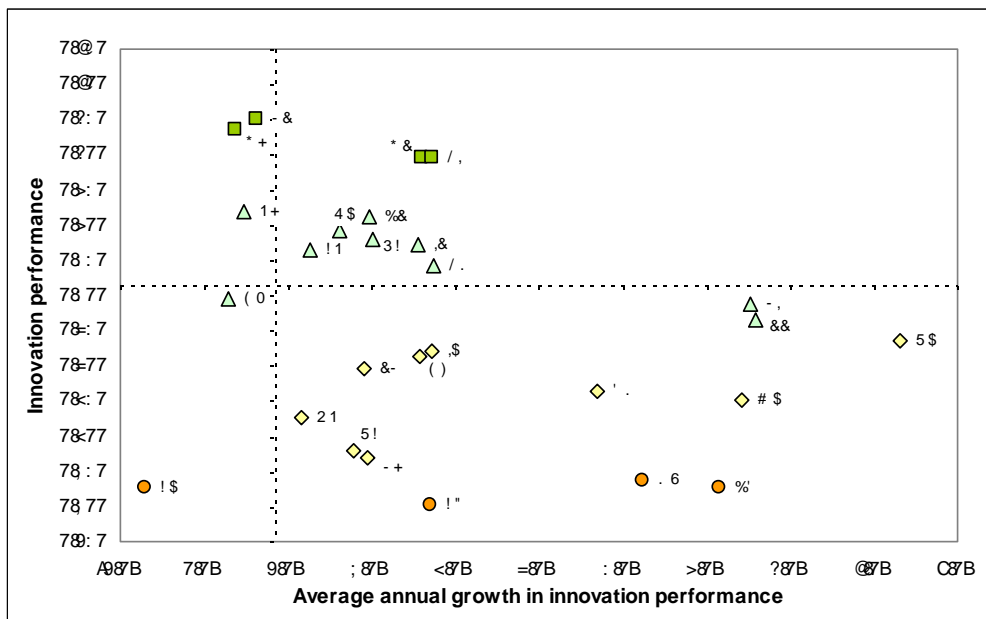


Note: Average performance is measured using a composite indicator building on data for 24 indicators going from a lowest possible performance of 0 to a maximum possible performance of 1. Average performance in 2010 reflects performance in 2008/2009 due to a lag in data availability.

The performance of Innovation leaders is 20% or more above that of the EU27; of Innovation followers it is less than 20% above but more than 10% below that of the EU27; of Moderate innovators it is less than 10% below but more than 50% below that of the EU27; and for Modest innovators it is below 50% that of the EU27.

Figure 2 EU Member States Innovation Performance

As one can check on the following figure, which plots the growth rate and level of each country innovation performance, a convergence process is in progress: level and growth rate are inversely related, with important divergences between countries in each group. For each category we can find countries with slow, moderate or fast growth. It is worthwhile to note that the largest disparities appear on the modest (round, orange) and moderate innovator (diamond shaped, light yellow) countries, which means that the performances of each national innovation systems are quite different. For example Hungary and Romania, which have close innovation performance level, show an important gap in their growth, in favour of the latter.



Colour coding matches the groups of countries identified in Section 3.1. Average annual growth rates as calculated over a five-year period. The dotted lines show EU27 performance and growth.

Figure 3 Convergence in Innovation performance

Table 1 Innovation growth leaders

Group	Growth rate	Growth leaders	Moderate growers	Slow growers
Innovation leaders	1.6%	Finland (FI), Germany (DE)		Denmark (DK), Sweden (SE)
Innovation followers	2.6%	Estonia (EE), Slovenia (SI)	Austria (AT), Belgium (BE), France (FR), Ireland (IE), Luxembourg (LU), Netherlands (NL)	Cyprus (CY), United Kingdom (UK)
Moderate innovators	3.5%	Malta (MT), Portugal (PT)	Czech Republic (CZ), Greece (GR), Hungary (HU), Italy (IT), Poland (PL), Slovakia (SK), Spain (ES)	
Modest innovators	3.3%	Bulgaria (BG), Romania (RO)	Latvia (LV)	Lithuania (LT)

Average annual growth rates as calculated over a five-year period.

Source: Innovation Union Scoreboard 2010, Innometrics, 2011

2.2 Innovation performance and catch up process

As we have seen, evaluating the performance of national innovation systems is not an easy thing to do. Some studies tried to evaluate the performance of the national innovation systems using CIS surveys, and their results converge with the Innovation Union Scoreboard. Edqvist and Zabala found that catch up countries perform better in process innovation rather than product innovation, and in services activities. (Edquist et Zabala (2009)). Another study on the South, Central and Eastern Europe proves that the investment in the knowledge industries is weaker than in Western Europe, even when the sectoral structure of these countries is taken into account. (J. Meriküll, R. Eamets, U. Varblane, (2009)).

In the field of Innovation, the situation is comparable to that of macroeconomic convergence models: the relative performance of catch up countries is higher than that of more advanced countries (Edqvist et Hommen (2008)). With a low investment in knowledge activities, it is not surprising that they got a higher return than countries with higher input level in knowledge. A recent study on the efficiency of R&D spending carried out on European data confirms this point (Harfi et Mathieu (2009)). The authors rank the countries according to an efficiency index calculated according to a technical efficiency model that links the RD input to their innovation capacity. This capacity is measured by their ability to create new products for the market (product innovation), or for the enterprise (imitation): we can check that the performance ranking of countries doesn't fit their level of R&D investment. For example, Romania which invests less than 0,5% of its GDP in R&D is 5th in Innovation and 7th in imitation (on 17 countries) in technical efficiency term, as Poland and Estonia whose results are far better than their R&D investment let us guess.

Tableau 2 : Mesure de l'efficience technique par pays

Pays	Effort de R&D en % du PIB	Imitation		Innovation		Global	
		%	Rang	%	Rang	%	Rang
Allemagne		68.91	3	67.54	4	74.30	2
France	Plus de 2%	66.40	10	67.83	3	72.06	4
Suède		69.59	1	69.48	1	74.50	1
Belgique	Compris entre 1,5 et 2%	64.57	13	62.33	12	70.12	12
Norvège		63.20	15	61.02	15	68.31	16
Pays-Bas		68.99	2	67.98	2	73.35	3
Espagne	Compris entre 1 et 1,5%	66.92	9	62.27	13	70.25	11
Italie		67.02	8	64.95	8	71.67	6
Tchéquie		67.42	6	64.79	9	71.32	7
Bulgarie		60.46	17	61.85	14	69.64	14
Estonie		64.93	12	65.56	5	70.78	10
Hongrie	Compris entre 1 et 0,5%	61.77	16	63.69	11	69.63	15
Lituanie		63.91	14	59.41	16	69.66	13
Pologne		68.21	4	65.38	6	71.31	8
Portugal		65.36	11	64.44	10	71.79	5
Chypre	Moins de 0,5%	67.21	7	51.39	17	64.86	17
Roumanie		67.71	5	65.08	7	71.22	9

Table 2 Source: Harfi et Mathieu (2009)

Another recent research confirms these results, since in a rather more pessimistic manner (Veugelers, 2010). Using a large panel data over 24 countries from Central and Eastern Europe, the Caucasus and Central Asia (CEECCA) countries, it tries to test their ability to develop a knowledge based growth path or to have the potential to develop in the near future. All these CEECCA Countries can be clustered according to their ability to “buy”, or to “make” new technologies: it can be checked that some of modest innovators belongs rather to the first rather to the second category, while most of the newcomers in The European Union belongs to the category of Innovation active countries.

Table 3 Ranking of the CEECCA Countries by Innovation Activities

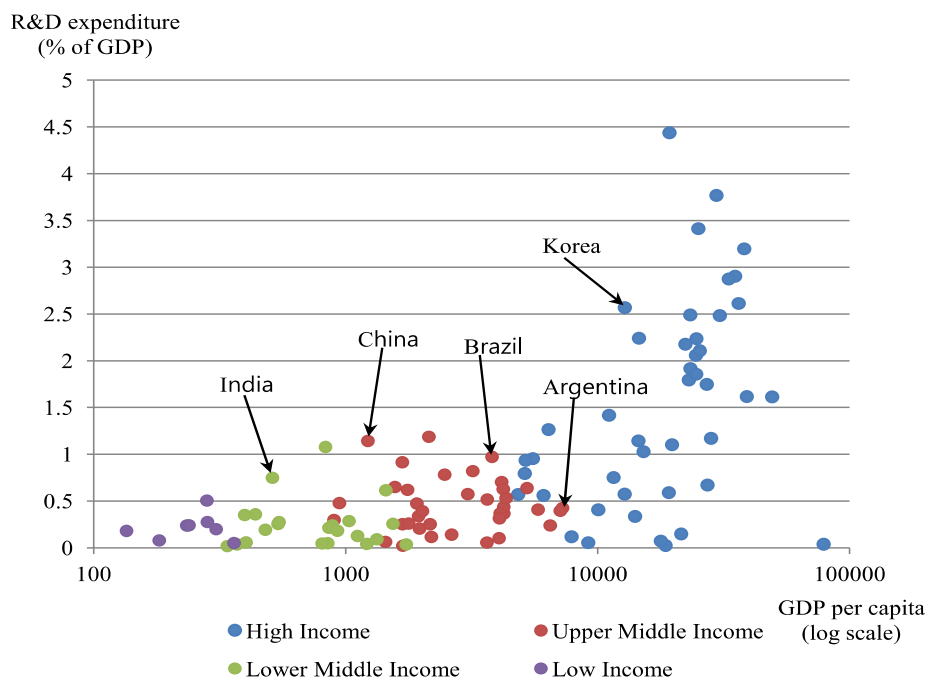
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Source: R. Veugelers, Assessing the potential for knowledge-based development in transition countries, Bruegel Working Paper 2010/01

Studies carried out by Kuen Lee (Lee , 2013) leads to a more pessimistic conclusion: it shows that Middle income countries generally present low ratios of R&D, and that the relationship with the GDP per head is flat over a long variation range, as shown in the following figure. It means that the R&D Productivity know large disparities between countries, and moreover that these countries haven't any ability to rise these spending. Lee sees in this fact a main characteristics of the Middle Income Trap, which will be studied later.

Figure 4 R&D Expenditures Ratios by Country Income Group



2.3 Some Lessons from the emerging countries experience

Studies of the developing national innovation systems are still at an early stage, mainly because of the lack of data, except the case of the industrialization of East Asia, which has been widely documented, especially in the Korean case (Kim, (1980) (1997) Shin (1996). Nevertheless, recent studies have been realized, using innovation surveys with the CIS methodology.

A first comprehensive survey have been made by Bogliacino and others (Bogliacino et alii, 2010), which covers Latin America, Eastern Asia, Central and Oriental Europe, Russia, and Africa. Despite some comparability and measurement problems, some main features appear. When compared with European Union firms, which are used as benchmark, developing innovating firms have a slightly lower innovation capacity, as measured by the part of turnover in new products. Even when these countries results are close to the European ones (like Eastern Asia), most of these innovations concern new products to the firms. When considering the means devoted to innovation the gap within the European Union is deepening, this gap being mainly measured by the share of R&D spending in GDP. We find the same characteristics observed within the European Union: disparities are more important in means than in results of the innovation. Indeed, these disparities are diminishing sharply on recent years: countries like China, Brazil or Turkey having figures that will allow them to belong to the group of moderate innovators in the EIS terms. More detailed results have been obtained by recent studies on the mediterranean countries (Marocco, Tunisia) (Rigas et Hatem, 2008, Ayadi., Rahmouni, Yildizoglu,2009), using innovation survey data. They prove that the main sources of innovation are external to the firms and to the countries themselves, and that the most innovative firms are working on both the domestic and foreign market, on the contrary of “purely” exporting or domestic firms which perform poorly in this field. Another recurring problem concerns the working of the national innovation systems, still in an infant stage: most of the firms don’t know the existence of national innovation support schemes, and links between the universities and enterprises are still weak.

3. Some open questions: What kind of Industrial Specialization?

At first studied in a macroeconomic framework, the analysis of economic convergence and catch up had experienced recent advances, from a theoretical and an empirical point of view. It followed the tradition of historical works initiated by Gerschenkron (1962) and Abramovitz (1986), from the study of the XIXth century European experience to the contemporary experience of Asian emerging countries (Shin (1996), Chang (2002)). While convergence can be defined according to Fagerberg and Godinho (2005) as a trend toward a reduction in differences in productivity and income in the world, catch up is linked to the process by which a late-developing country narrows its gap income (“economic catch up”) and technological capability (“technological catch up”) vis-à-vis a leading country (Odragi and al (2010)).

3.1 Industrial Specialization and the “Middle-Income Trap”

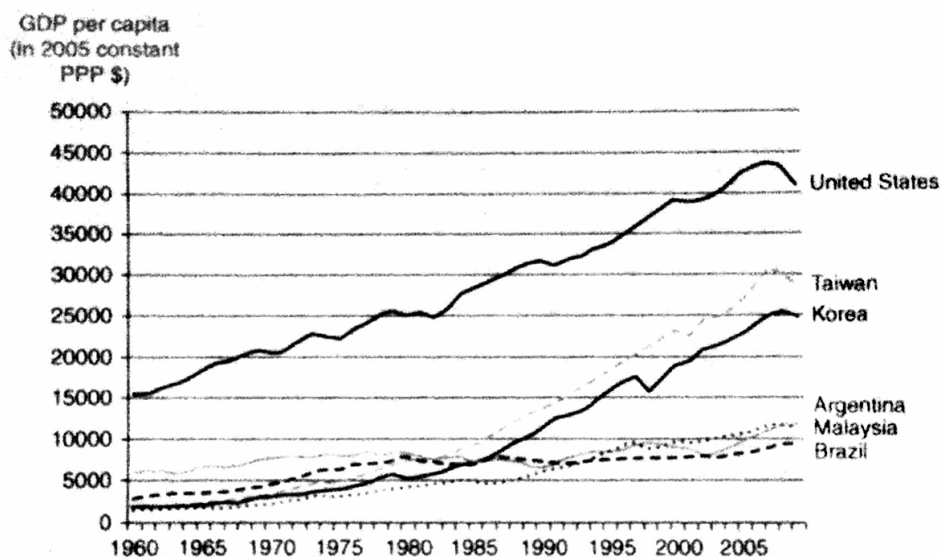
Most industrialization policies has followed the same process: using their comparative advantages, developing countries begin to set up basic industries, using low skilled labor, and after try to upgrade this specialization once they got this comparative advantage in international Trade. This process allowed these countries to leave the categories of low income countries to the middle income group.

Studies made on the Asian experience, lead by Lee (2013) question this linear process, from two points of view.

The first is that last experience from the Asian countries proved that alongside the traditional “path following catch up process”, some countries has proved their ability to skip one or more steps of this process, in a “leapfrogging” strategy, or better in experiencing new stages in this process.

The second is that the linear process doesn’t drive a country following it to its last stage. Some countries could be blocked in a “middle income trap”: while they proved their ability to leave the lower income category to the middle income category, they could be unable to upgrade their performance and reach the highest category. Lee (2014, *ibid*) gives the example of Argentina and Brazil, on one side, and Korea and Taiwan, on the other side: after following the same growth path during in the 70’s and early 80’s, their GDP by head trajectories diverges dramatically during the 80 and 90’s.

Figure 5 GDP per capita, 1960-2005.



According to Lee, this divergence is due to at first to a change in the industrialization strategy. He creates a typology in 3 categories, “Path Following” (A), “Path Skipping”(B) and “Path Creating” (C) catch up strategy (Table below).

The first strategy A, “Path Following”, seems the most natural to follow; it supposes that the country will progressively upgrade its capabilities, but it needs a long time to succeed. As it doesn’t require a high level of R&D activities, it is mainly dependant on simple technologies.

So its success is largely dependant to the ability to increase this R&D expenditures and capabilities, even if they are not strictly necessary on a short term horizon.

Table 3 The three Patterns of technological Catch-up

Table 1: Three patterns of technological catch-up

Path of the Forerunner: stage A → stage B → stage C → stage D
1) Path-Following Catch-up: stage A → stage B → stage C → stage D ^a
2) Stage-skipping Catch-up (leapfrogging I): stage A → stage C → stage D ^b
3) Path-Creating Catch-up (leapfrogging II): stage A → stage B → stage C' → stage D' ^{c, d}

Source: Authors.

Notes:

^a For example, consumer electronics in Korea during analogue era, PC, and machine tools

^b For example, engine development by Hyundai Motors; DRAM development by Samsung (Lee and Lim, 2001, and digital telephone switch development by China (Mu and Lee, 2005)

^c For example, CDMA mobile phone, and digital TV (Lee, Lim & Song, 2005)

^d In stage C, the two technologies, C and C', represent alternative technologies.

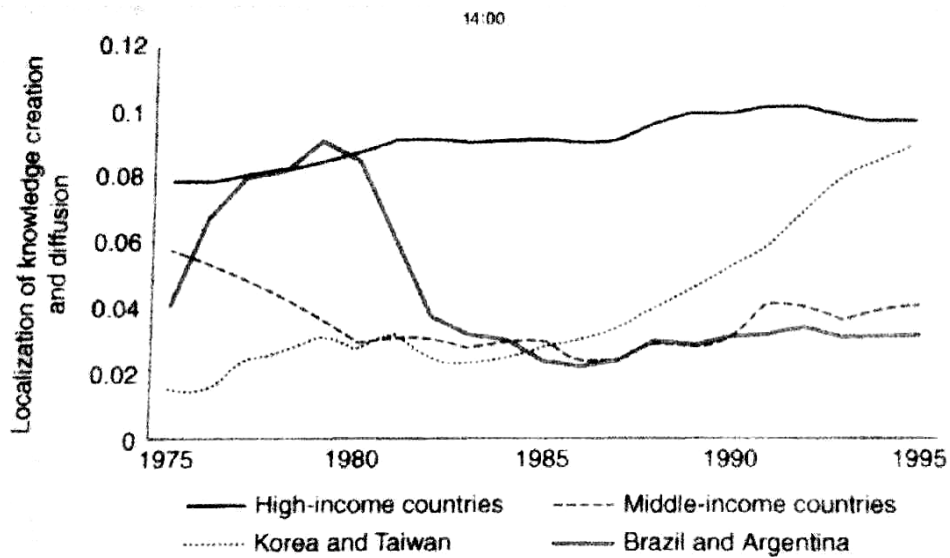
Source: K. Lee (2013)

The second and third Strategies have been followed by South Korea and Taiwan. The key of success of these strategies lies in the ability of these countries to develop “short cycle technologies”, mainly used in ICT technologies. On the contrary the middle income trap can be explained by the fact that middle income countries are generally failing in trying to develop “long cycle technologies” in the main industrial sectors. On the contrary, as short cycle technologies are changing permanently, they allow latecomers to enter more easily in these sector and to obtain competitive advantages.

The question that has to be address is linked to the capabilities these strategies require. Such capabilities need at first for the country to have an access to a large knowledge base. Park and Lee (2006) defined the accessibility to this base by measuring the share of the citations by non-G7 country (typically, a middle-income country) held patents to G7-held patents out of the total citation in a class. This variable of accessibility is positively related to the speed of catch-up, measured by the patent growth rate, and to the level of technological capability (latecomer' shares in each class of technology).

But access to a knowledge base is a necessary, not sufficient condition to a leapfrogging strategy. It needs also a localization and a concentration of knowledge creation in the country, as they are measured by the Jaffe et al (1993) patent index. In this field the Korea and Taiwan performance is impressive, while on the contrary Brazil and Argentina exhibit a sharp decrease in this index. This divergent evolution is due to the fact that specialization of the latter in long cycle technologies made them increasingly dependant from foreign technologies – mainly, technologies coming from High-income countries.

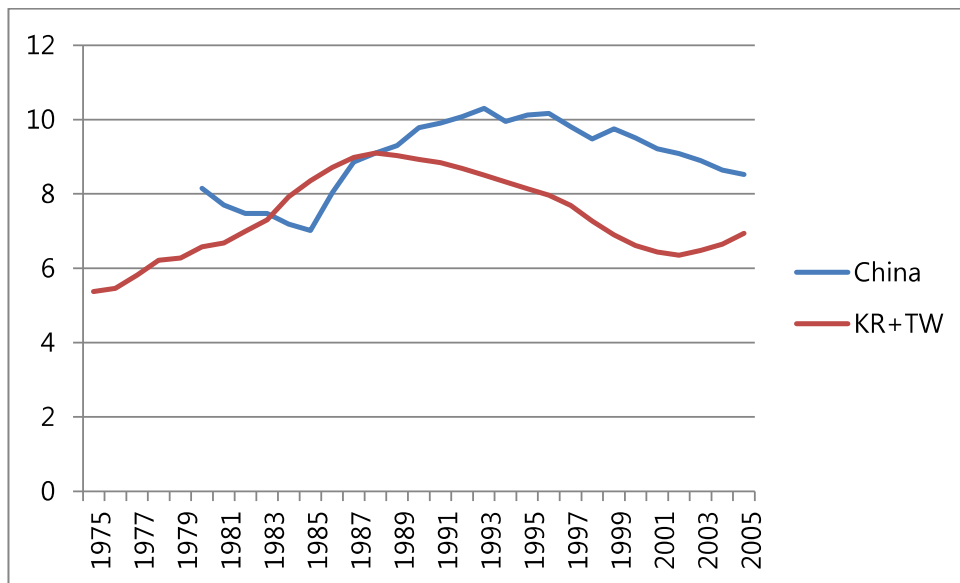
Figure 6: Localization of Knowledge creation and diffusion.



Source: Lee, (2013, p.74)

As we already said, the success of this strategy is highly depending on the choice of the industrial sectors to be promoted. Moving investment and industrial development to short cycle technologies is a crucial point. As rapid renewal of these technologies allows middle income countries to create their own knowledge base, and to localize knowledge creation on their territory. As the following figure shows, China should follow the same way, if it wants not to fall into the Middle Income trap.

Figure 8 Cycle Time of Technologies in US Patents by China, and Korea/ Taiwan



Source: K. Lee (2014), Possibility of a middle-income trap in China, Frontiers of Economics in China, forthcoming

3.2 New channels for new national innovation systems ?

Another issue is linked to the channel by which Innovation is created. Catch-up strategy depends on the ability of countries to adopt new technologies, to adapt them to their needs, and to promote their own national innovation system. So the working of national innovation systems depend crucially on the way they promote Innovation Users.

National Innovation systems needs to promote Innovation Users..

According to the pioneering approach of E. Von Hippel (2005), innovation process concerns, not only its producers, but more and more its users, who are a major source of innovation product and process (Von Hippel, 1998). The development of these innovations has been boosted by the Information and Communication techniques, but it raises one question. According to Von Hippel, (Von Hippel, 2005) it will help to democratize innovation, but it is a controversial point. In fact this new innovation pattern first appeared in the more advanced countries, with an important population of high skilled “lead users”, fond of new technologies and able to master and transform them. Most of the recent works on Innovation users have been done in these countries, mainly in Canada (Gault et Von Hippel, (2009)), Nederland (de Jong and Von Hippel (2008), de Jong and Von Hippel (2009)) and in Europe (Flowers, Sinozic, Patel, (2009). This last study, using the 2009 European Innovation Scoreboard is the most extensive ever. It draws a distinction between three kinds of Innovation users, named “User process Innovation”, “Innovation Product Innovation”, and “Involver Innovation”. While the first two cover the well-known categories of innovation, the third appears when a firm decides to associate its product users to the evolution of their product. According to this study, User innovation is more developed in large firms (more than 250 and 500 employees) than in small and medium sized firms, with a slightly prevalence in middle and high technology industries. All industries are evenly concerned by this kind of Innovation. When the comparison is done between countries, User innovation is more widespread in the innovation leaders, even if the observed disparities between countries categories are rather small. On the average, in the European Union, 30,3% of firms are User process innovators, 27% innovation product innovators, and 53,1% involver innovators, a higher proportion than observed on former studies, where it reach the average of 20% of the Innovative firms.

So the main results obtained in this field prove that the firms and countries that have the highest capability to produce innovation are the most able to use it. It shouldn't be surprising: it means that innovation production and use are more complementary than substitute. Flowers go so far as calling the innovation users as “super innovators”, which have to be promoted by innovation policies⁸⁷(Flowers and alii, op. cit., 2009).

⁸⁷ Let's point out that the first Free Open Source Software (FOSS) appeared in the community of computer “geeks” coming from University or computing company of the more advanced countries. Even the Ubuntu software, although born in Africa (South Africa), owes his success to its adoption in advanced countries.

How to improve the "Below the radar Innovation" (Kaplinsky et alii, 2010) ?

For the middle-income countries, promoting innovation users is a key challenge. It is important to point out that if this issue has not been well studied in these countries, it does not mean it doesn't appear. In fact, the development of ITC in the traditional sectors like agriculture and fishing (Galiègue, 2009, Jensen, 2008) can be considered as an innovation User strategy, as in a broader sense most of the strategy of technological adoption/adaptation. Others facts and arguments can be used to support this idea. As Kaplinski and alii argue, innovation should be bend to meet the needs of developing and emerging countries, and become, according to their term, " below the radar" (Kaplinski and alii, 2010). Firstly it is important to point out that the R&D expenditures of developing countries have reached significant levels: from 2% in 1990, they reached more than 20% in 2000 of the total world spending, if we count all the spending outside the Triad (Japan, USA, and Europe). So developing countries have already the technology capabilities and innovation capacity to change its pattern. A second important point is related to the change of localization of production: most of the world industrial production is now realized in developing countries, and their demand for adapted products and technology is rising. As the innovation capacity of developing countries has been created in major exporters of manufactured goods (China) or services (India), they need to follow the demand of the most growing demand potential, which is in other developing countries. As Kaplinski and others claim that developing countries should accompany and accelerate this evolution, by promoting their own innovation systems. In another words, it is necessary to promote the production and use of innovation in these countries, in making their producers and consumers new lead users.

4. Conclusion

In this survey we state that, if a catch up process is well under way for the Eastern and Southern Europe Countries, it is basically because these countries have been able to develop their own technological and social capabilities, which allow them to adopt external technology at a low cost. But if these countries want to go further in the process of technological appropriation, they need to build up their own innovation system. These innovation systems should follow the way of countries that develop short cycle technologies, an easy way to create and localize their own knowledge base. Moreover, they should also promote innovation users, who will have the ability to find use of products adapted to the needs of their enterprises and population. It is one vital condition to upgrade their innovation performance, and help them to avoid to fall down into the "middle-income trap".

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CUSTOMER SATISFACTION MEASUREMENT PRACTICES IN HOTELS: SOME EVIDENCE FROM ALBANIA

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ABSTRACT

Services sector continues to be the big contributor in GDP of Albania, with about 60% in 2011, where trade, hotels and restaurants constitute the main part of this sector. Number of hotels is increased during the last years. In 1995, the number of hotels was 62 with 2,016 beds places, whereas in 2012 the number of hotels was 248 with 18,905 beds places (INSTAT). To be successful in the market it is not sufficient to attract new customers, hotel managers must concentrate on retaining existing guests implementing effective policies of customer satisfaction.

The monitoring process of customer satisfaction and service quality play a key role in the success of hotel business and tourism. If this process is managed and analyzed directly on a scientific basis then it can constitute a competitive advantage for hoteliers, regardless of business size. The aim of this study is to analyze the customer satisfaction management scheme in hotels of Albania. For this purpose, questionnaires are distributed to managers of hotels with 3, 4 and 5 stars in major destinations of Albania. The data are collected in the period July - August 2013. The objectives of the research are: to analyze the way that are built, managed and processed hotels guest comment cards (where is applicable) and to assess hoteliers' attitude towards customer satisfaction management. The method used is mainly based in the applied content analysis (Gilbert & Horsnell 1998) which compares and analyzes outcomes based on best practices criteria.

This study can be of great use to hotel managers in providing a direction on how to conduct and modify the existing practice of measuring customer satisfaction in hotels. The primary objective of GCCs is to understand guests' needs, gather their opinions and comments, most importantly, to assess guests' satisfaction with services provided. Although in 72% of analyzed hotels, GCCs are recognized as an important tool for measuring guest satisfaction, results indicate that in most hotels measurement practice should be improved.

Keywords: customer satisfaction, service quality, guest comment card; content analysis, hotels.

1. Introduction

Service quality and customer satisfaction have a significant impact on business development. Service quality has a direct impact on customer satisfaction, and consequently increases the profit. These two concepts have been continually in the focus of managers and researchers of the field. One of the most important challenges for the managers of the hotels is the evaluation and monitoring of customer satisfaction.

For measuring customer satisfaction exist some ways, however, in accommodation services one of the most widespread ways is the guest comment cards (GCC). The GCCs are commonly used in most hotels to measure customer satisfaction. The purpose of this study is the examination of (GCCs) in hotels and evaluation of management schemes in customer

satisfaction of Albania hotels. In this study was used method of the applied content analysis according to Gilbert and Hornell (1998). The results of this study provide the hotel management staff, an evaluation of the current methods for measuring and managing customer satisfaction in hotels of Albania.

2. Literature Review

2.1. Service quality and customer satisfaction

The primary function of the hotel units is to offer quality service to its customers. Service quality is defined as how well customer's needs are met, and how well the service delivered meets the customer's expectations (Lewis and Booms, 1983). Gronoos (1984) has shown that the perceived quality of service is a function of the comparison of expected service with perceived service, in other words is the result of a comparative evaluation process. Parasuraman et al. (1985) has defined "quality of service" as the degree and direction of discrepancy between perceptions and expectations of their customers, where "perceived service quality" is the gap between customer's expectations and perceptions as a measurement of service quality. Smaller the gap, the better is the quality of service and greater customer satisfaction is.

2.2. Measuring customer satisfaction

The main reason for measuring customer satisfaction is to collect information from one side to see what customers require to be done differently and in turn to assess how client needs are met. However the reasons for measuring customer satisfaction differ from one hotel to another. Some of the hotels fail to properly pursue programs dedicated customers not only because they have not defined program to get feedback from customers, but because they lack a complete database which not only monitors sales but it is also a source of innovation.

According to literature customer satisfaction measurement is done in different ways, for example one of the ways is to include a single question in customer satisfaction questionnaire: "In general, how satisfied are you with...?" where responses of the questionnaire questions are made according to a system with 7 degrees from "very satisfied" (coded 1) to "very satisfied" (coded 7), known as Likert scale. Problems associated to the answer of one single question in this case, are mitigated by the simplicity of the question. (Heskett et al., 1994; Schneider and Bowen, 1995) have developed a theory for the measurement of customer satisfaction based on key elements of satisfaction in service and price, but their valuation is done independently through the "index service" and "price index".

In this study are discussed practices that hotels in Albania use to design questionnaires, including the purpose, clarity, measurement scaling and validity assessment, and methodological problems of the time, size and order of questions in the questionnaire.

According to Gilbert & Horsnell (1998), Su (2004), GCCs are commonly used in hotels to assess customer satisfaction. GCCs usually are distributed in hotel rooms, in reception or other visible places in the hotel. However, some studies suggest that a number of hotels

chains use assessment methods for customer satisfaction based on improper practices to take important managerial decisions (Barsky, 1992; Barsky and Huxley, 1992; Gilbert & Horsnell, 1998; Su, 2004). Therefore is required to apply a more scientific method to use the GCCs in order to make fair and appropriate managerial decisions (Deveau et al., 1996, Jones and Sasser, 1995; Jones and Ioannou, 1993). Despite the different types of customer satisfaction systems, they generally have some common mistakes (Gilbert & Horsnell, 1998). Common mistakes are divided into three groups: the quality of the model, the design of the GCC as well as collection and data analysis (Gilbert & Horsnell, 1998). Gilbert & Horsnell (1998) have developed a "checklist GCCs criterion" to estimate practices for measuring and managing customer satisfaction in the hotel.

2.3. Content analysis

Content analysis is a research and survey method that is used to systematically evaluate the symbolic content of all forms of recorded communications (Kolbe and Burnett, 1991). It can be exercised virtually in every media containing verbal and/or visual, printed materials, radio and television programs, recorded meetings, movies, songs, etc. Content analysis is widely used in marketing and consumer behavior research (Kassarjian, 1977; Sayre, 1992; Guthrie & Abeysekera, 2006).

The basic technique of content analysis involves counting the times the predefined categories appear in a given context. An effective content analysis must meet certain conditions (Kassarjian, 1977; Guthrie and Abeysekera, 2006). Initially, is randomly selected a representative sample. Second, units of measurement, such as analysis criteria, should be clearly defined. These units can be a word, phrase, theme, paragraph, symbols, pictures, or simple table existence or not of certain events or statements. Third, categorisation of he data must be systematic. It should be clear that an object belongs or not to a particular category. We can finally perform the statistical analysis and interpretation of the data. Krippendorff (1980) has identified three types of reliability for content analysis, which are: stability, reproducibility and accuracy.

To achieve reliability is need that the same content to processed by using several types of judgment. Smaller the discrepancies are, higher the degree of reliability is. Another element to be considered is the reliability of the judgment instrument itself, which would bring the reduction of the number of judgment instruments. On the other hand, validity is defined as the degree to which an instrument measures what it aims to measure.

3. Research Metodology

The target population of the study consists of 3, 4 and 5 stars hotels in Albania. During the period July - August 2013, a questionnaire was distributed to 64 hotel managers, in order to determine how they distributed their GCCs (in those hotels where used) and how they processed the information gathered from them. The questionnaire is distributed by e-mail and direct interviews with hotel managers are made when it was possible. The response rate is 28%.

Content analysis applied by Gilbert & Horsnell (1998) is used to assess GCCs of 18 hotels with 3 , 4 and 5 stars (with 15-80 rooms) , distributed mainly in Tirana, capital of Albania and other destinations in Albania: Durres, Berat, Vlore and Sarande .

Based on previous studies is created a checklist with 32 points, which can be grouped into five general areas: 1) the focus and value of the management of GCCs attributes, 2) measurement techniques of GCCs attributes, 3) measures of GCCs to the overall satisfaction and guests loyalty, 4) marketing measures to GCCs for identifying key market segments, 5) effective desing and presentation of questions.

4. Results and Discussion

Frequency of information collection: All 18 hotels analyzed, regularly receive guests feedback and suggestions about hotel stay.

The methods of information collection: Around 72 % of the hotels in the sample use GCCs in their hotel rooms for gathering information. About 84 % of hotel managers confirm that they receive evaluations directly from contacts with guests during their stay at the hotel and all hotels endeavor to encourage guests to give their impressions of their stay at the hotel. Around 89% of hotels report that a member of the staff is charged to monitor the evaluations of their guests in the media and social networks and about 78% of hotels have a staff member to respond in a professional manner the estimates of the guests in the media and social networks.

The rate of response: The number of completed GCCs is low. In about 45 % of hotels that use GCCs, the response rate (number of completed GCCs) is 7-12%, while in 33% of them the response rate is about 40% and in 22% the response level is above 60%.

Method of sampling: In all hotels, GCCs is distributed to all their guests.

GCCs distribution process: About 66% of hotels distribute their GCCs through staff cleaning rooms and in 78% of hotels the data analysis is conducted from the manager/board of directors. In 22% of hotels, the GCCs are distributed in the hotel reception.

Staff: All hotel sstaff is well-trained for the process of measuring customer satisfaction, but only in 45% of hotels the staff is rewarded for good work and only 22% of hotels rewards is made according to a predetermined scheme.

Analysis of results: In 72% of the hotels, the analysis of the assessments tests is made periodically (once a month) and the rest evaluations is done continuously.

Handling Complaints: In the case of any complaint is done by a client, the hotel manager immediately fix the problem and asks forgiveness to the client.

The design method of GCCs: In all hotels of the sample, GCCs are designed according to personal opinion of manager relying on other hotels practices and his experience.

Surveying time (receiving customer evaluations): In all hotels, GCCs are distributed during the stay of the guests in the hotel, and only in 4 hotels of the sample the evaluations are taken in

check-out, differently from the big travel agencies as Booking.com and Expedia & Hotels.com when evaluations of guests are taken via email after leaving the hotel, not the hotel itself practice this manner. However, this is a manner that remains to be evaluated and adapted with facilities that are offering new online booking systems and PMSs (Property Management Systems).

Accessing GCCs: About 78% of hotels place the GCCs in the desk of the hotel room and 22% in the hotel reception.

Foreign Languages: In all hotels, the GCCs are in English language, even though a number of clients come from neighboring countries such as Italy, Kosovo, Greece, etc.

A letter with a special request: Previous studies recommend writing a special letter to the guests. However this study shows that managers do not use this particular technique to motivate guests but on the other hand all hotels report that encourage guests to give their impressions directly and even write their online reviews.

Return completed GCCs: the completed GCCs can be delivered in reception or left to the hotel room. About 77% of hotels declare that GCCs are collected in the hotel reception.

Reasons why GCCs are not used: About 34% of analyzed hotels, do not use GCCs to measure customer satisfaction. The managers of these hotels identify several reasons among which we can mention: GCCs are not filled by the guests, the hotels do not want to disturb guests with GCCs, and hotels do not consider GCCs a valid practice.

The results of applying the content analysis according to the best practices criteria for GCCs are presented below.

Number of questions: Models of GCCs that are considered have a number of questions ranging from 10 to 30 questions. Around 66% of hotels apply up to 20 questions. (Gilbert & Horsnell, 1998) have recommended that GCCs must contain 40 to 60 questions in order to obtain information necessary for decision making. So it can be stated that the considered models of GCCs do not contain enough questions to provide relevant information to managers and board of directors of the hotel.

Number of offered intangible and tangible attributes: The analyzed GCCs indicate that most of the questions are oriented toward the intangible services performance offered at the hotel. This conclusion goes well with the results of a study of Su (2004) and Gilbert & Horsnell (1998).

Establishment of independent indicators together in one attribute: The design of composite questions seeking information about the problems at the same time may cause uncertainty in question and the wrong interpretation of the response. In three of the GCCs two questions resulting composite, which are primarily used to assess intangible services such as friendship and staff efficiency, quality and diversity of food, etc.

The scale of attributes measurement: Best Practices recommend that the effective rate for measuring customer satisfaction is the degree of achievement of expectations. However, almost half (48%) of analyzed GCCs use the scale YES / NO, while in all GCCs to estimate

customer satisfaction and service quality the used scale is the Likert scale from 1 - " very satisfied " to 7 - " very unsatisfied " .

A space for comments: All GCCs have space for specific comments of the guests. About 89% of GCCs have space for comments at the end of questionnaire; only one GCC is built with a space at the end of each question, while another one has a whole page for comments. Space for the comments improves the information quality of GCCs.

A direct or indirect measure for overall satisfaction and a measure of customer loyalty: About 44% of GCCs contain a direct or indirect question about overall satisfaction of customers and around 66% of GCCs contain a question about loyalty. Gilbert and Horsnell (1998) and Su (2004) have determined that the GCCs assessment of loyalty is more common than the assessment of overall satisfaction. Such a conclusion goes well with our analysis, but although other studies show that guest satisfaction does not bring necessarily retaining guest and vice versa customers loyalty comes not necessarily from their overall satisfaction with hotel services.

Marketing measures: GCCs are a good opportunity to get information for clients and for marketing purposes. About 83 % of GCCs containing questions about the purpose of visit, room number and date of stay, but none of GCCs does not contain demographic questions such as gender, income, education, and other experiences in the same area, etc.

Testing of the effectiveness of marketing channels: Around 72% of the GCCs include questions in order to assess the effectiveness of marketing channels. Such questions generally have the following form: "How did you find out about our hotel?"

Questions about the competition: None of GCCs includes questions about competitors and the same conclusion is obtained also by Gilbert and Horsnell (1998) and Su (2004).

Introduction sentences: Introduction sentences are used to thank the guests for choosing the hotel and to show the importance of guests impressions in improving the quality of hotel services. All the analyzed hotels contained introduction sentences.

Instructions showing where to put the completed GCCs: All hotels in the sample contain instructions for guests where they can leave the completed cards.

Indicate the name of the member of the hotel staff: Around 89% of GCCs require information about the name of the employee who has left a special impression to guests, and only 11% of GCCs ask for the name of the employee who does not leave a good impression.

Assessment of the value of service: About 66% of GCCs require an assessment about the offered price to service quality ratio.

Customer expectations: Around 44% of GCCs contain questions about customer expectations, but none of GCCs assess customer satisfaction and quality of service compared with expectations.

Assessment of some key attributes of hotel services: All analyzed GCCs require evaluation for hotel rooms, cleanliness, comfort and facility. About 73% contain questions about the restaurant, the quality and diversity of food, while 89 % of GCCs contain questions for the staff, how friendly and helpful they are; and 78 % contain questions to assess the reception.

5. Conclusion

In this study has been made an attempt to analyze customer satisfaction evaluation in Albania hotels. Results of the study show that all analyzed hotels evaluate customer satisfaction as a key factor for success and sustainable development of their business, in 72% of the hotels are analyzed the GCCs used for this purpose. Through GCCs information is collected to understand guest needs, opinions and comments about the hotel stay experience and perception of quality of service provided.

About 84% of hotel managers take impressions from direct contacts with guests which can be explained by the fact that in the current development conditions of the hotel business in Albania dominate small hotels to level 3 and 4 stars with the average number of 20 rooms, but this does not justify the failure to exclude other means such as GCCs.

According to study results, in most hotels, GCCs are placed in hotel rooms and in several hotels GCCs are also placed in the hotel reception, but is noticed that the rate of response (fill in GCCs) is low. Consequently should reconsider the way of distribution GCCs by sending email to guests after they have checked out the hotel, as well as making efforts to offer ways encouraging guests to complete the GCCs.

GCCs design method is mainly based on personal experience of managers and consequently there are different types of GCCs but none of them is consistent with the best practices suggested by previous studies in this direction. Explored models of GCCs do not contain sufficient number of questions to provide relevant information to managers and board of directors of the hotel. None of GCCs contain any questions to test the relative effectiveness of marketing channels.

Besides measuring customer satisfaction, other studies in the future may focus on identifying crucial performance indicators of employees. Withan understanding of which employee groups' performances are necessary to a positive guest assessment hotel managers will develop and implement strategies to provide an overall best evaluation of the quality of service.

It is recommended that the hotel business in Albania to review the evaluation methods of customer satisfaction and service quality in order to be in compliance with all the best practices identified so far. It is clear that new forms must be found to motivate more customers and GCCs must be designed in order to fit with models that suggest scientific studies and best practices. Valid information and reliable data will enable hotel managers to make appropriate decisions about the quality of services that hotels offer.

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REGIONAL PERSPECTIVES Session

SEE COUNTRIES TRADE SPECIALIZATION AND POST-CRISIS RECOVERY – EMPIRICAL EVIDENCES

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ABSTRACT

Foreign trade is one of the sectors of the economy, which is dependent both on changes in market conditions, and on national policies. It can be studied both in terms of the potential for economic growth and as an expression of economic competitiveness. The purpose of this paper is to examine the changes in foreign trade and specialization of the South Eastern Europe (SEE) countries for the period 2008 – 2012/2013. Parallel to this, we need to account for the challenges of the global economic crisis and the consequences thereof that national economies have been facing. In our analysis we will use indicators such as the value of exports and imports, net trade, geographic concentration (Herfindal Index),the main export group and the Lafay index of international specialization.

The economic and financial crisis of 2008 put to the test all economies and encouraged governments to seek solutions that combine the complexity of international economic relations on the one hand and employ various demand for sources of growth on the other. This naturally drew the attention of policymakers and researchers back to international trade as an important factor for economic recovery and development. Considering the political processes on a global and Pan-European scale we may claim that the foreign trade of any country is indicative of both its competitiveness and its ability to take advantage of the global economy. The purpose of this paper is to examine the changes in foreign trade and specialization of the SEE countries for the period 2008-2012.

Theoretical background

According to an opinion of the European Commission, trade intensification is one of the few ways to stimulate the economic growth and create new jobs without resorting to the extremely scarce public finance. However, the question whether a more intensive international trade will have a positive effect for the opening of a country's economy remains debatable. There are many opinions regarding the relationship between international trade and economic development.

The first proponents of the idea that trade has a positive effect for the national economies and that a country's specialization in the production and marketing of products for which it has certain advantages were Adam Smith and David Ricardo. These ideas were subsequently developed and approved by other researchers, who came up with rather controversial conclusions.

In 1950 Raul Prebisch and Hans Singer found that specialization in primary industries reduces the benefits of international trade and the growth rate of the economy⁸⁸. Their conclusion was later confirmed by other researchers, among whom Bencindoun, Gaulier and Ünal-Kesenci⁸⁹, who concluded that the nature of specialization affects growth. The analysis of the specialization profiles of 53 countries for the period 1967-1997 shows that the GDP per capita of some less-developed economies that shifted from production of consumer goods to more complex (dynamic) products has increased significantly. However, their conclusion that a country's openness does not always guarantee high economic growth was later confirmed by Amable.⁹⁰ Since the openness of an economy facilitates the allocation of its resources (technologies, labour, etc.) worldwide, if its international specialization does not promote its technology-intensive industries, its GDP may grow at a much lower rates than that of a closed economy. The empirical results of his study largely confirm the results of Bencindoun, Gaulier and Ünal-Kesenci. Their main conclusion is that countries with a higher degree of specialization and a comparative advantage in the production of electronic products benefit more from their increased productivity compared to countries that do not have a comparative advantage in these industries. A key factor in this regard is the theory of the "learning by doing".⁹¹The main assumption of this theory is that international trade is the main factor that makes the less-developed countries initially change their product specialization and subsequently their trade specialization as well as they import high-tech products and thus acquire these new technologies and become producers and exporters of such products themselves. For example, such an effect is observed in China.⁹²

However, when specialization is too narrow it is considered a potential risk to economic growth because it results in dependence on specific products or countries.⁹³

⁸⁸See also: Zaharieva, G., Iliev, Dr., Sarkisyan, K., Stefanov, G. Foreign trade specialization and economic growth of the EU Member States. Tsenov Academy Publishing House, Almanah scientific research. Volume 17, 2012, pp. 305-332.

⁸⁹Bencindoun, I., G. Gaulier and D. Ünal-Kesenci. The nature of specialization matters for growth: An empirical investigation. CEPII, Document de travail 2001. Op. cit.; see also: B. Amable. International Specialization and Growth.

⁹⁰Amable, Br. International Specialization and Growth, 2000, Op. cit. p.2.

⁹¹For more details see: Yih-Chyi Chuang. Learning by doing, the Technology Gap, and Growth. International Economic Review, Vol. 39, No.3., 1998, pp.697-721; Weinhold, D. and J. Rauch. Openness, Specialization, and Productivity Growth in Less developed Countries. The Canadian Journal of Economics, Vol. 32, No. 4, 1999, pp. 1009-1027.

⁹²Peng Sun, Almas Heshmaty. International Trade and its Effects on Economic Growth in China. DPS, August 2010. (<http://ftp.iza.org/dp5151.pdf>, 1.02.2014).

⁹³Kellman, M., Shachmurove. Adam Smith Meets an Index of Specialization in International Trade". PIER Working Paper 10-029 <http://economics.sas.upenn.edu/pier>, 1.02.2014).

Research methodology

International trade research literature⁹⁴ provides a wide range of tools for analyzing the foreign trade performance and the specialization of each country⁹⁵. In our analysis we will use indicators such as the value of exports and imports, net trade, geographic and product concentration⁹⁶, the main export group and the Lafay index of international trade specialization⁹⁷.

These indices were calculated using the statistical database of UN Comtrade (Standard International Trade Classification, Rev.3) and for some of the indices we used data from a second level of disaggregation.

Results

Although many aspects of the SEE economies are similar, some of them are quite different.

After the initial decrease, in 2010 the international trade began to recover gradually but each of the SEE countries recovered at a different rate (see Fig. 2 and Fig. 3). Overall, however, all countries reported significant deficits in their net trade in goods (see Fig. 4).

The lowest degree of deviation from the average GDP in the period (2008-2012) was reported for Albania (4.02%), Bosnia and Herzegovina (4.28%) and Montenegro (4.37%)⁹⁸ while the highest degrees of deviation was reported for Serbia (10.85%), Greece (11.74%) and Moldova (12.41%).

⁹⁴ See: Adamov, V. and Zahariev. A. International Finance. Svishtov, 2014; Damyanov, At. and others. International Economy. V. Tarnovo, Faber, 2011.

⁹⁵ Legend of SEE Countries: Albania (AL), Bosnia and Herzegovina (BA), Bulgaria (BG); Croatia (HR); Greece (GR); TFYR of Macedonia (MK), Moldova (MD), (Montenegro (ME), Romania (RO), Serbia (RS), Turkey (TR).

⁹⁶ The Hirshman Index and the Herfindahl Index are widely used for this purpose. The Hirschman index is a measure of product concentration of exports. It shows the degree to which a country's export consists of different products. High concentration levels are interpreted as high dependence from the trade with specific products. The values of HI fluctuate between 0 and 1. Values close to 1 indicate a high level of concentration. The geographical concentration is measured by the Herfindahl Index.

⁹⁷ Note. The Lafay index value may be below -1 as well as above +1. Positive values of the Lafay index indicate the existence of comparative advantages in a given item; the larger the value the higher the degree of specialisation. On the contrary, negative values points to de-specialisation.

⁹⁸ Note. These results show the coefficient of variation of each country's GDP from its average for the period.

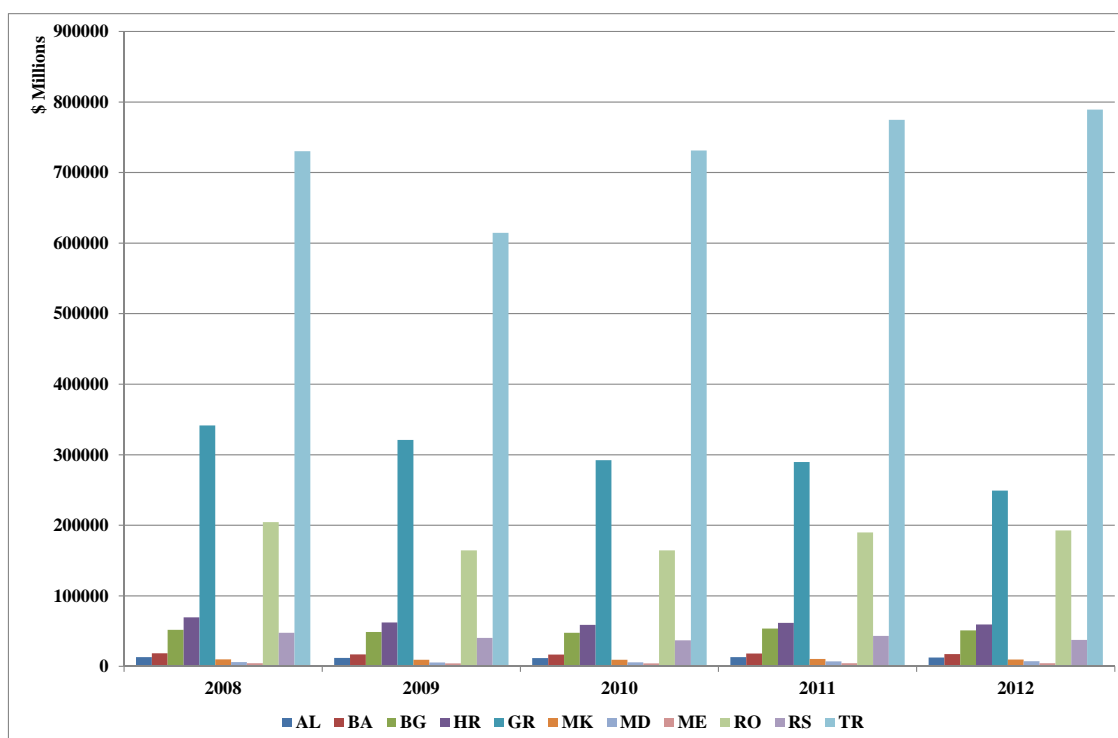


Figure 1. GDP of SEE Countries⁹⁹

The ratio of the range of GDP levels towards the lowest (crisis) annual GDP of each of the 11 SEE countries varies from 9.36% to 37.13% as follows: Albania (9.36%); Montenegro (9.84%); Bosnia and Herzegovina (10.54%); TFYR of Macedonia (12.08%); Bulgaria (12.19%); Croatia (18.21%); Romania (24.33%); Turkey (28.43%); Serbia (29.12%); Moldova (33.34%); Greece (37.13%).

The lowest deviation from the average level of export of goods in the period (2008-2012) was reported for Croatia (11.29%), Serbia (13.29%) and Bosnia and Herzegovina (13.80%). The highest deviation was reported for TFYR of Macedonia (23.34%), Albania (24.07%) and Greece (24.07%).

⁹⁹<http://data.worldbank.org/indicator/NY.GDP.MKTP.CD>.

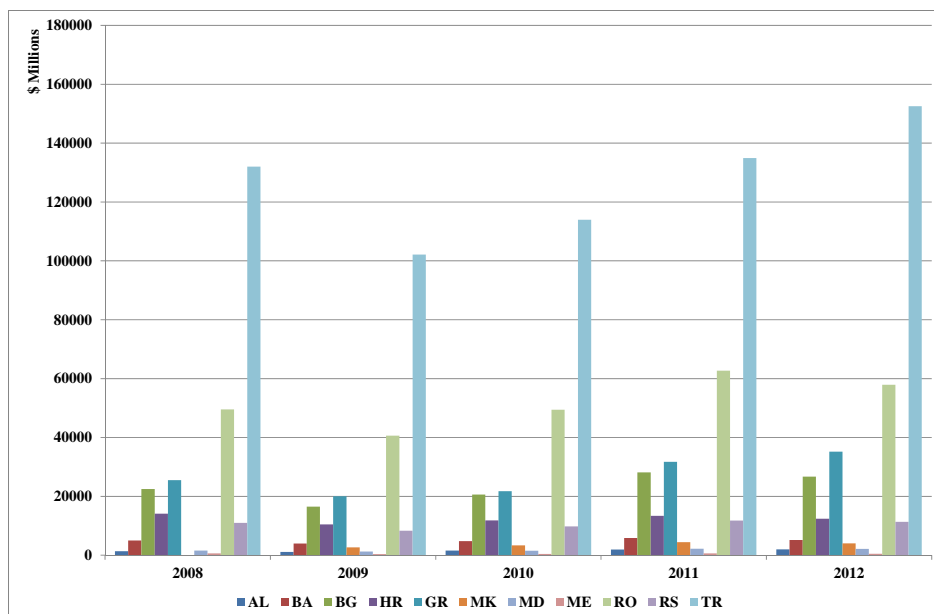


Figure 2. Export of goods of SEE Countries

The ratio of range of the levels of export of goods towards the lowest (crisis) annual level of each of the 11 SEE countries varies from 34.6% to 80.9% as follows: Croatia (34.6%); Serbia (41.2%); Bosnia and Herzegovina (48.0%); Turkey (49.3%); Romania (54.3%); Montenegro (61.9%); TFYR of Macedonia (65.5%); Bulgaria (70.7%); Moldova (72.8%); Greece (75.4%); Albania (80.9%).

The lowest deviations of the level of import of goods in the period 2008 – 2012 were reported for Albania (7.68%), Macedonia (14.10%) and Serbia (14.38%) while the highest deviations were reported for Moldova (19.47%), Turkey (20.36%) and Montenegro (24.18%).

The ratio of range of the levels of import of goods towards the lowest (crisis) annual level of each of the eleven SEE countries varies from 18.63% to 71.00% as follows: Albania (18.63%); TFYR of Macedonia (38.95%); Serbia (42.55%); Bosnia and Herzegovina (45.73%); Greece (46.80%); Romania (52.91%); Croatia (53.12%); Bulgaria (58.59%); Moldova (59.01%); Turkey (70.97%); Montenegro (71.00%).

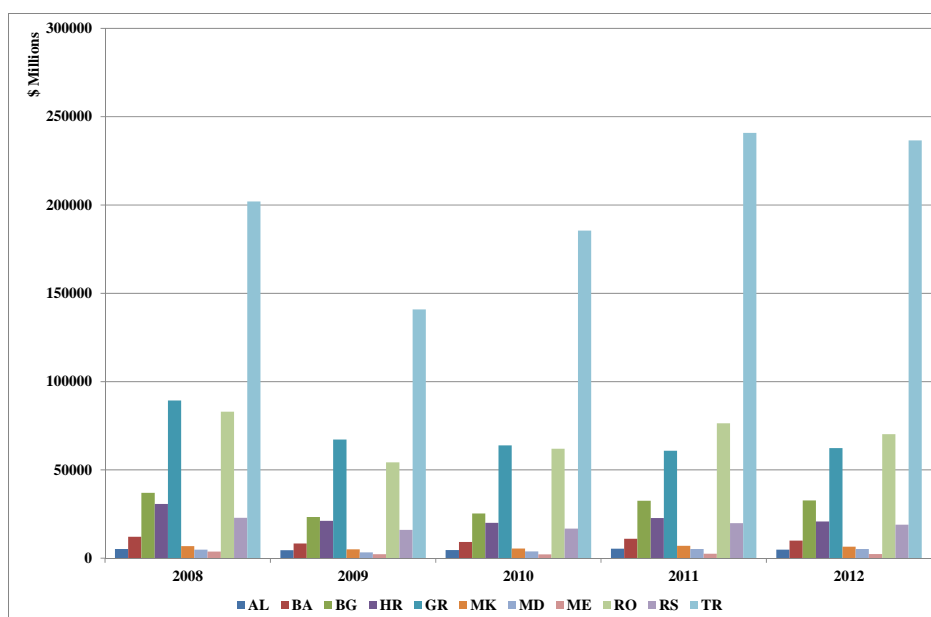


Figure 3. Import of goods of SEE Countries

The comparison of the ration of the annual export/import range (2008 – 2012) and the lowest level of foreign trade operations has shown that export is much more sensitive to the impact of the crisis (an index value of 34.6% for the country with the best level of export (Croatia) vs. an index value of 18.63% for the country with the best level of import (Albania)).

Regarding their net trade in goods all countries reported huge deficits (from 9.19% do 48.58% of GDP) of their balance of payments in the period. The reported average annual deficits (as a percentage of GDP) of foreign trade in goods for the period were as follows: Romania (9.19%); Turkey (10.00%); Greece (13.75%); Bulgaria (14.40%); Croatia (16.90%); Serbia (20.38%); Albania (26.79%); Bosnia and Herzegovina (29.42%); TFYR of Macedonia (33.64%); Moldova (43.12%); Montenegro (48.58%).

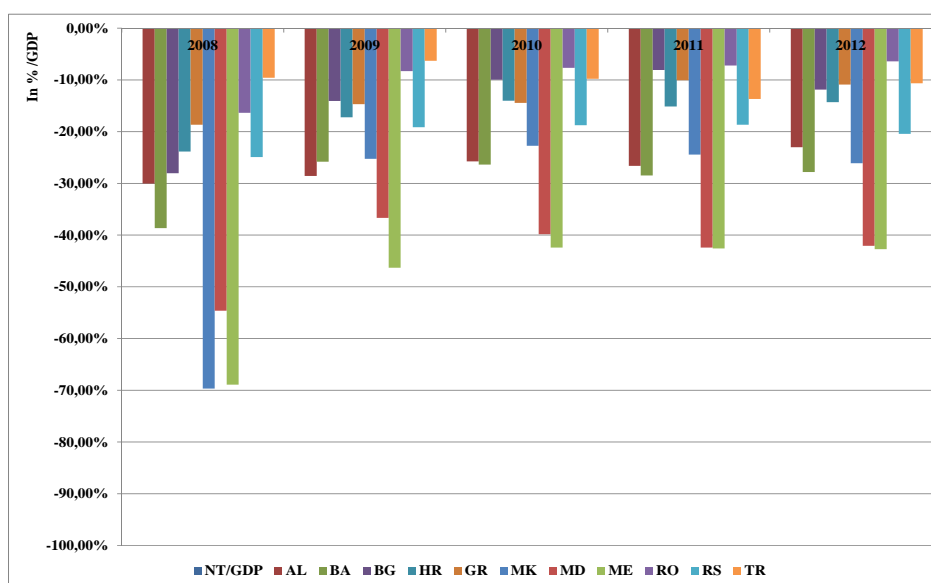


Figure 4. Net trade in goods (in %/GDP) of SEE Countries

The world trade ranks (see Table 1) of the SEE countries were as follows:

- between 32 and 168 in the export of goods;
- between 28 and 126 in the export of services;
- between 21 and 152 in the import of goods; and
- between 40 and 159 in the import of services.

The best world positions of the SEE countries of the four indices were reported for Turkey, followed by:

- Romania, Greece and Bulgaria in the export of goods;
- Greece, Croatia and Romania in the export of services;
- Romania, Greece and Bulgaria in the import of goods; and
- Greece, Romania and Bulgaria in the import of services.

Most of the SEE countries have a balanced structure of exports and imports. The data show that none of the commodity groups is main group, i.e. has a share higher than 50%. Note that a group that invariably accounts for a relatively high share of the import (as well as the export of some countries) is group 33 (Petroleum, petroleum products and related materials), which is understandable considering the availability of oil fields. The share of this group was particularly high in both the import and the export of Greece in 2012 (see Table 2).

Table 1. Rank in world trade of SEE countries

SEE Countries	Rank in world trade, 2012			
	Export		Import	
	Merchan-dise	Com. Services	Merchan-dise	Com. Services
AL	135	101	130	111
BA	110	117	98	158
BG	67	61	63	75
HR	84	49	75	83
GR	62	32	47	48
MK	118	118	117	133
MD	134	126	127	137
ME	168	114	152	159
RO	56	53	43	61
RS	86	80	78	82
TR	32	28	21	40

Other groups with large shares of the foreign of trade of the SEE countries are: 77 (Electrical machinery, apparatus and appliances, n.e.s., and electrical parts thereof (including non-electrical counterparts, n.e.s., of electrical household-type equipment)), 78 (Road vehicles (including air-cushion vehicles)), 67 (Iron and steel); group 68 (Non-ferrous metals), 84 (Articles of apparel and clothing accessories) and 28 (Metalliferous ores and metal scrap.)

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Overall, the relative shares of all commodity groups in the international trade of the SEE countries did not change significantly during the period 2008-2012.

The Lafay Index shows that during the period the SEE countries specialized in different commodity groups. Bosnia and Herzegovina, Turkey, Moldova, Serbia and Romania retained and even diversified their specialization, while the international trade positions of other countries such as Bulgaria, Croatia and Greece remained unchanged.

Table 2. Share of commodity groups in the total foreign trade of SEE countries (2008; 2012)¹⁰⁰

SEE Countries	2008				2012			
	Share in export		Share in import		Share in export		Share in import	
	5-10 %	>10 %	5-10%	>10%	5-10 %	>10 %	5-10 %	>10%
AL	33;67	28;84*;85	33;69;78		28;67	84;85;33*	35;78	33
BA	24;28;35;67; 68;69;82			33	28;67;68;69; 82;85		33;78	
BG	67;77;84	33;68	67;78	33	77;84	33;68	28;77	33
HR	33;77	79	79	33	77;79	33		33
GR	05;54;66;67;84	33	54;78	33	05;68	33*	54	33*
MK	05;67 ¹⁰¹	84*	65;67;78		28;33	59;67*84	65;67;68	33
MD	05;77	11;84	34;77;78	33	11;77	05;84	65;77;93	33
ME	11	67*;68*	33;66;78		28;11	35;68*	35;78	33
RO	33;67;78;84	77	33;67;77	78	74;84	77;78	33;74;77;78	
RS	68;84	67	34;78	33	04;68;77;78		33;34;78;93	
TR	33;65;77	67;78;84	67;78;93	33	65;67;77;78;84;97		33;78	93

Table 3. Lafay Index of SEE countries (2008;2012)

SEE countries	2008				2012			
	From 1 to 5	>5	From -1 to -5	< -5	From 1 to 5	>5	From -1 to -5	< -5
AL	28;67	84; 85	04;35;74;77;78		28;67;84;85	33	04;35;54;65; 77;78	
BA	24;28;35;67; 68;71; 82;85		33;78		24;25;52;67;68; 69;82;85;93		33;78	
BG	04;35;84	68	33;34;72;78		04;22;84	68	28;33;34;78	
HR	24;77;79		33;67;78		24;28;77;79		33;35;67;78	
GR	05;68		33;78		05;33;68		34;54;79	
MK	05;11;85;93 ¹⁰²	84	65;74;78		05;12;74	59;67; 84	33;35;65;68;78	
MD	05;11;22;27;42	84	33;34;35;78		05;11;22;42;77; 82;84		33;78;93	
ME	67	68	33;35;66;78		24;28;35	68	33;78	
RO	77;79;82;84		35;54;65;78		62;77;78;82;84		33;54;65	
RS	04;05;67;68;84		33;34;72;74;78		04;05;28;62;68; 77;84		33;34;57;93	
TR	05;65;66;67;69; 78;84		28;33;57;93		05;65;67;69;77; 78;84;97		28;33;57	93

On the other hand the advantages of Macedonia and Montenegro in the trade in goods changed significantly (see Table 3).

¹⁰⁰Note. * indicates a value greater than 20 %. The table shows only the groups with a relative share of at least 5%.

¹⁰¹Calculations for TFYR of Macedonia are for the year 2009 because of lack of information for the year 2008.

¹⁰²Calculations for TFYR of Macedonia are for the year 2009 because of lack of information for the year 2008.

None of the SEE countries reported a significant geographical concentration in terms of both its exports and imports. The highest values of the Herfindahl index were reported for the export of Albania, followed by Montenegro and Moldova because they traded with fewer countries, especially in 2008 (see Table 4). Although the SEE countries trade with partners from all over the world, the EU remains the main trade partner most countries in this region (except for Greece, Moldova, Turkey and Montenegro in terms of export, and for Bulgaria and Bosnia and Herzegovina in terms of import) with a relative share of both their export and import exceeding 50%. Other important partners for many of the SEE countries were Turkey and Russia.

Table 4

SEE Countries	Geographical concentration			
	2008		2012	
	export	import	export	import
Albania	0.401	0.112	0.287	0.129
Bosnia and Herzegovina	0.103	0.078	0.088	0.073
Bulgaria	0.050	0.067	0.049	0.073
Croatia	0.088	0.074	0.069	0.069
Greece	0.049	0.051	0.041	0.050
TFYR of Macedonia	-	0.056	0.134	0.060
Moldova	0.113	0.083	0.139	0.078
Montenegro	0.203	0.092	0.128	0.119
Romania	0.072	0.067	0.069	0.069
Serbia	0.066	0.063	0.061	0.053
Turkey	0.035	0.055	0.035	0.048

The values of the Hirschman index (which measures product concentration of exports) are quite similar. The top ranking countries according to this index are again Montenegro and Albania. In 2008 the groups 67 (Iron and steel) and 68 (Non-ferrous metals) accounted for about 66% of the total export of Montenegro compared to 40% in 2012. The greatest share of Albania's export have groups 84 (Articles of apparel and clothing accessories) and 85 (Footwear.)

Table 5

SEE Countries	Product concentration			
	2008		2012	
	export	import	export	import
Albania	0.128	0.035	0.130	0.040
Bosnia and Herzegovina	0.047	0.036	0.044	0.042
Bulgaria	0.058	0.053	0.056	0.062
Croatia	0.048	0.045	0.040	0.045
Greece	0.043	0.055	0.155	0.128
TFYR of Macedonia	-	0.052	0.096	0.048
Moldova	0.070	0.042	0.063	0.044
Montenegro	0.245	0.041	0.155	0.038
Romania	0.050	0.044	0.052	0.040
Serbia	0.041	0.043	0.035	0.037
Turkey	0.065	0.049	0.053	0.055

In 2012 the trade concentration of Greece increased due to the large volumes of trade in group 33 (Petroleum, petroleum products and related materials) (see Table 5).

* * *

We may conclude that the economic crisis of 2008 has had a tangible effect on the foreign trade of the See countries. After the record low levels of their GDP as well as import and export of goods in 2009, the countries entered a period of gradual recovery and growth (2010-2012). According to the Lafay Index, the most important factor for the post-crisis recovery of the SEE economies was the increase of the volume of their foreign trade with their main trade partners in goods related to their trade specialization.

Appendix

0 - Food and live animals; 00 - Live animals other than animals of division 03; 01 - Meat and meat preparations; 02 - Dairy products and birds' eggs; 03 - Fish (not marine mammals), crustaceans, molluscs and aquatic invertebrates, and preparations thereof; 04 - Cereals and cereal preparations; 05 - Vegetables and fruit; 06 - Sugars, sugar preparations and honey; 07 - Coffee, tea, cocoa, spices, and manufactures thereof; 08 - Feeding stuff for animals (not including unmilled cereals); 09 - Miscellaneous edible products and preparations

1 - Beverages and tobacco; 11- Beverages; 12 - Tobacco and tobacco manufactures

2 - Crude materials, inedible, except fuels; 21 - Hides, skins and furskins, raw; 22 - Oil-seeds and oleaginous fruits; 23 - Crude rubber (including synthetic and reclaimed); 24 - Cork and wood; 25 - Pulp and waste paper; 26 - Textile fibres (other than wool tops and other combed wool) and their wastes (not manufactured into yarn or fabric); 27 - Crude fertilizers, other than those of division 56, and crude minerals (excluding coal, petroleum and precious stones); 28 - Metalliferous ores and metal scrap; 29 - Crude animal and vegetable materials, n.e.s.

3 - Mineral fuels, lubricants and related materials; 32 - Coal, coke and briquettes; 33 - Petroleum, petroleum products and related materials; 34 - Gas, natural and manufactured; 35 - Electric current

4 - Animal and vegetable oils, fats and waxes; 41 - Animal oils and fats; 42 - Fixed vegetable fats and oils, crude, refined or fractionated; 43 - Animal or vegetable fats and oils, processed; waxes of animal or vegetable origin; inedible mixtures or preparations of animal or vegetable fats or oils, n.e.s.

5 - Chemicals and related products, n.e.s.; 51 - Organic chemicals; 52 - Inorganic chemicals; 53 - Dyeing, tanning and colouring materials; 54 - Medicinal and pharmaceutical products; 55 - Essential oils and resinoids and perfume materials; toilet, polishing and cleansing preparations; 56 - Fertilizers (other than those of group 272); 57 - Plastics in primary forms; 58 - Plastics in non-primary forms; 59 - Chemical materials and products, n.e.s.

6 - Manufactured goods classified chiefly by material; 61 - Leather, leather manufactures, n.e.s., and dressed furskins; 62 - Rubber manufactures, n.e.s.; 63 - Cork and wood manufactures (excluding furniture); 64 - Paper, paperboard and articles of paper pulp, of paper or of paperboard; 65 - Textile yarn, fabrics, made-up articles, n.e.s., and related products; 66 - Non-metallic mineral manufactures, n.e.s.; 67 - Iron and steel; 68 - Non-ferrous metals; 69 - Manufactures of metals, n.e.s.

7 - Machinery and transport equipment; 71 - Power-generating machinery and equipment; 72 - Machinery specialized for particular industries; 73 - Metalworking machinery; 74 - General industrial machinery and equipment, n.e.s., and machine parts, n.e.s.; 75 - Office machines and automatic

data-processing machines; 76 - Telecommunications and sound-recording and reproducing apparatus and equipment; 77 - Electrical machinery, apparatus and appliances, n.e.s., and electrical parts thereof (including non-electrical counterparts, n.e.s., of electrical household-type equipment); 78 - Road vehicles (including air-cushion vehicles); 79 - Other transport equipment

8 - Miscellaneous manufactured articles; 81 - Prefabricated buildings; sanitary, plumbing, heating and lighting fixtures and fittings, n.e.s.; 82 - Furniture, and parts thereof; bedding, mattresses, mattress supports, cushions and similar stuffed furnishings; 83 - Travel goods, handbags and similar containers; 84 - Articles of apparel and clothing accessories; 85- Footwear; 87 - Professional, scientific and controlling instruments and apparatus, n.e.s.; 88 - Photographic apparatus, equipment and supplies and optical goods, n.e.s.; watches and clocks; 89 - Miscellaneous manufactured articles, n.e.s.

9 - Commodities and transactions not classified elsewhere in the SITC; 91 - Postal packages not classified according to kind; 93 - Special transactions and commodities not classified according to kind; 96 - Coin (other than gold coin), not being legal tender; 97 - Gold, non-monetary (excluding gold ores and concentrates)

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LONGLIVE THE DIFFERENCE: RESTRUCTURING AND PRIVATIZATION IN CENTRAL AND EASTERN EUROPE

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ABSTRACT

The Central and Eastern European Countries, including Romania, have faced similar challenges in the process of restructuring and privatization.

Thus, the last two decades have been marked by a difficult transition from a centrally planned economy to a free market model, and experienced very different phases of development .

Most CEEC's economies have registered, in the early years of the first decade, suboptimal economic performances characterized by severe declines in the GDP, huge losses of the SOE and substantial inter-enterprise arrears. The core objective for all CEEC was to restore efficient employment of industrial assets; both capital and labor, solving the debt overhang of enterprises and the portfolio quality problem in banks.

The privatization process was started in most of the countries in the same period, but there is a clear evidence that privatization was achieved more rapidly in some countries due to influx of significant foreign investment. As countries used mass privatization programs, the actual change to ownership restructuring was made directly through privatization or IPOs. This shift to a new paradigm, underpins the second wave of restructuring that can be noticed in the case of Romania and other countries in Central and Eastern Europe.

Given the circumstances, in a first phase the dominant place among the economic policies used was to encourage restructuring of SOE and its ultimate phase: the privatization, both aiming at speeding up the transition to a mature market economy. At this stage time was of the essence and it was imperative that immediate steps are to be taken to prevent further deterioration of SOE's operations and to preserve value that can ultimately be privatized. Most analysts criticized the reforms made in some of CEEC's economies based on "pre- privatization restructuring", ignoring the need and vocation of SOE's restructuring process that paved the way of further successful large-scale privatizations.

The large-scale privatization has emphasized a serie of challenges, that states the purpose of this article which is to create the framework for analysing restructuring and privatization as methods of high-impact on macroeconomic indicators.

Our study aims at analyzing the differences between these two processes within the territory of CEEC over the last two decades (1992-2013) in terms of: goals, patterns, institutions, methods used, outcomes etc. Results of these processes have been analyzed in correlation with the evolution of CEEC's macro-indicators (FDI, GDP, Inflation Ratio, Exports) or micro ones (Stock Exchange). Our findings underlie the necessity of further research in the field of restructuring and privatization and the necessity of assessing the important effects on post-crisis macroeconomic indicators.

Keywords: restructuring of SOE, privatization, liquidation, corporate governance, privatization, economic crisis

JEL codes: D21, D23,D24, G28, G32,G34, L33, O16.

INTRODUCTION

The purpose of this paper was two-fold:

- to improve the analysis of the differences between these two processes (privatization and restructuring) within the territory of CEEC over the last two decades (1992-2013) in terms of: goals, patterns, institutions, methods used, outcomes etc;
- to underpin the correlation between the restructuring results, followed by privatization and the impact on macroeconomic figures (FDI, GDP, Inflation Ratio, Exports) or micro ones (Stock Exchange)

Literature Review

Over the past fifteen years there has been a vast literature on FDI in Eastern Europe. This is not surprising, since foreign capital has played an important role in most countries during the twenty-year transition to market economy. A number of studies have looked into the key features of FDI in Eastern Europe – its volume, forms, origins, destination by economic activity, and case studies (see, for example, Lankes and Venables, 1996; Meyer, 1998; Estrin, Richet and Brada, 2000; Bartlett, 2008; Kolotai, 2010; Hunya, 2011,2012), as well as the determinants of FDI based on econometric research (for example, Bevan and Estrin, 2004; Bevan, Estrin and Meyer, 2002; Janicki and Wunnava, 2004; Dikova and van Witteloostuijn, 2007).

Romania - had a tenfold increase in its inward FDI stock between 2000 and 2010 - from US\$ 7 billion in 2000 to US\$ 70 billion in 2010. The theory of the multinational enterprise (MNE) suggests that firms engage in outward FDI when they have some resources that they can transfer and exploit, known in the literature varyingly as firm specific advantages (FSAs) (Rugman, 1982) or ownership (O) advantages (Dunning, 1993). Only certain types of firms and products are suitable for exploiting these advantages through internalization (I), namely creating subsidiaries for research, production and distribution in other countries, rather than by exporting or the use of licenses and long term contracts. Finally, the choice of location (L) is driven by firms finding the optimal place where to *combine* their FSAs with locational advantages to both exploit and explore their FSAs. This framework is known as the OLI paradigm (Dunning, 1993, Dunning & Lundan, 2009). It argues that firms expand internationally where they can redeploy their internationally-transferable proprietary resources and capabilities to both exploit and explore their resource base. The combination of the FSAs of the firm with the specific conditions found in potential host locations is essential. In other words, different types of firms are attracted to different locational advantages. The study of locational determinants of FDI represents a long-established literature that originated with Mundell's (1957) factor endowment theorem(see Brainard,

1997). The predominant empirical approach to the study of FDI flows is based on gravity models borrowed from international trade research, which posit that the main drivers of trade or foreign investment flows are a) the size of the host economy, b) the size of the source economy, and c) the distance between the two economies (Bloningen, 2005, Carr et al., 2001). While these variables have persistently shown to be an important – if not the most important – determinants of the attraction of FDI (Chakrabarti, 2001, Anderson and van Wincoop, 2003), recent literature has considerably broadened the notion of locational advantages to encompass the attractiveness of a potential host economy as both a site for production and as a market. Contemporary literature therefore additionally considers:

1. the costs of production, especially unit labour costs (or wage differentials) and locally available intermediate goods (Bevan and Estrin, 2004);
2. specifically for investment in the primary sector, the presence of natural resources (Hejazi & Pauli, 2003);
3. the institutional framework facilitating or inhibiting the operations of foreign investors, either in an aggregate form, by focusing on specific aspects such as corruption (Habib and Zurawicki, 2002), or by analyzing multiple aspects simultaneously (Bevan et al., 2004, Globerman and Shapiro, 2003, Grosse and Trevino, 2005);
4. membership of international trade and economic associations; for example Bevan and Estrin (2004) studying transition economies explored the effects of announcements of likely European Union (EU) membership.

One can also come to a similar estimating framework by considering the four classic motivations for FDI (Dunning, 1993); these are market seeking; efficiency seeking; resource seeking; and asset seeking. Market seeking FDI is driven by size and growth of the host economy market; for example the large inflows of FDI to China in recent years have often been argued to be explained in terms of firms seeking new or quickly growing markets for their products. Market seeking investments probably also played an important role in the investment into the transition economies, especially in the early years (Lankes and Venables, 1996; Estrin et al., 2004).

For most transition economies, the process of privatization has formed a distinct motivation for FDI. Western multinationals are attracted to enter reforming economies during privatization programmes by making acquisitions because prices are relatively low and because of highly favorable tax policies or even subsidies associated with the privatization.

Throughout the transition region, foreign capital has been an important supplement to domestic savings, and thus has greatly contributed to financial accumulation during the past twenty years. In the transition region the ratio of FDI to gross fixed capital formation has tended to be higher than the world average and has increased over time (Kalotay, 2010). Recent data suggest that FDI has contributed quite substantially to gross fixed capital formation in all the CEEC countries from 2003 onwards (Uvalic and Estrin 2013). The stock of inward FDI as a percentage of GDP is considered an indicator of foreign capital penetration in an economy (UNCTAD World Investment Report-26 July 2011)

FDI contribution to structural changes

FDI has played an important role in enterprise restructuring in the whole transition region during privatizations, in this way greatly strengthening the private sector and contributing to structural changes. Industrial restructuring usually tended to accelerate when privatization involving FDI was implemented, frequently creating a dichotomy between the modern, foreign owned enterprises and the traditional industries. The dominant view has been that FDI has had positive spill-over effects for the whole economy, though there have also been findings that run counter to such optimistic conclusions (see, for example, Mencinger, 2003).

Restructuring and Privatization

Frydman, Rapaczynski et al (1993) – discussed about legal and ownership structure, institutions for state regulation, overview of privatization process and the initial transformation of enterprises. Some authors refer to transition economies in the early stages of transformation as a “weakly structured market economy” (Dobrescu 1996) or a “previously centrally planned economy” (Calvo and Fenkel 1991). Grosfeld and Senik (1996) They were thinking that the change of ownership was a necessary and a sufficient condition of capitalism. The literature on financial repression and financial reform provides a thorough macroeconomic link between the development of financial markets and economic growth (Fry 1982, 1993, 1995, Roubini and Sala-i-Martin 1992, Rayon 1994, Chang 1994). The need for a closer analysis of the microeconomic roots of financial repression, however, is a new approach in the studies of financial markets in developing and transition economies (Amrit-Poser 1996, Popa 1998). Nicolescu et al (1996) – developed the “efficiency-based” restructuring concept and Crum and Goldberg (1998) – analyzed restructuring as a complex set of decisive measures in order to increase competitiveness.

The inter-enterprise arrears, as well as the bank, tax and wage arrears phenomena provide a good example of a microeconomic problem in the financial markets of Romania. The accumulation of inter-enterprise arrears can also cause inflation. Monetary control can be defeated by firms that circumvent a tight credit market by creating their own liquidity through trade credits (e.g. Daianu, 1994). Credit and liquidity constraints affect indiscriminately viable and non-viable businesses, or, even worse, create adverse selection effects – artificially sustaining large loss-makers and preventing new private firms from developing profitable investment projects (see Berglöf and Roland 1997 and 1998). As shown in Croitoru and Schaffer (2000) for the case of tax arrears, an increasing real gross arrears aggregate would be a sign that more and more firms are running into arrears. In Romania’s case, the commitment of the government to economic reforms by liquidating inefficient firms Stiglitz (1994, p. 238) would have extended mainly to state-run utility companies because they were the biggest actors in accumulating enterprise arrears (Santarossa, 2001; OECD, 2002).

Bowman and Singh (1999) classified restructuring activities into three categories namely portfolio restructuring, financial restructuring and organizational restructuring. Kornai (2000) considers that the pre-privatization restructuring serves as a useful screening device in order to interest private investors, who buy the firms.

Debande and Friebel (2004) advocates for the firmly reestablishing of the State control of SOE cause it avoids that (unproductive) managers abuse and divert capital or funds which are for restructuring. Djankov (1998) – selected a sample of Romanian companies from the period 1992-1996. He concludes that isolating programs have delayed restructuring imposing budget constraints on loss-making enterprises. on the other hand Djankov (1999) – studies the relation between ownership structure and enterprise performance in newly independent states: Georgia, Kazakstan, Kyrgyz Republic, Moldova and Russia. He concluded that non-linear analysis showed some significant relation between different types of ownership and enterprise restructuring. Fidrmucova (2000) made an analysis on channels of restructuring on a panel of Czech companies and found that investment is not a significant determinant of enterprise performance. Koh, Dai & Chang (2010) – examined the impact of lifecycles on restructuring strategies. Distress firm's access to different types of restructuring strategies is limited by the lifecycle stage they are in. Frydman, Hessel & Rapaczynski (2001) – followed the entrepreneurship and restructuring of enterprises in Central Europe (Czech Republic, Hungary and Poland) and explained the market impact of ownership on firm performance. Sberman (2002) analyzed restructuring as diverse activities such as divestiture of under-performing business, spin-offs, acquisitions, stock repurchases and debt swaps. Gibbs P.A. (2007) considers that restructuring means changes in the operational structure, investment structure, financing structure and governance structure of a company.

SEQUENCING RESTRUCTURING, PRIVATIZATION AND FDI IN CEE

The Central and Eastern European Countries, including Romania, have faced similar challenges in the process of restructuring and privatization. Thus, the last two decades have been marked by a difficult transition from a centrally planned economy to a free market model, and experienced very different phases of development. The Central and Eastern European Countries had a common general aim in the early 1990s: a transition to a more effective economic system, based on principles of market economy, enabling a growth of living standards.

The reforms of the early 1990s focused on stabilization, liberalization and the privatization of existing firms (SOE). Some countries, such as Poland and Slovenia, registered significant entrepreneurial activity, but showed that entrepreneurship levels were in fact lower in the transition economies as a group than in the other developed and developing economies.

Most CEEC's economies have registered, in the early years of the first decade, suboptimal economic performances characterized by severe declines in the GDP, huge losses of the SOE and substantial inter-enterprise arrears. The core objective for all CEEC was to restore efficient employment of industrial assets; both capital and labor, solving the debt overhang of enterprises and the portfolio quality problem in banks. The privatization process was started in most of the countries in the same period, but there is a clear evidence that privatization was achieved more rapidly in some countries due to influx of significant foreign investment. As countries used mass privatization programs, the actual change to ownership restructuring was made directly through privatization or IPOs. This shift to a new paradigm, underpins the second wave of restructuring that can be noticed in the case of Romania and other countries in Central and Eastern Europe.

Given the circumstances, in a first phase the dominant place among the economic policies used was to encourage restructuring of SOE and its ultimate phase: the privatization, both aiming at speeding up the transition to a mature market economy. At this stage time was of the essence and it was imperative that immediate steps are to be taken to prevent further deterioration of SOE's operations and to preserve value that can ultimately be privatized. Most of analysts criticized the reforms made in some of CEEC's economies based on "pre-privatization restructuring", ignoring the need and vocation of SOE's restructuring process that paved the way of further successful large-scale privatizations.

During the transformation crisis (1990–1994/1995), CEE countries experienced a major economic recession.

Instead of the almost continuous, even if at times very modest, improvement of average income per capita that many EU countries have experienced, these countries had to deal with a huge decline in personal income, made even worse by a total collapse of their social institutions. The situation in the CEE countries was in many cases much worse than that of the leading Western economies in the 1930s as the table below shows:

Table 1 The Transition Recession

Countries	Consecutive years of output decline	Cumulative output decline (percent)	Real GDP 2000 (1990 = 100)
Bulgaria	4	16	81
Croatia	4	36	87
Czech Republic	3	12	99
Estonia	5	35	85
Hungary	4	15	109
Latvia	6	51	61
Lithuania	5	44	67
Poland	2	6	112
Romania	3	21	144
Slovakia	4	23	82
Slovenia	3	14	105
CIS	6.5	50.5	62.7
Output decline during the Great Depression 1930-34			
France	3	11	N/A
Germany	3	16	N/A
United Kingdom	2	6	N/A
United States	4	27	N/A

Source: World Bank 2002: Transition, The First Ten Years.

Subsequently, however, they followed a robust growth path (1995–2007), and were among the most dynamically developing regions of the world. From the mid 1990s to the onset of the global financial crisis in 2008, the economies of Central and Eastern Europe (CEE) established a record of growth and economic progress that few regions have matched. Emerging from decades of socialism, the nations that we consider—Bulgaria, Croatia, the Czech Republic, Hungary, Poland, Romania, Slovakia, and Slovenia—became standout performers in the global economy. They unleashed the inherent strengths of their economies by privatizing state-owned industries and implementing labor reforms.

The FDI inflow in the CEE economies has been a vital factor in the first stage of the privatization process during the transition period and has started to be seen as a crucial source of capital and potential catalyst for the economic and social transformation . The volume of FDI inflows has grown rapidly, as the Governments of the CEE countries have been officially encouraging FDI and developing a formal FDI promotion programs providing substantial incentives for the foreign companies. FDI helped drive productivity improvements and rising per capita GDP. Foreign direct investment has increased in the past twenty years to become the most common type of capital flow during transition period in the CEE. The most important economic reason for attracting FDI at the beginning of the transformation process was to facilitate the privatization and restructuring of the central planning economies The economic miracle of the 2000s was ended by the current global crisis in 2008.

But, time for change has come and the pre-crisis growth model, which was built largely on booming credit growth and huge inflows of cheap capital from abroad, stopped to be the basis for future growth, and foreign investment is likely to stay well below levels seen in 2005-08, at least for the foreseeable future.

Enterprise restructuring is the process through which an enterprise adjusts its behavior to changes in its circumstances arising from actions of rivals, changes in market conditions, technological changes, institutional reforms or economic policies. These changes provide the enterprises with an opportunity to change their operations in order to expand their market share (often at the expense of their rivals). Enterprises which do not react to changes in their circumstances will ultimately suffer the consequence and may be driven out of the market. However, the competitiveness of nations and industries rests on the back of their enterprises - whose ability to compete in turn depends on their behavior. From here it follows that enterprise restructuring holds the key to competitiveness of enterprises, industries and national economies. Enterprise restructuring is part of the wider concept of economic restructuring which also includes changes in the relative size of different sectors of the national economy, development of new forms of inter-enterprise networks and changes in the structure of production at the level of industry . Restructuring measures are often necessary **to** enable the privatization of an SOE. Where the purpose is to make an enterprise at least potentially viable as a going concern once it is privatized, restructuring measures will focus mainly on the management and finances of the SOE. If the SOE is governed by public law, it will probably have to be converted into a company established under private law. In other cases, more radical action may be deemed preferable, including breaking up the SOE or liquidating it completely. Decisions on prior restructuring are often complex and difficult. Those in charge should be committed to the privatization process and have broad powers to take the measures that may be needed. Such responsibility could be vested with the supervising ministry, the privatization agency, the management of the enterprise itself, or a special entity set up for the purpose, such as the public enterprises restructuring agency. In transition countries and other countries that need to radically restructure their parastatal sectors, a separate body is often designated to manage the public enterprises during the preprivatization period ;Albania, Romania, and Slovenia have set up separate SOE management and restructuring agencies. Though they avoid the problem of overburdening a single agency with too many responsibilities and often conflicting goals, parallel agencies

may increase the likelihood of battles over power and influence with the privatization agency, as illustrated by the pre-1995 situation in Hungary .

In many respects, the East German experience has important implications for the restructuring process in other post-socialist countries; in particular, the countries approaching EU-membership (Poland, the Czech and Slovak Republics, Hungary, Romania, Bulgaria, Slovenia, Lithuania, Latvia, Estonia). Basically, two patterns can be identified so far:

- 1) the "classical" approach with a central agency, controlling privatization, formally, but lacking control over its large number of enterprises;
- 2) the mass-privatization approach of diversifying and diluting ownership and control, favoring informal holding companies and insider control.

The privatization process was started in most of the countries in the same period, but there is a clear evidence that privatization was achieved more rapidly in some countries due to influx of significant foreign investment. As countries used mass privatization programs, the actual change to ownership restructuring was made directly through privatization or IPOs. Most of the Central and Eastern European countries were members of the Warsaw Pact and almost all took part in the COMECON, implying that the Central and Eastern European countries not only had domestically planned economies but also took part in economic planning at a regional level. With the exogenous shock of the Soviet collapse, the Central and Eastern European countries had the opportunity to fundamentally restructure their economic and political institution.

Some Central and Eastern European countries chose shock therapy to privatize, others succeeded in implementing more gradual reforms.

Privatization methods in CEE

Different privatization methods have created different profitable investment opportunities for the penetration of foreign firms. Studies present various major types of privatization methods like:

- i. employee ownership programmes and management buy-outs (*insiders* privatisation);
- ii. **voucher** (mass) privatization;
- iii. sales to local and foreign **strategic** investors;
- iv. privatization initial public offerings (**PIPOs**);
- v. **restitution** (return of assets to either the original owners or their heirs). *Mass or voucher privatization*. Eligible citizens can use vouchers that are **distributed free** or at nominal cost to bid for stakes in SOEs or other assets. This method has been used only in the transition economies of CEE. Problems: establishment of irresponsible quasishareholders and transfer of state assets to few political "cronies" without entrepreneurial and managerial skills, lack of finance resources.

Privatization through sale of state property. Government trades its ownership claim for an **explicit cash payment** through *direct sales* (or asset sales) of state-owned enterprises (or some parts thereof) to an individual, an existing corporation, or a group of investors. .

Privatization initial public offerings (PIPOs). Some or a government's entire stake in an SOE is sold to investors through a public share offering. PIPOs are structured **to raise money** and to respond to some of the political factors mentioned earlier.

Privatization through restitution. This method is appropriate when land or other easily identifiable property that was expropriated in years past can be returned to either the **original owners** or to their heirs. The major difficulty with this method is that the records needed to prove ownership are often inadequate or conflicting.

Table 2 Privatization Methods by Country

Country	Classification of privatization	Year of privatization	Primary method	Secondary method
Bulgaria	Full	1993	Direct sales	Vouchers
Croatia	Mixed	1992	MEBO	Vouchers
Czech	Mass	1992	Vouchers	Direct sales
Estonia	Full	1993	Direct sales	Vouchers
Hungary	Full	1990	Direct sales	MEBO
Latvia	Full	1992	Direct sales	Vouchers
Lithuania	Mass	1991	Vouchers	Direct sales
Poland	Full	1990	Direct sales	MEBO
Romania	Mixed	1992	MEBO	Direct sales
Slovak	Full	1995	Direct sales	Vouchers
Slovenia	Mixed	1998	MEBO	Vouchers

Note: Year of privatization was established based on EBRD information on Primary Method of privatization and its privatization chronicle. Date of privatization is consistent with primary method of privatization.

Sale of government or SOE assets, European Bank for Reconstruction and Development (EBRD) provides a complex tool to measure the privatization by weighing seven key variables: 1) privatization revenues (cumulative, in percent of GDP); 2) private sector share in GDP (in percent); 3) private sector share in employment (in percent); 4) budgetary subsidies and current transfers (in percent of GDP); 5) the share of industry in total employment (in percent); 6) the change in labour productivity in industry (in percent); and 7) investment/GDP (in percent). The data cover two privatization indicators: privatization of small-scale industries (EBRD-Small) and privatization of large-scale industries (EBRD-Large). Most privatization techniques have been borrowed from private commercial practices, where mergers and acquisitions are common. Other methods, however, are specific to SOE privatization and may have to be included in the privatization law if the government intends to use them. Privatization by free distribution of shares to the population, or by issuance of privatization vouchers or coupons, are perfect examples.

THE DIFFERENCE BETWEEN PRIVATIZATION, RESTRUCTURING AND FDI: THE ROMANIAN CASE

We will focus on the Romanian case of sequencing of restructuring and privatization processes. Romania started in 1993 the Restructuring Process that dominated the transformation of Romanian economy in the last twenty years. This process can be structured in two waves with two stages each as follows:

The FIRST WAVE (FW) started in 1993 known as the “Large-scale corporate and financial restructuring process” and consisted in two stages:

- a first stage of two exercises: a pilot program of 30 companies followed by a more systematic exercise that included in excess of 400 companies and regies autonomes focused on a “top-down” model of restructuring that was finalized with notable results 1993-1995;
- second stage (for accurate quantification of restructuring results purposes) known as “LARGE-SCALE PRIVATIZATION”(OWNERSHIP RESTRUCTURING” 1996-2000;

The SECOND WAVE (SW) started in 2001 and consisted in two stages as well:

- first stage 2001-2009 dedicated exclusively to the ownership restructuring (privatization) of SME’s and few large-sized companies through direct sale and initiated sale throuh IPO on the Bucharest Stock Exchange;
- second stage 2010-2013 that included three main categories: SOE for Stock Exchange listing (Nuclearelectrica, Romgaz, Transelectrica, Fondul Proprietatea,Transgaz etc., SOE for privatization and Special cases (Hidroelectrica,Oltchim,CFR Marfa etc)

Naturally, starting even with the second stage of the FW and in both stages of SW the restructuring process was based on a new paradigm, that ignored the involvement of the state institutions in the micromanagement of the process and focused on a unique element of a standard restructuring = the ownership restructuring.

THE IMPACT OF RESTRUCTURING,PRIVATIZATION AND FDI ON MACRO AND MICRO AGGREGATES:

We focused in this paper ,too, on the Romanian case of sequencing of restructuring and privatization processes in relationship with FDI. Romania started in 1993 the Restructuring Process that dominated the transformation of Romanian economy in the last twenty years.

This segregation in waves and stages on the one hand and of the results of restructuring(in immediate -short-term and long-term as result of the finalization of the restructuring process through ownership restructuring in the second stage of the FW, on the other hand gives us the possibility to better quantify the effects of the restructuring process in Romania.

A key result is that the effects of restructuring in both waves are positive, which provides evidence in support of the structure-conduct-performance hypothesis, while at the same time some relevance of the efficient-structure hypothesis cannot be rejected.

Based on the segregation that we stated, we computed correlations with: Real GDP, FDI and exports, BET index and EBRD: large scale privatization index, small scale privatization index, government and enterprise restructuring index.

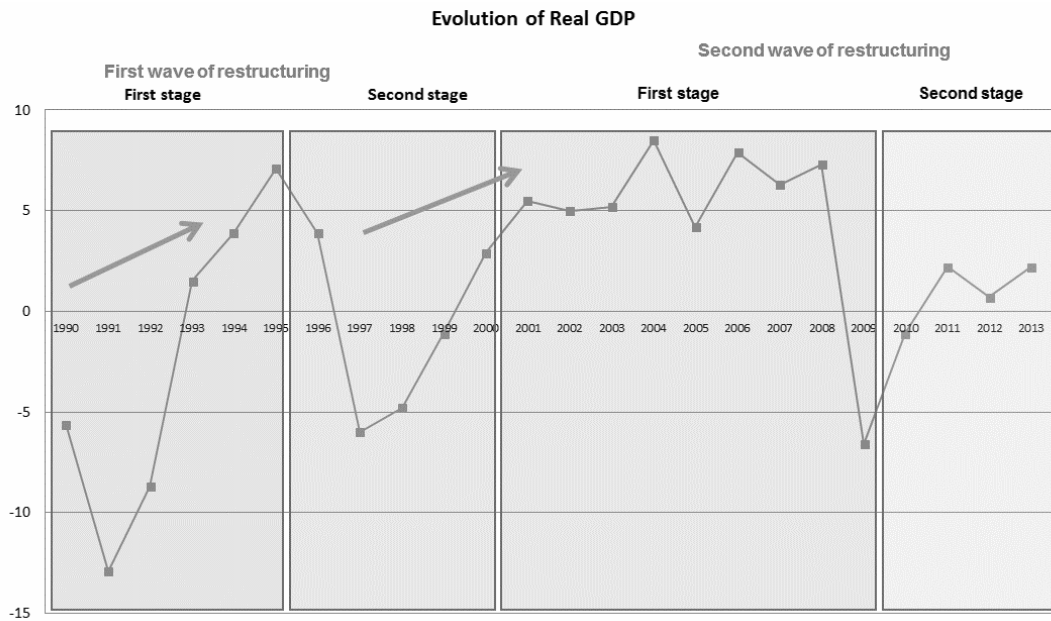


Fig. 1 Evolution of GDP during the waves of restructuring and privatization

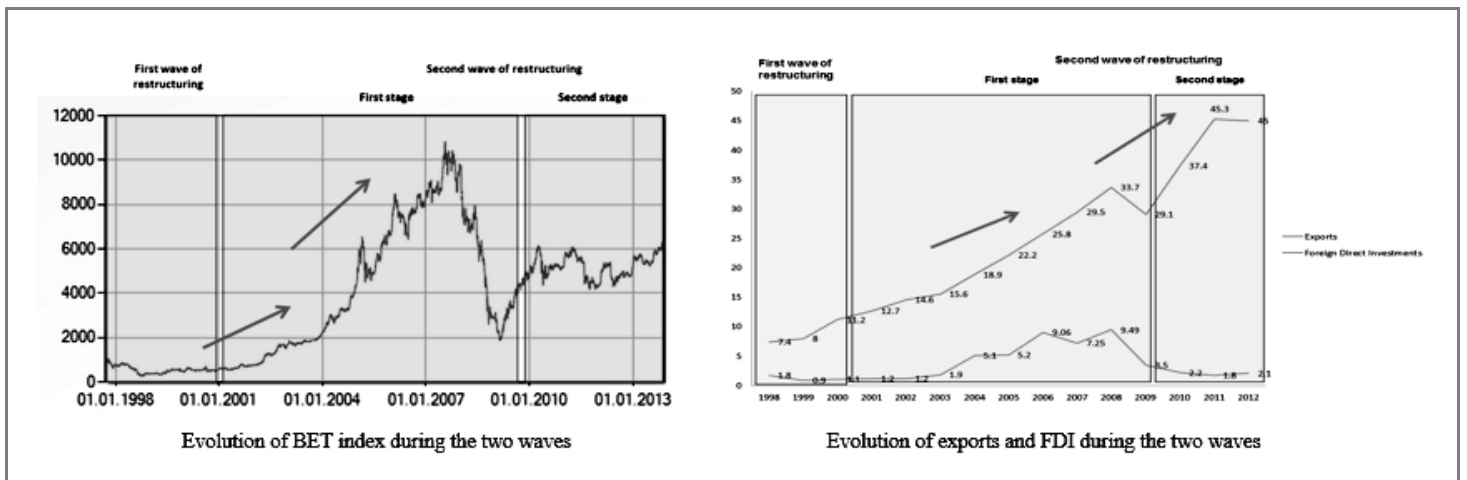


Fig.2 Evolution of BET index, exports and FDI during the restructuring and privatization

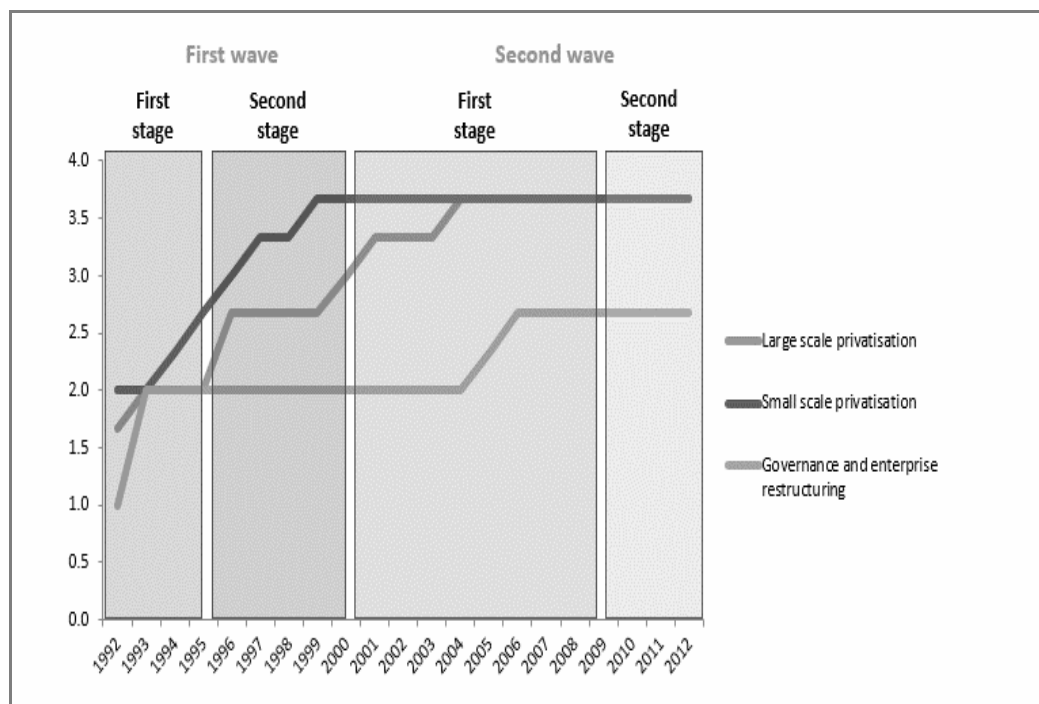


Fig. 3 EBRD indexes during the two waves

CONCLUSIONS

Our study analyzed the differences between these two processes within the territory of CEEC over the last two decades (1992-2013) in terms of: goals, patterns, institutions, methods used, outcomes etc. Results of these processes have been analyzed in correlation with the evolution of CEEC's macro-indicators (FDI, GDP, Inflation Ratio, Exports) or micro ones (Stock Exchange)

The large-scale privatization has emphasized a serie of challenges, that states the purpose of this paper which is to create the framework for analysing restructuring and privatization as methods of high-impact on macroeconomic indicators.

For most transition economies, the process of privatization has formed a distinct motivation for FDI. Western multinationals are attracted to enter reforming economies during privatization programmes by making acquisitions because prices are relatively low and because of highly favorable tax policies or even subsidies associated with the privatization.

FDI has played an important role in enterprise restructuring in the whole transition region during privatizations, in this way greatly strengthening the private sector and contributing to structural changes..

We focused in this paper ,too, on the Romanian case of sequencing of restructuring and privatization processes in relationship with FDI. Romania started in 1993 the Restructuring Process that dominated the transformation of Romanian economy in the last twenty years.

A change of restructuring paradigm: switching from "pre-privatization restructuring" to "ownership restructuring" starting with the second stage of FW.

This segregation in waves and stages on the one hand and of the results of restructuring (in immediate -short-term and long-term as result of the finalization of the restructuring process through ownership restructuring in the second stage of the FW, on the other hand gives us the possibility to better quantify the effects of the restructuring process in Romania.

A key result is that the effects of restructuring in both waves are positive, which provides evidence in support of the structure-conduct-performance hypothesis, while at the same time some relevance of the efficient-structure hypothesis cannot be rejected.

Delayed results of privatization that crystallized by the end of first wave did not deny the principles that governed the first wave of restructuring process;

Significant improvement of macroeconomic results (GDP, FDI and exports) and stock exchange (BET index) in the second wave of restructuring.

The restructuring process must be seen on long term basis, as its effects are correlated with the macroeconomic results.

We analyzed also, the correlation between the restructuring results, followed by privatization and the impact on macroeconomic figures (FDI, GDP, Inflation Ratio, Exports) or micro ones (Stock Exchange)

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Table 3 – Growth in real GDP

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
	<i>Estimate Projection</i>												
Central eastern Europe and the Baltic states													
Czech Republic	5.9	4.2	-0.7	-0.8	1.3	3.6	2.5	1.9	3.6	4.6	6.5	6.4	5.5
Estonia	4.5	4.4	11.1	4.4	0.3	10.8	7.7	8.0	7.1	8.1	10.5	11.4	8.5
Hungary	1.5	1.3	4.6	4.9	4.2	5.2	4.1	4.4	4.2	4.8	4.1	3.9	2.5
Latvia	-0.9	3.9	8.4	4.7	3.3	8.4	8.0	6.5	7.2	8.5	10.2	11.9	9.0
Lithuania	3.3	5.1	8.5	7.5	-1.5	3.9	7.2	6.9	10.3	7.3	7.6	7.5	7.2
Poland	7.0	6.2	7.1	5.0	4.5	4.3	1.2	1.4	3.9	5.3	3.6	6.1	6.5
Slovak Republic	5.8	6.1	4.6	4.2	1.5	2.0	3.2	4.1	4.2	5.4	6.0	8.3	8.5
Slovenia	4.1	3.7	4.8	3.9	5.4	4.1	3.1	3.7	2.8	4.4	4.1	5.7	5.5
<i>Average</i> ¹	5.5	4.8	5.1	3.9	3.5	4.3	2.5	2.6	4.2	5.3	4.9	6.2	6.0
South-eastern Europe													
SEE-3													
Bulgaria	2.9	-9.4	-5.6	4.0	2.3	5.4	4.1	4.5	5.0	6.6	6.2	6.1	6.0
Croatia	6.8	5.9	6.8	2.5	-0.9	2.9	4.4	5.6	5.3	4.3	4.3	4.8	5.5
Romania	7.1	3.9	-6.1	-4.8	-1.1	2.1	5.7	5.1	5.2	8.5	4.1	7.7	6.5
SEE-5													
Albania	13.3	9.1	-10.9	8.6	13.2	6.5	7.1	4.3	5.7	6.2	5.6	5.0	6.0
Bosnia and Herzegovina	20.8	86.0	37.0	15.6	9.6	5.5	4.3	5.3	3.0	6.0	5.5	6.2	6.0
FYR Macedonia	-1.1	1.2	1.4	3.4	4.3	4.5	-4.5	0.9	2.8	4.1	4.1	3.2	5.5
Montenegro	6.2	13.9	4.2	4.0	-6.7	3.1	-0.2	1.7	1.5	3.7	4.1	6.5	7.0
Serbia	6.1	7.8	10.1	1.9	-18.0	5.2	5.1	4.5	2.4	9.3	6.3	5.7	6.0
<i>Average</i> ¹	6.0	2.1	1.3	0.6	-2.2	3.7	4.7	4.9	4.7	7.0	4.8	6.4	6.1

Source: Transition report 2007 – European Bank for Reconstruction and Development

Tabel 4– Foreign Direct Investments

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	Cumulative FDI inflows 1989-2006	Cumulative FDI inflows per capita 1989-2006	FDI inflows per capita 2005	2006	FDI inflows 2005	2006
														(in US\$ mln)	(US\$)	(US\$)	(in per cent of GDP)		
Central eastern Europe and the Baltic states																			
	(in US\$ million)																		
Czech Republic	2,531	1,280	1,259	3,575	6,220	4,942	5,474	8,282	1,814	3,941	11,630	4,667	5,200	57,922	5,650	1,135	455	9.3	4.2
Estonia	199	111	130	574	222	324	343	153	763	703	2,252	569	600	6,790	5,048	1,672	423	16.1	3.5
Hungary	4,772	3,335	3,715	3,070	3,060	2,151	3,573	2,722	479	3,542	5,412	3,055	3,000	45,738	4,545	537	304	4.9	2.7
Latvia	245	379	515	303	331	400	114	250	256	596	603	1,487	1,100	5,807	2,531	261	648	3.8	7.4
Lithuania	72	152	328	921	478	375	439	714	142	510	689	1,585	1,000	6,467	1,902	201	466	2.6	5.3
Poland	3,617	4,445	4,863	6,049	7,239	9,327	5,804	3,901	4,284	12,259	7,013	10,037	10,000	81,665	2,142	184	263	2.3	2.9
Slovak Republic	194	199	84	374	701	1,897	1,520	4,130	737	1,403	1,951	3,797	2,600	17,544	3,255	363	705	4.1	6.7
Slovenia	161	167	303	221	59	71	226	1,508	-174	281	-88	-377	1,012	2,652	1,333	-44	-189	-0.2	-0.9
<i>Total</i>	11,790	10,068	11,196	15,086	18,309	19,486	17,492	21,659	8,300	23,234	29,462	24,819	24,512	224,583	3,082	404	341	5.4	4.0
South-eastern Europe																			
SEE-3																			
Bulgaria	98	138	507	537	802	998	803	876	2,070	2,879	3,938	5,331	5,389	19,225	2,497	510	692	14.5	16.9
Croatia	101	466	348	842	1,393	1,075	1,188	580	1,932	732	1,551	3,170	3,845	13,623	3,067	349	714	4.1	7.5
Romania	417	415	1,267	2,079	1,025	1,051	1,154	1,080	2,156	6,368	6,587	11,430	5,131	35,550	1,636	303	526	6.7	9.4
SEE-5																			
Albania	89	97	42	45	51	143	207	135	178	344	277	360	450	2,098	656	87	113	3.3	3.9
Bosnia and Herzegovina	0	0	0	100	90	146	119	266	382	608	550	420	1,500	2,680	705	145	111	5.4	3.7
FYR Macedonia	10	11	30	128	32	175	441	78	96	156	97	350	170	1,628	814	49	175	1.7	5.6
Montenegro	na	na	na	na	na	na	10	84	44	63	474	650	750	1,326	2,009	719	985	22.8	28.7
Serbia	na	0	740	113	112	25	165	475	1,360	966	1,481	4,400	3,000	9,837	1,312	197	587	6.1	15.3
<i>Total</i>	715	1,127	2,933	3,844	3,505	3,614	4,088	3,574	8,218	12,116	14,956	26,112	20,235	85,966	1,684	293	512	8.1	11.4

Source: Transition report 2007 – European Bank for Reconstruction and Development

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Tabel 5 – Inflation

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
												<i>Estimate</i>	<i>Projection</i>
Central eastern Europe and the Baltic states													
Czech Republic	9.6	8.9	8.4	10.6	2.1	4.0	4.7	1.8	0.2	2.8	1.9	2.5	2.7
Estonia	29.0	23.1	11.2	8.1	3.3	4.0	5.8	3.6	1.3	3.0	4.1	4.4	6.0
Hungary	28.2	23.6	18.3	14.3	10.0	9.8	9.2	5.3	4.7	6.8	3.6	3.9	7.8
Latvia	35.9	25.0	17.6	8.4	4.7	2.4	2.6	2.5	1.9	2.9	6.2	6.5	8.0
Lithuania	39.6	24.6	8.9	5.1	0.8	1.0	1.5	0.3	-1.2	1.2	2.7	3.7	4.4
Poland	27.8	19.9	14.9	11.8	7.3	10.1	5.5	1.9	0.8	3.5	2.1	1.0	2.4
Slovak Republic	9.9	5.8	6.1	6.7	10.6	12.0	7.3	3.3	8.5	7.5	2.7	4.5	2.5
Slovenia	13.5	9.9	8.4	8.0	6.2	8.9	8.4	7.5	5.6	3.6	2.5	2.5	3.2
<i>Median</i> ¹	28.0	21.5	10.1	8.3	5.5	6.5	5.7	2.9	1.6	3.3	2.7	3.8	3.8
<i>Mean</i> ¹	24.2	17.6	11.7	9.1	5.6	6.5	5.6	3.3	2.7	3.9	3.2	3.6	4.6
South-eastern Europe													
SEE-3													
Bulgaria	62.0	123.0	1,082.0	22.2	0.7	9.9	7.4	5.9	2.3	6.1	5.0	7.3	8.0
Croatia	2.0	3.5	3.6	5.7	4.0	4.6	3.8	1.7	1.8	2.1	3.3	3.2	2.3
Romania	32.3	38.8	154.8	59.1	45.8	45.7	34.5	22.5	15.3	11.9	9.5	6.6	7.0
SEE-5													
Albania	7.8	12.7	33.2	20.6	0.4	0.1	3.1	5.2	2.4	2.9	2.3	2.5	3.0
Bosnia and Herzegovina	na	na	na	-0.3	3.4	5.0	3.2	0.3	0.6	0.4	4.0	7.0	2.5
FYR Macedonia	16.4	2.3	2.6	-0.1	-0.7	5.8	5.5	1.8	1.2	-0.4	0.5	3.2	2.5
Montenegro	97.0	80.2	23.4	32.4	67.6	97.1	22.6	18.2	6.7	2.2	2.6	3.0	3.0
Serbia	78.6	94.3	21.3	29.5	37.1	60.4	91.1	21.2	11.3	9.5	17.2	12.5	7.0
<i>Median</i> ¹	32.3	38.8	23.4	21.4	3.7	7.9	6.5	5.6	2.4	2.6	3.7	4.9	3.0
<i>Mean</i> ¹	42.3	50.7	188.7	21.1	19.8	28.6	21.4	9.6	5.2	4.3	5.6	5.7	4.4

Source: Transition report 2007 – European Bank for Reconstruction and Development

ASSESSMENT OF INSTITUTIONAL PERFORMANCE OF RESTRUCTURING AND PRIVATIZATION PROCESSES

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ABSTRACT

Experience of Romanian “pre-privatization” restructuring and large-scale privatization showed some major elements that underlined new paradigms. Initial conditions, modes of restructuring and privatization, institutional environments, and particularly the capacity of governments to regulate determine efficiency outcomes. These important processes have created functional relationships between institutions, correlated with the government strategy and specific legislation. New specialized institutions have been set up (State Ownership Fund -SOF, Agency of Restructuring and later the Office of State Participations and Privatization in Industry-OPSPI)

A comprehensive strategy and methodology for restructuring, encompassing both the corporate and financial sectors, was put in place once the economic crisis in Romania is judged to be systemic in scope. The extent of the restructuring, the required resources and timing became the critical issues. The European Bank for Reconstruction and Development (EBRD) had governance and enterprise restructuring as basic indicator of economic transition and defines it as effective corporate governance and corporate control exercised through domestic financial institutions and markets, fostering market-driven restructuring.

The shift in the role of Romanian government from a “top-down approach” for general restructuring to “top-down” only for ownership restructuring was possible only after the critical mass of companies has been privatized through the SOF (later transformed in the Authority for Privatization and Management of the State Ownership-APAPS) and OPSPI . Thus, the residual number of companies, were privatized or listed at the stock exchange during the second wave of restructuring, started in 2001 and continued during the financial crisis. We noticed new instruments, specific to privatization, that were used in the last five years: spin-offs, mergers and listing of minor packages of stocks from SOEs. Series of performance-based indicators of the restructuring and privatization institutions have been calculated .

Keywords: restructuring of SOE, privatization, liquidation, corporate governance, privatization, economic crisis

JEL codes: D21, D23,D24, G28, G32,G34, L33, O16.

INTRODUCTION

The purpose of this paper was three-fold:

- to do the assessment of the Restructuring and Privatization Processes in Romania and the role of the institutions involved from 1992 to 2013 ;
- the analysis of the institutional performance of restructuring and privatization processes;
- to underpin the correlation between the restructuring results, followed by privatization and the impact on macroeconomic figures;
- to study the effects of restructuring and privatization on a representative number of companies

LITERATURE REVIEW

The key for the success of the transition process in Eastern Europe is gradualism argues Cohen (1993). He claims that a rapid transition will fail and the outcome will be massive unemployment, bankruptcies, and social distress, ultimately requiring the intervention of the state. In this view, the development of proper institutional structures, such as tax laws, financial intermediaries, and capital markets, must precede the formation of property rights.

Economists who favor rapid transition are concerned with many of the same problems, but claim the key is macroeconomic stability. Macroeconomic stability for them consists of low inflation, economic growth, low unemployment, and stable fiscal and monetary policy. Sachs (1997) argues that monetary growth, due to budget deficits, additional government spending, and credit expansion, is the main cause of inflation. Bruno (1994) on the other hand, argues that the monetary overhang and price liberalization that resulted in unstable prices throughout Eastern Europe could have been less severe. According to Sachs (1992), privatization of enterprises is important for a successful transition. Thus, he claims that commercialization should be the first step toward privatization. Commercialization converts the enterprise into a treasury owned joint-stock company. While Lipton and Sachs (1990) favor a rapid approach they doubt that it will produce immediate increases in productivity or managerial efficiency.

After commercialization, the next step requires the restructuring of the enterprises. Although a logical course of action, this policy prevents the rapid implementation of reforms within individual enterprises. Boycko and Shleifer (1993) argue that the prerequisite for this step is the depoliticization of firms. In contrast, Blanchard et al. (1994) question whether traditional Western stabilization methods can be effective in an economy where state ownership prevails. In the neoclassical paradigm, the establishment of private property involves three major steps in the following order: commercialization, restructuring, and privatization. The main difference between the gradual and rapid approach in the neoclassical transition process is not the agenda of issues, but the pace at which this process is implemented. Examining Romania's transition process reveals that the new government has followed the neoclassical paradigm. It is also clear that after a decade of reform

Romania's attempt at a big bang approach has, as predicted, evolved into gradualism. In a description of the legislation and government intervention that has occurred Daianu (2001), Stan (1995), Earle and Sapatoru (1993), and Demekas and Kahn (1991) all claim that the Romanian economy, under the rule of Ceausescu, was the most Stalinist regime in Eastern Europe.

Frydman, Rapaczynski et al (1993) – discussed about legal and ownership structure, institutions for state regulation, overview of privatization process and the initial transformation of enterprises. Some authors refer to transition economies in the early stages of transformation as a “weakly structured market economy” (Dobrescu 1996) or a “previously centrally planned economy” (Calvo and Fenkel 1991). Grosfeld and Senik (1996) They were thinking that the change of ownership was a necessary and a sufficient condition of capitalism. The literature on financial repression and financial reform provides a thorough macroeconomic link between the development of financial markets and economic growth (Fry 1982, 1993, 1995, Roubini and Sala-i-Martin 1992, Rayon 1994, Chang 1994). The need for a closer analysis of the microeconomic roots of financial repression, however, is a new approach in the studies of financial markets in developing and transition economies (Amrit-Poser 1996, Popa 1998). Nicolescu et al (1996) – developed the “ efficiency-based” restructuring concept and Crum and Goldberg (1998) – analyzed restructuring as a complex set of decisive measures in order to increase competitiveness.

The inter-enterprise arrears, as well as the bank, tax and wage arrears phenomena provide a good example of a microeconomic problem in the financial markets of Romania . The accumulation of inter-enterprise arrears can also cause inflation. Monetary control can be defeated by firms that circumvent a tight credit market by creating their own liquidity through trade credits (e.g. Daianu,1994) .Credit and liquidity constraints affect indiscriminately viable and non-viable businesses, or, even worse, create adverse selection effects – artificially sustaining large loss-makers and preventing new private firms from developing profitable investment projects (see Berglöf and Roland 1997 and 1998).

As shown in Croitoru and Schaffer (2000) for the case of tax arrears, an increasing real gross arrears aggregate would be a sign that more and more firms are running into arrears. In Romania's case, the commitment of the government to economic reforms by liquidating inefficient firms Stiglitz (1994, p. 238) would have extended mainly to state-run utility companies because they were the biggest actors in accumulating enterprise arrears (Santarossa, 2001; OECD, 2002).

Bowman and Singh (1999) classified restructuring activities into three categories namely portfolio restructuring, financial restructuring and organizational restructuring. Kornai (2000) considers that the pre-privatization restructuring serves as a useful screening device in order to interest private investors, who buy the firms.

Debande and Friebe (2004) advocates for the firmly reestablishing of the State control of SOE cause it avoids that (unproductive) managers abuse and divert capital or funds which are for restructuring. Djankov (1998) – selected a sample of Romanian companies from the period 1992-1996. He concludes that isolating programs have delayed restructuring imposing budget constraints on loss-making enterprises. on the other hand Djankov (1999) – studies the relation between ownership structure and enterprise performance in newly independent states: Georgia, Kazakstan, Kyrgyz Republic, Moldova and Russia. He concluded

that non-linear analysis showed some significant relation between different types of ownership and enterprise restructuring. Fidrmucova (2000) made an analysis on channels of restructuring on a panel of Czech companies and found that investment is not a significant determinant of enterprise performance. Koh, Dai & Chang (2010) – examined the impact of lifecycles on restructuring strategies. Distress firm's access to different types of restructuring strategies is limited by the lifecycle stage they are in. Frydman, Hessel & Rapaczynski (2001) – followed the entrepreneurship and restructuring of enterprises in Central Europe (Czech Republic, Hungary and Poland) and explained the market impact of ownership on firm performance. Sterman (2002) analyzed restructuring as diverse activities such as divestiture of under-performing business, spin-offs, acquisitions, stock repurchases and debt swaps. Gibbs P.A. (2007) considers that restructuring means changes in the operational structure, investment structure, financing structure and governance structure of a company.

THE ASSESSMENT OF INSTITUTIONAL PERFORMANCE OF RESTRUCTURING AND PRIVATIZATION IN ROMANIA

The last decade of the past century was dominated by paradigmatic controversy on the sequences of restructuring and privatization processes. The economy was registering suboptimal economic performances characterized by severe declines in the GDP; huge losses of the state-owned companies, and huge inter-enterprise arrears that accounted for over 35% of Romania's GDP.

There were two main perspectives on how the transition process and privatization should occur: (1) a gradual process or (2) a "big-bang" or "shock-therapy" approach to the establishment of property rights.

Moving from a command economy to a free-market one is a complex process involving the establishment and evolution of institutional arrangements that support a private property rights system.

The solutions designed and managed by the macro decision-makers of the time (starting with 1993) focused on a "top-down" model of restructuring, which precedes the privatization process and were institutionalized and included in common governmental and international financial institutions programs (such as "stand-by" loans concluded with IMF, IBRD, and EBRD, etc).

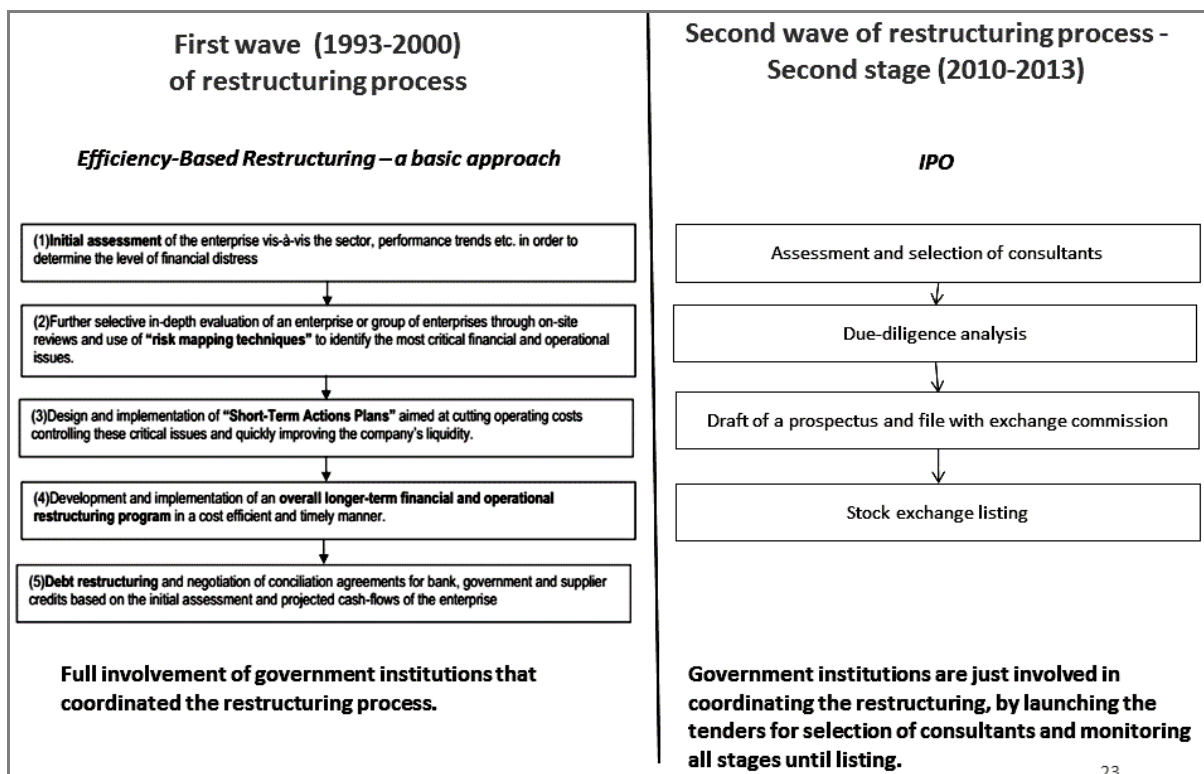
The "Pre-Privatization" process was designed to define the strengths and weaknesses of the enterprise, put in place a program to enhance the strengths and minimize the weaknesses – simply, the process identifies the risks and clarifies to some extent the value and with this a "price" can be developed for negotiation with potential investors. Not knowing the value and risk associated with an enterprise are the single biggest obstacles to privatization.

Experience of Romanian "pre-privatization" restructuring and large-scale privatization showed some major elements that underlined new paradigms. Initial conditions, modes of restructuring and privatization, institutional environments, and particularly the capacity of governments to regulate determine efficiency outcomes. These important processes have created functional relationships between institutions, correlated with the government strategy and specific legislation. New specialized institutions have been set up (State

Ownership Fund -SOF, Agency of Restructuring and later the Office of State Participations and Privatization in Industry-OPSPI)

A comprehensive strategy and methodology for restructuring, encompassing both the corporate and financial sectors, was put in place once the economic crisis in Romania is judged to be systemic in scope. The extent of the restructuring, the required resources and timing became the critical issues. The European Bank for Reconstruction and Development (EBRD) had governance and enterprise restructuring as basic indicator of economic transition and defines it as effective corporate governance and corporate control exercised through domestic financial institutions and markets, fostering market-driven restructuring.

Fig.1 The waves of restructuring in Romania



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This first wave has been followed by a second wave starting from 2001 that included a limited number of companies but of higher value and impact on the economy (biggest banks, big industrial and energy companies, former regies autonomes etc.)

The second wave of restructuring meant a change of paradigm for companies in need of restructuring, developed in two important stages, when SOE were listed at the stock exchange, privatized or placed in a „stand-by” process in order to be restructured. Thus, the methodology of restructuring in the second wave has been retooled and correlated with the evolution of the macroeconomic conditions and agreements with IFI's. The EBRD index of privatization show a direct relation between the two waves, as Romania received a higher value for this index as it moved to next level of restructuring and privatization.

THE ASSESSMENT OF INSTITUTIONAL PERFORMANCE OF RESTRUCTURING PROCESS

The restructuring process of the state-owned companies in Romania started by the **Government Decision no. 301/06.29.1993** with an special surveillance program for some companies selected on the basis of their critical financial status with a negative impact on the Romanian economy, as a result of the accumulated outstanding debts to the suppliers, banks and state budget. The first exercise included 30 state-owned companies from various sectors :chemical, petrochemical, machine building, metallurgy, construction materials and textile industries. The coordination of the overall process was in charge of a Restructuring board made up of representatives of the Ministry of Finance, the Ministry of Industries, the State Ownership Fund and the National Bank of Romania. The setting up of the Selective Restructuring Division within the SOF led to the termination of the initial Restructuring Comitee.

In order to increase the coherence and unity in the mobilization of the mechanisms, operations and human resources required for the materialization of the restructuring process – generator of the implementation of macroeconomic reforms and adjustment options expressed by the Government, the Agency for Restructuring was set up by Government Decision no. 780/1993.

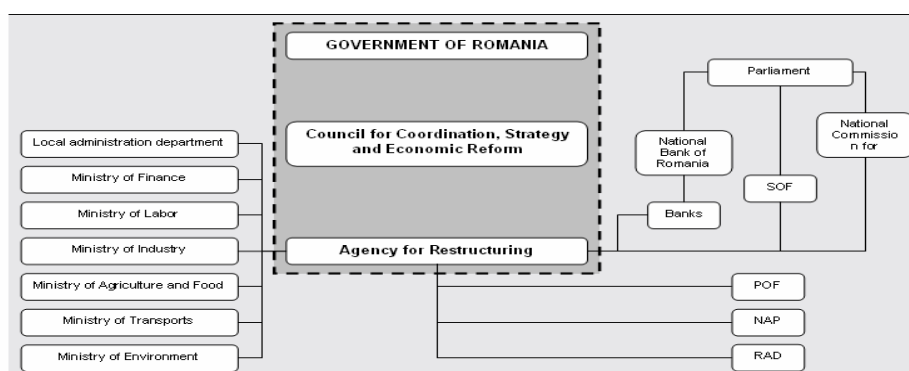


Fig. 3 AR's relations with other entities involved in restructuring

	TOTAL INDUSTRY 1995			TOTAL AGRICULTURE 1995			GENERAL TOTAL AR 1995		
	Forecast	Achieved	%	Forecast	Achieved	%	Forecast	Achieved	%
I. MEASURES – TOTAL (technical, organizational, management - no.)	1.077	873	81,1%	975	720	73,8%	2.052	1.593	77,6%
II. OWNI EFFORT (million lei)									
1 Closed capacities (mil. lei output)	722.138	3.068.767	425,0%	13.723	448.685	3269,6%	735.861	3.517.452	478,0%
2 Assets leading to closing of capacities (mil. lei to salvage value)	*	439.324		*	300.869		*	740.193	
3 Sales of assets (mil. lei)	27.275	6.495	23,8%	2.750	3.061	111,3%	30.025	9.556	31,8%
4 Lay-offs – total (no.), of which:	(23.745)	(19.796)	83,4%	(3.427)	(1.989)	58,0%	(27.172)	(21.785)	80,2%
– with severance of 6 salaries (no.)	(17.667)	(15.249)	86,3%	(3.427)	(1.013)	29,6%	(21.094)	(16.262)	77,1%
III. OUTSIDE EFFORT									
1 SOF credits (mil. lei)	213.294	100.390	47,1%	202.001	79.474	39,3%	415.295	179.864	43,3%
2 Bank credits (mil. lei)	368.000	217.000	59,0%	293.000	279.000	95,2%	661.000	496.000	75,0%
3 Budget (recovery fund) – total (mil. lei), of which:	175.419	147.263	83,9%	11.420	1.431	12,5%	186.839	148.694	79,6%
– for gas and energy (mil. lei)	149.333	129.314	86,6%	9.157	1.044	11,4%	158.490	130.358	82,2%
– for severance payments (mil. lei)	26.086	17.949	68,8%	2.263	387	17,1%	28.349	18.336	64,7%
4 Conciliation – total (mil. lei), of which:	1.314.955	843.096	64,1%	603.992	503.376	83,3%	1.918.947	1.346.472	70,2%
a) with the state budget – rescheduled tax (mil. lei)	320.909	319.671	99,6%	22.646	20.243	89,4%	343.555	339.914	98,9%
b) with banks (mil. lei)	118.324	112.525	95,1%	381.073	358.499	94,1%	499.397	471.024	94,3%
c) with the suppliers (mil. lei)	875.722	410.900	46,9%	200.273	124.634	62,2%	1.075.995	535.534	49,8%

Fig.4 Synthetic efforts in 1995 for the commercial companies in the AR's portfolio

The analysis undertaken by the Agency for Restructuring highlighted that the main causes of the critical financial situation of the SOE under special surveillance were mainly related to:

- the loss of traditional markets, especially of the former CMEA ones;
- overcapacity;
- overstaffing;
- insufficient financial resources for carrying a normal activity;
- the severe need to modernize the operating capacities in order to:
 - cut the specific material and energy costs with positive effects on cost reduction;
 - improve the quality of products with positive effects on the competition level;
 - resolve the serious environment protection problems;
- the lack of well defined strategies and actual business plans;
- obsolete technologies;
- low value added by product;
- ineffective and unskilled management facing new market conditions;
- inefficient in-house control systems;
- high pressure of the unions and low labor discipline.

With a view to resolving the problems arising, all the FRP's included:

- actual measurable steps to reduce costs and improve collections;
- credible projections to demonstrate how a positive cash-flow can be generated;
- reducing dependence on the governmental financial support as subsidies and guarantees for new credits;
- the approval of equipment replacement and modernization costs in order to increase incomes and decrease expenses without leading to capacity expansion or new costly investments.

The FRP's, as Figure 3 shows, provided for 1995 measures oriented mainly to:

- closing of capacities representing the equivalent of a production worth 735,861 million lei;
- sales of assets worth 30,025 million lei;
- staff reduction of approximately 27,172 persons of which 21,094 with severance payments totaling 6 salaries.

Additional measures were provided for which financing shall be supported by the SOF, the Ministry of Finance and the banks as follows:

- funds worth 415,295 million lei from SOF for modernization and technology upgrading;
- bank credits worth 661,000 million lei;
- state budget allocation worth 186,839 million lei from the financial recovery fund destined both to energy and gas payments and to severance payments totaling 6 salaries to the staff downsized per the FRP's.

The work-out process was carried out by direct negotiation depending on the debtors' payment capability and the creditors' financial power.

Of the total number of 120 commercial companies under special surveillance, in the portfolio of the Agency for Restructuring, between August 25, 1995 – September 26, 1995 a number of 115 commercial companies were conciliated (39 from industry and 76 from agriculture); conciliation agreements were signed with the main suppliers and the financing banks (BCR, BRD, BANCOREX, EXIMBANK) and also the Ministry of Finance signed agreements for tax facilities.

Synthetically, the results of the conciliation process at the 115 commercial companies that signed the conciliation agreement are as follows:

- of the total debts of 1,918,947 million lei on September 29, 1995, 1,343,664 million lei (71%) were conciliated;
- of the total conciliated debts of 1,343,664 million lei, 964,070 million lei represent rescheduled debts to the suppliers, banks and the state budget (71.8%), 6,856 million lei represent reduced payment of the debts to the suppliers, banks and the state budget (0.5%) and 372,738 million lei represent cancellation of penalties granted by the suppliers, banks and the state budget (27.7%).

THE ASSESSMENT OF INSTITUTIONAL PERFORMANCE OF PRIVATIZATION PROCESS

The legal framework set up for the privatization included the following:

- Law 58/1991 regarding the privatization of commercial companies;
- Law 77/1994 regarding the associations of the employees and management of the companies under privatization;
- Law 55/1995 for acceleration of privatization process amended by the Law 129/1995;
- Emergency Ordinance of the Government 15/1997 regarding the modification of the Law 58/1991;
- Emergency Ordinance of the Government 88/December 1997 regarding the privatization of SOE ,approved through Law 44/1998 and Government Decision 55/1998 regarding the approval of the methodological norms concerning the privatization of the SOE and assets sale, as well as the Organizing and proper functioning Regulation of the State Ownership Fund.

The privatization process in Romania has been quite heterogeneous, involving all the major methods employed in transition economies: employee buyouts, mass privatization, and sales to outside investors. The privatization process in Romania has been quite heterogeneous, involving all the major methods employed in transition economies: employee buyouts, mass privatization, and sales to outside investors.

The Management-Employee Buyout (MEBO) Method

Transfer of shares to employees, through giveaways or sales at low prices, has been a common privatization method in transition economies due to the relative ease of administrative and political implementation. The method is controversial, however, and frequently alleged to be ill-suited to the restructuring demands of the transition. On the one hand, insider privatization may improve work incentives, company loyalty, and support for

restructuring. If ownership is widely dispersed among employees, it may also facilitate takeovers by outsiders. On the other hand, employees may lack the necessary skills, capital, access to markets, and technologies necessary to turn their firms around. Corporate governance by employees may function particularly poorly when the firm requires difficult restructuring choices that have disparate distributional impacts within the firm. MEBOs were most common in the years 1994 and 1995, although employees continued to buy out their companies through 1998.

The Mass Privatization Program (MPP)

The second major method used in Romania was mass (or “voucher”) privatization. As elsewhere in Eastern Europe, the rationale for this method was that the speed of privatization could be increased by overcoming the problems of insufficient demand due to low domestic savings and reluctance of foreign investors (Earle, Frydman, and Rapaczynski, 1993; Boycko, Shleifer, and Vishny, 1994). These programs were intended to jump-start domestic equity markets with a rapid release of shares, but with the risk of highly dispersed ownership. The Romanian mass privatization program (MPP), carried out in 1995-96, had as main features: in most companies included in the program, only 60 percent of the shares were offered. In those deemed strategic, which tended to be relatively large firms, the figure was only 49 percent. Even these percentages were reached in very few companies, due to the peculiar asymmetry in the treatment of excess demand and excess supply in the allocation procedure. The consequence of the MPP was inevitably an ownership structure heavily dominated by the state, which usually retained a majority stake, with a highly dispersed group of private owners. Shares allocated in the MPP were taken from the portfolios of both the SOF and the five POFs, but the POFs could regain some shares if citizen-participants in the MPP exercised their option to place their vouchers with them.

Privatization through Sales to Outsiders

The third major privatization method employed in Romania involved case-by-case sales of large blocks of shares to outside investors. The most important methods were sealed-bid tenders and auctions, in which not only the price offer but also the business plan, investment and employment promises, and other considerations were taken into account by the SOF in pre-selecting the buyer.

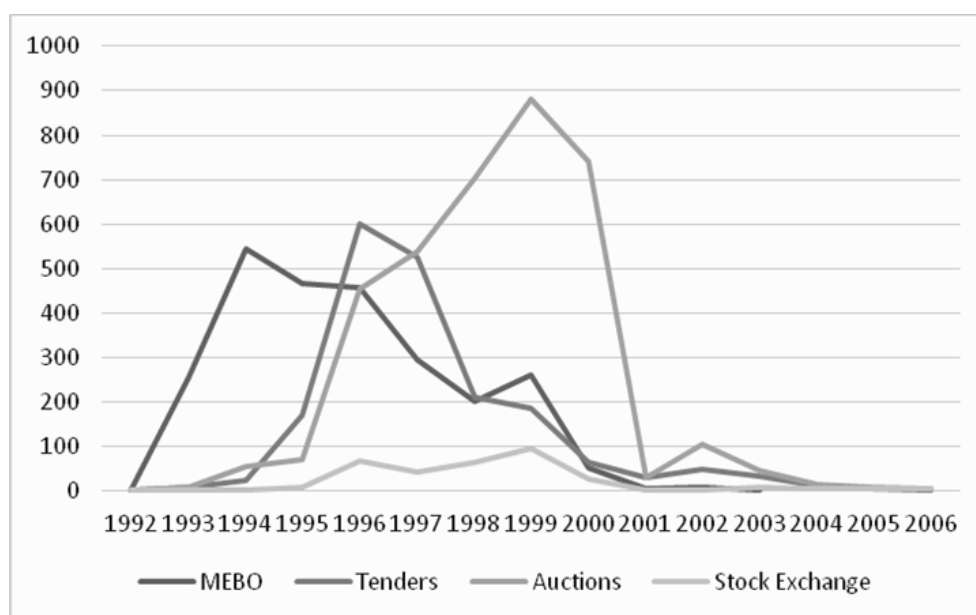
Privatization through Stock exchange

This type was used through :Romanian Stock Exchange,OTC(RASDAQ) and I nternational Stock Exchanges

As an example,in the following table is represented the number of companies that have been privatized and the methods of privatization used by SOF between 1992-2006:

Table 1 Number of companies privatized in Romania through different methods

Year	MEBO	Tenders	Auctions	Stock Exchange	TOTAL
1992	1	0	0	0	1
1993	253	8	9	0	270
1994	543	22	55	1	621
1995	465	170	71	9	715
1996	456	602	454	66	1578
1997	296	527	537	42	1402
1998	202	209	702	64	1177
1999	259	185	880	94	1418
2000	50	64	740	26	880
2001	4	31	29	2	66
2002	9	48	104	1	162
2003	2	33	45	7	87
2004		12	14	6	32
2005		6	8	4	18
2006		2	6	4	14
TOTAL	2540	1919	3654	326	8441

**Fig.5 Number of companies privatized in Romania through different methods**

After 1999 this process overlapped with preparations for accession to the European Union (2000-2007) which, in addition to the effort involved in transposing the *acquis communautaire*, required transformation and adaptation of administrative capacity in favor of the anticipation and management functions, with consequences for the effective functionality of the labor market as well.

In the second decade (after 2000) when the economy started growing – sometimes spectacularly - Romanian society began gradually to rid itself of a mode of thinking and acting geared primarily to times of crisis, under the impact of a flow of announcements from private companies and the public sector relating to opening of new units and new job creation.

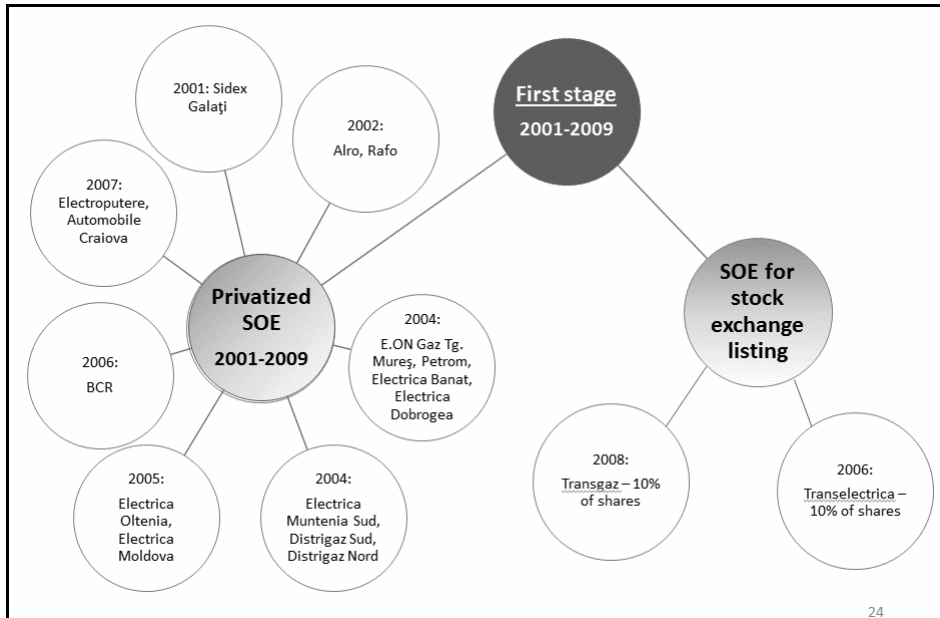


Fig.6 The first stage of restructuring

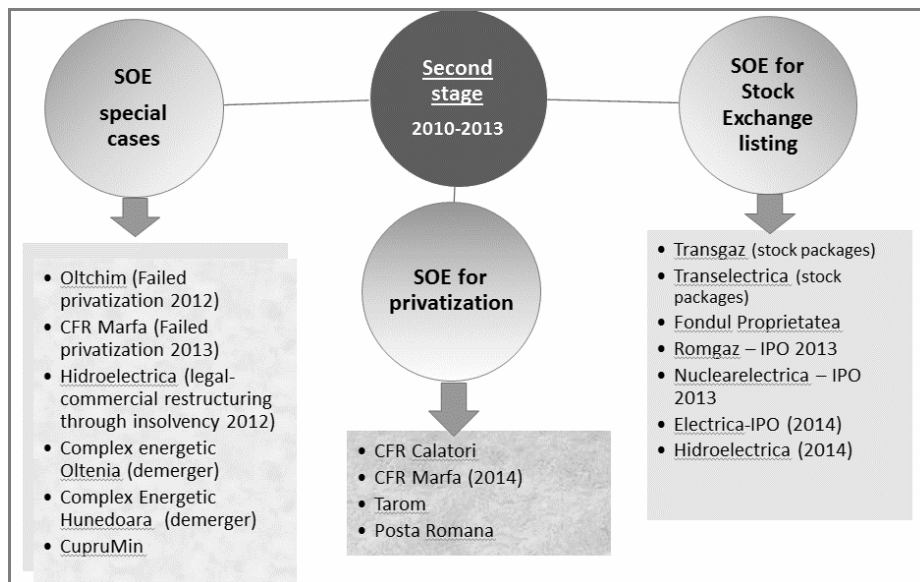


Fig.7 The second stage of restructuring

Following the severe downturn during the 2008–09 crisis, Romania has made significant progress in restoring macroeconomic stability. Large external and fiscal imbalances have been reduced to more sustainable levels under two consecutive IMF Stand-By Arrangements, supported by the European Union and the World Bank. Since 2010, Romania

has maintained continued market access and has begun to rebuild fiscal, capital, and reserve buffers even as it has started to make large repayments to the Fund.

Romania successfully completed in June 2013 a 27-month Stand-By Arrangement (SBA), including a three-month extension, equivalent to SDR 3,090.6 million (€3.4 billion, 300 percent of quota). The authorities have requested a successor 24-month SBA with proposed access of SDR 1,751.34 million (about €2 billion, 170 percent of quota). The first tranche of SDR 194.7 million would be made available upon program approval. The authorities intend to treat the SBA as precautionary and have also requested support from the European Union (€2 billion), while €1 billion remains available under a World Bank policy loan.

The key objectives of a new program are to provide a buffer against possible external shocks, while assisting Romania in preserving the hard-won macroeconomic stability and catalyzing difficult structural reforms that were initiated under the previous program. In particular, the program seeks to:

- (i) safeguard sound public finances underpinned by a stronger institutional fiscal framework;
- (ii) continue monetary and financial sector policies that restore buffers shielding the economy against external shocks; and
- (iii) reduce bottlenecks to the country's growth potential and competitiveness through structural reforms. The program aims to preserve investor confidence by ensuring policy discipline and stability.

SELECTED COMPANIES' PERFORMANCES

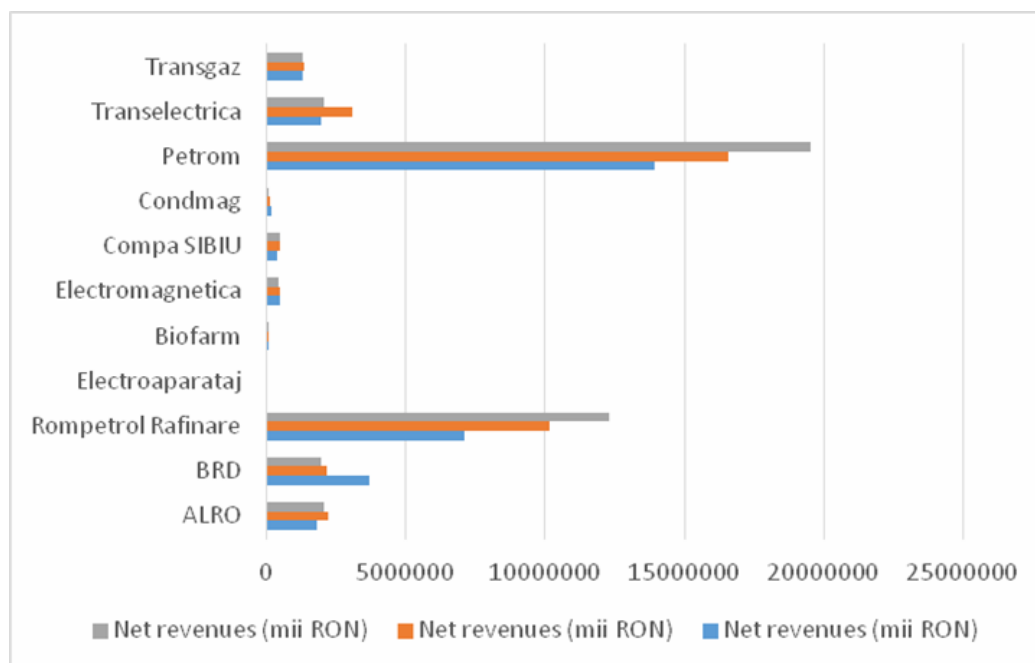


Fig.8 Net revenues of selected group of companies from 2010-2012

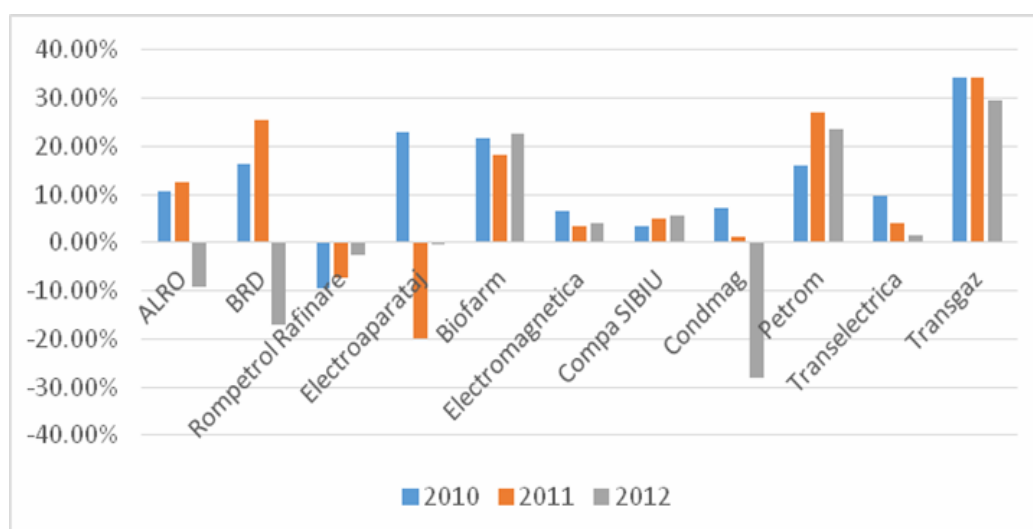


Fig.9 The post-restructuring gross profit margin of selected companies from 2010-2012

CONCLUSIONS

A change of restructuring paradigm: switching from “pre-privatization restructuring” to “ownership restructuring” starting with the second stage of FW

This segregation in waves and stages on the one hand and of the results of restructuring(in immediate -short-term and long-term as result of the finalization of the restructuring process through ownership restructuring in the second stage of the FW, on the other hand gives us the possibility to better quantify the effects of the restructuring process in Romania.

A key result is that the effects of restructuring in both waves are positive, which provides evidence in support of the structure-conduct-performance hypothesis, while at the same time some relevance of the efficient-structure hypothesis cannot be rejected.

Large-scale restructuring was a process both useful and efficient.

Djankov conclusion (that the large scale restructuring process had no results) was made on a methodological error, because the first FRP were set up in 1995-1996, and the results of the implementation of an FRP is measurable and relevant on a short –term basis (30-90 days) cumulated with medium and long term (2-5 years) that escaped from his calculation (his data base was consisting in 1992-1996 period, and cumulated effects were not yet visible);

Delayed results of privatization that crystallized by the end of first wave did not deny the principles that governed the first wave of restructuring process;

Residual stock of mid and big companies that entered the restructuring process in the first wave where privatized in the second wave (first stage). Significant improvement of macroeconomic results (GDP, FDI and exports) and stock exchange (BET index) in the second wave of restructuring.

The correlations showed us high correlation in terms of impact of government and enterprise restructuring on privatization and also moderate correlation in terms of effects. The restructuring process must be seen on long term basis, as its effects are correlated with the macroeconomic results.

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FERAIOS REVISED: INTER-REGIONAL CROSS-NATIONAL SOCIOECONOMIC COOPERATION IN SOUTH AND EASTERN EUROPE

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ABSTRACT

Contemporary systemic, global crisis enhances the risks of internal and transnational aberrations. Precisely for that reason, the need for an inter-regional, cross-national cooperation emerges even more emphatically. South and Eastern Europe provides an area where enhanced intercultural, business and socioeconomic interrelations generate a fertile environment for collaboration. The region, consisted of a broad mixture of national and cultural identities, rather presents great diversity, heterogeneity and complexity in transnational cooperation. Since the emergence of new countries, and consequently the establishment of new frontiers, the region has been experiencing fundamental changes in economic, political, social and cultural patterns.

The present paper starts from the characteristics of the wider region that came out of a historical analysis, in the frame of a broader research project. We proceed with a SWOT analysis of the prospects for an inter-regional, cross-national cooperation. Based on this analysis as well as on a comprehensive literature review of relevant theoretical contributions, we provide a specific proposal for the structural reorganization of the existing institutions for transnational collaboration in the area, co-integrated in a mutual context of democratically legitimized, socially and environmentally balanced cooperation, taking into consideration local and ethnic specificity.

Key words: Regional development, Cross-regional socioeconomic co-operation

1. Introduction

Throughout the years, the Eastern and Southeastern European countries are affected by a number of economic integration and transition forces shaping at the same time the economic landscape in Europe. The Balkan and the Black Sea identity is dominated by its geographical location. Throughout history, the area constituted a net of crossroads of ethnicities and cultures (Greek, Latin, Slav, Islamic, Jewish), while it incorporated very poor areas as well (Kondonassis et al. 2008: 1). The great number of population, poverty and the long standing ethnic diversities led to conflicts and instable political and economic environment. The weak background of the region encouraged the penetration of the Great powers in the region in collaboration with local reactionary forces. As they were competing in promoting their products in new open markets, as well as in controlling important channels, global rulers recognized significant economic benefits in supporting, sometimes even fomenting ethno-political conflicts and separatist processes.

Nowadays, almost 100 years after the Balkan Wars, a significant part of the region remains fragile to a greater or lesser extent. The states in Southeastern Europe are not able (or

unwilling) to control their territories, insure a safe environment for their citizens, provide them with essential public goods (health care and education) and proper structure for economic growth, while there are no effective institutions for guaranteeing law enforcement and ensuring participation in the political environment (Kempe/Klotzle 2006: 6). The old structures of internal organization and external economic relations have collapsed; the establishment of new economic, political and institutional structures is rather painful. According to Petrakos & Totev (2000), the Southeastern region is dominated by “*unfavorable structural adjustments*” and this may lead to further divergence from the more advanced countries of Europe.

Overall, contemporary systemic, global crisis enhances the risks of internal and transnational aberrations. Eastern European regions experience also a dangerous exacerbation of transnational, intercommunal clashes, which are being undermined by the deterioration of the systemic distortions globally and by the intensified antagonism for controlling the lacking energy and material resources. Precisely for that reason, the need for an inter-regional, cross-national cooperation emerges even more emphatically. South and Eastern Europe provides an area where enhanced intercultural, business and socioeconomic interrelations generate a fertile environment for collaboration.

Feraios is probably the pioneering European thinker who expressed the perspective of socioeconomic and ultimately of political integration in this region, already in the second half of the 18th century. The modern conditions in the region, as part of the process of globalization and the European integration in particular, call into the technical, social and global political conditions for the reintroduction of this perspective. Nevertheless, it is precisely the neo-liberal internationalization that contributes to, or even seeks for, the reversal of corporatism into a scraping of rivalry and conflicts. We may have to admit that the membership in the European Union (EU) perspective facilitated the Southeastern states to overcome their dilemmas related to their fundamental and simultaneous transformation of their economic, political and national order (Heidenreich, 2003). Yet, despite the external assistance that was provided to the region by inter-regional, cross-border cooperation projects (CBC projects), it should be strongly considered the fact that various sociopolitical distortions of the EU along with local economic deficiencies in the region make the reforms’ implementation rather difficult.

In the following, we proceed with a SWOT analysis of the prospects for an inter-regional, cross-national cooperation in the area. In the third section we provide a specific proposal for the structural reorganization of the existing institutions for transnational collaboration, co-integrated in a mutual context of democratically legitimized, socially and environmentally balanced cooperation, taking into consideration local and ethnic specificity.

2. A SWOT Analysis of the prospects of inter-regional cross-national cooperation in South and Eastern Europe

2.1 Definition and establishment

Since 1990s there is a significant increase in the number of cross-border relations all over Europe, although some of these initiatives date back to 1950s. Today, all local and regional authorities located in border areas participate, in one way or another, in cross-border cooperation (CBC) initiatives. Those initiatives are supported by the European Commission

annually by approximately €700 million and by European nation states by a similar amount (Perkmann 2003).

Perkmann (2003: 156) defines cross-border cooperation “*as a more or less insitutionalised collaboration between contiguous subnational authorities across national borders*”, while Gabbe, Martinos et. al (1999: 1) as “*neighbourly co-operation in all areas of life between regional and local authorities along the border and involving all actors*”, solving problems of everyday administrative life and stabilizing contacts across border region. Cross-border cooperation has been mainly motivated by the aim to unify communities in border region by removing physical barriers, restrictions and other factors separating them.¹⁰³ People living in those communities characterize them as a mean “*to alleviate the negative effects of border and to improve their daily lives*” (eg. business, work leisure, housing, planning social facilities etc) (Brinkhoff & Martinos, 1997).

Gabbe, Martinos et. al (1999: 5) observe the factors that accelerated the cross-border cooperation processes since the late 1980s:

- internal changes in the European Union (enlargement, the completion of the Single Market, the Economic and Monetary union);
- political changes in Central and Eastern Europe;
- the EU initiative and funding programmes supporting cross-border cooperation (Interreg).

Through the years, CBC developed over various institutionalized forms. The continuous enlargement of the European Union contributed to the emergence of initiatives aiming to enhance people to people contacts and to eliminate the barriers to trade, especially at the external borders. Therefore, the relations between cross-border regions, which according to the Council of Europe’s definition are “*characterized by homogenous features and functional interdependencies because otherwise there is no need for cross-border cooperation*” (Boman & Berg, 2007: 156), increased significantly due to mainly two factors: first, the non-state specific variables that affect the emergence and shape of CBC initiatives; second, the impact EU policies have on CBC (Boman & Berg, 2007).¹⁰⁴

Nevertheless, CBC programs and policies are by far not the main focus of our claim; it constitutes only a sub-category of inter-regional cooperation and it provides a good example for arguing that the current global trends, especially the process of European integration, makes our appeal even more realistic und up to date.¹⁰⁵ Beyond any cross-border coupling,

¹⁰³ Regarding the EU policies impact on CBC initiatives, the researchers are divided. According to Anderson & Bort (1997), given the diminishing importance of the borders and the increase of the regional representation at the supranational level, European Union could be considered a significant factor “behind the emergence and proliferation of CBC across Europe”. On the other hand, Anderson observes that the impact of EU is often overestimated and that a great number of CBC initiatives come up as “a response to growing cross-border functional interdependencies”.

¹⁰⁴ Regarding the first factor, Osthol (1996) infers that the number of the CBC initiatives that affect specific countries depends on “federal constitution”, meaning the extent to which each country is a unitary or a federal state, “centrality” i.e. whether a country’s economy is central or peripheral, “EU-membership”. From the regression analysis that Osthol run, could be concluded that centrality and EU-membership constitute determining factors, while federal constitution is not that significant.

¹⁰⁵ Cross-border cooperation is referred to cases of contiguous cooperation, while inter-regional cooperation refers to cases of non-contiguous, long-distance interaction Perkmann (2003).

we focus on the possibility of transnational cooperation of communities that not only belong to a wider geographic area, but, aside to their long-lasting and deep differences, they share common ideological, historical and socio-cultural bonds.

Inter-regional, transnational cooperation is defined “as subject oriented cooperation across national borders between regional and local authorities and other organizations which can be located anywhere within a state’s territory”. Inter-regional cooperation has been developed during the last decades and it has been mainly encouraged by the need for experience transfer and know-how exchange among various regions within Europe (Brinkhoff & Martinos, 1997: 2). The form an inter-regional and trans-national cooperation could take depends on two dimensions: first “*the geographical scope of the cooperation initiative*”; second “*the condition of contiguity*”, meaning the extent of the geographical contiguity of the co-operating partners’ territories.

2.2. SWOT analysis

Inter-regional, transnational cooperation has an important role to play within the European Union, but even more specifically within South and Eastern Europe. CBC may support sustainable development along the Union, alleviate differences in living standards and deal with the challenges and opportunities arose from the European Union enlargement European Neighborhood & Partnership Instrument (2007-2013). On the other hand, transnational cooperation in the South and Eastern Europe can be the answer to the local disparities, while it is a strategy that steps upon current opportunities and builds up a historical perspective, opening new ways of socio-economic evolution, in this region and for the world.

The above mentioned objectives of an inter-regional cooperation in general actually constitute its strengths:

- promotes regional socio-economic development;
- deals with common challenges (environment, public health, organized crime);
- ensures efficient and secure borders;
- encourages “people-to-people” local cross-border actions European Neighborhood & Partnership Instrument (2007-2013).

The development of this type of transnational interconnections is a rather effective process, though it is proceeding slowly, mainly hindered by parameters such as:

- the various administrative systems implemented in the cooperating regions, meaning differences in the jurisdiction, competencies, resources and decision making policies of the local and regional government authorities;
- the fact that legal personality can derive only from one body of the law;
- the fact that national authorities apply constraints to local or regional authorities, as for example to the right to transfer competencies or liabilities to cross-border bodies Gabbe, Martinos et. al (1999: 3).

Despite the obstacles and the differences among Eastern and Southern European border regions, transnational, interregional cooperation has to deal with a number of challenges:

- the different rates of economic development, the high disparities in incomes and the various demographic dynamics demand an integrated and harmonious regional development across the EU border. To that direction could drive joint development strategies;
- the treatment of environmental issues, such as water pollution, marine pollution, water-shortage, the sustainable management of fisheries' resources;
- the treatment of public health issues, related to the communicable diseases, possible epidemic or pandemic diseases, consumer protection, food safety and quality assurance and surveillance systems;
- the fight against organized crime, corruption and terrorism, illicit trafficking of human beings, smuggling of firearms and stolen vehicles;
- effective border management. For the cross-border cooperation to deal with this challenge, efficiency and security and close cooperation among the EU's external borders should be promoted;
- promotion of people-to-people cooperation. The Eastern European borders are characterized by traditional economic, social and cultural links, while cooperation in terms of education, society and culture could break down all barriers and encourage democratic reforms;

In order to complete the SWOT analysis of the prospects for a strengthened interalliance and cooperation in South and Eastern Europe, there remains only for the threats to be referred to. Similar to the arguments mentioned in the Neighbourhood & Partnership Instrument (2007-2013), there are four main risks for the cross-border cooperation in general:

- the willingness and capacity of the partners to enter into a program partnership;
- the willingness and capacity of the partners to manage the program and establish a joint management responsibility program;
- the knowledge and capacity of the partners to develop and implement project proposals;
- the support in national level of the establishment and management of the program by local partners.

3. Institutional restructuring towards a transnational cooperation in the area

There are various levels of governance and to each one of them there exist many institutional, cross-border, even transnational initiatives. The local public authorities for example contribute to inter-regional and inter-municipal networks and initiatives (think of the Euroregions, or inter-municipal agreements); on the other hand, the central authorities provide the domestic legal framework, as well as the framework of various interstate agreements, both being quite significant for the form and the intensity of cross-border and transnational cooperation; last but not least, the supranational level of institutional and / or legal formations, being either of global (UN, World Bank, WTO, etc.) or regional scale (EU, Black Sea Trade and Development Bank, Organization of the Black Sea Economic Cooperation, etc.), providing financing alternatives, frameworks for collaboration and interstate consultation (Boman & Berg, 2007).

The establishment of the appropriate institutions should follow some general principles and share some common characteristics in order for their role to be efficient. Gabbe, Malchus &

Martinos (1999) observe that the international institutions should promote the expansion and deepening of cooperation activities and not be regarded as the “*preliminary step*” towards cross border cooperation. In cases of diversity in structures and jurisdictions, the most practical solution for each situation should be found.

Furthermore, the interregional, international institutions should improve the local/regional authorities’ effectiveness and not create new administrative structures. Although they are different in terms of organizational structure or their legal form, they should be characterized by permanence, a separate identity from their members, their own resources of administration, technical and financial support, and their own decision-making structures. In relation to the stage of cooperation, the familiarization between the two (and more) partners and the creation of the appropriate networks, forums, contact mechanisms and mechanisms for information exchange constitutes an essential step. The formation of the transnational concepts and strategies necessitates the establishment of mechanisms for joint working (commissions, councils, working groups, secretariats), while the establishment of informal structures is required for the development and management of the transnational projects.

Nevertheless, beside the organizational, institutional remarks, the present paper wants to contribute first to the (re-) generation of a principal discussion, dealing with the necessity to work on the strengthening of regional economic cooperation and sociopolitical integrations, before going into wider amalgamation, like the EU, where the basic specifications required are lacking or missing. Often, one step back can be really progressive, as it facilitates the further development towards multicultural, transnational cooperation and progress. Second, we wish to open the dialogue for a deepening integration of socio-economic and political space in southern, eastern European and Black Sea area. It is necessary to evolve the historical binders of this region in a modern context ideological, cultural, social and economic identity. The above quotation of arguments and ideas speaks both, for the feasibility, but also for the necessity of such an aim.

4. Conclusions

The Eastern and Southeastern European countries are affected by a number of economic integration and transition forces shaping at the same time the economic landscape in the European Union and the continent as a whole.

The Union consists a multilevel system where social conflicts dominate among territorial categories. The increasing territorial inequalities in the enlarged Europe will possibly enhance the creation of barriers in closer cooperation. In the context of increasing Europeanization and internationalization, cross-border and especially regional, transnational cooperation among neighboring local and regional authorities constitutes one special case of initiatives promoting co-ordination and cooperation.

The Southeastern and Eastern European region provides a fertile environment for collaboration generated by intercultural, business and socio-economic interrelations of longer lasting, historical sense. The transnational cooperation in the area is rather complex, due to the heterogeneity and diversity of the states. The region has been experiencing fundamental changes in terms of economic, social and cultural life, since the emergence of

new countries led to the restate of the frontiers. Some of the Southeastern countries are adapting themselves rather well to the changes, while others try to re-orient themselves.

To that direction important role play the inter-regional cross-border cooperation initiatives within the European Union and more specifically within South and Eastern Europe. Yet, more important is to open the dialogue for a deepening integration of socio-economic and political space in southern, eastern European and Black Sea area (as well as in other regional sub-divisions, European or not). It is necessary to evolve the historical binders of this region in a modern context ideological, cultural, social and economic identity. Considering the local and ethnic specificity, there is a need for the structural reorganization of the existing institutions for transnational collaboration in the area, co-integrated in a mutual context of democratically legitimized, socially and environmentally balanced cooperation.

Above all, there is a need for a vision, a new "Charta". We wish to think of the present paper as a justified contribution for the structural reorganization of the existing institutions (local, national or cross-national) in the area, co-integrated in a mutual context of democratically legitimized, socially and environmentally balanced cooperation, taking into consideration local and ethnic specificity. A noble cause that will encourage the revolutionary potentials of our time, regionally or even globally. Today, in the time where the "suspended step" of a monetary unification in the European Union and the asymmetrical financial integration worldwide generate severe imbalances, there is a cry for democratization and socio-political integration too. Even if that means that we have to revert to regional socioeconomic and political associations, on the basis of the existing cultural, economic and historical bonds, like those of the South and Eastern Europe.

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IS MIDDLE-INCOME TRAP IN POLAND INEVITABLE?

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ABSTRACT

According to Felipe, Abdon, Kumar (2012) Poland is the country which was lower income before 1950 and in 2000 was graduated to upper-middle income. It was the only EU country with no fall of GDP during the last global financial crisis but the rates of growth have been very low after the crisis which may indicate that Poland is approaching a middle-income trap. In the following paper, firstly the concepts of the middle-income traps are analyzed. Secondly, a brief characteristic of Poland as a typical middle-income country is presented (the GDP level, the structure of output, trade and FDI, the role of technological imitations and innovations, and so on). Then it is argued that there are some risks that the slow-down of the Polish economy can become permanent.

The slow-down of the Polish economy can occur because there are some inherent barriers to growth. The paper identifies the barriers: inefficient justice system, complicated tax code, red tape (especially in the case of construction permits), not very high quality of tertiary education, low innovativeness and adverse demographic trends are among the most important ones.

Finally the authors of the paper argue that the situation is not inevitable. There has been substantial improvement in transport infrastructure (which was an Achilles heel of the Polish economy for many years). And some improvement in the business environment, in quality of education and the growing – it is a pity not very fast – number of innovations give still some hopes that Poland will be able to catch-up with advanced economies and become a country which economy is based on knowledge. The EU transfers and the EU integration can help in achieving higher rates of growth but the most important are institutional reforms. The crucial areas of these reforms are indicated in the paper.

Keywords: middle-income trap, Polish economy, emerging economies

1. Introduction

Poland with total income of \$489,795 (in 2012 year) is the 24th largest economy in the world and 6th largest economy on the EU (World Bank, 2014)¹⁰⁶. and is one of the major economies in the UE. The transition recession – which occurred after the collapse of communism in Poland in 1990 and 1991 – affected a large part of the Polish society the recession was not as big and not as long as in many other transition economies. The recession was a result of a change of the economic system and of a series of tough policy measures taken by the government. Price controls were lifted, public sector employees wages were capped, trade was liberalized, and the Polish currency, the zloty, was made convertible. The policies left millions out of work but freed Poland to begin to recover from decades of mismanagement.

¹⁰⁶ The population of Poland is about 38.2 million.

In spite of some internal and external problems the Polish economy has been constantly growing since 1992. One can distinguish three periods of quite periods of growth or economic booms (Nazarczuk, Marks-Bielska, 2009):

- in 1994-1998 – the result of reforms,
- in 2004–2008 – the result of the unification with the UE,
- in 2010-2011 – the result of responsible macroeconomic policies (and also some luck) which caused that the economy resisted the global financial turmoil.

First boom was due to the reform stimulating supply and the end of the crisis characteristic to the transition period. The enterprises started to adjust to the conditions of the new economy, investment and business environment was good, and there was also favourable world economic climate. This positive trend (with the rates above 5%) ended in 1998 as a result of the financial crisis in Russia. After 1998 the economy was still growing but the rates of growth were much lower. The next stage of fast growing GDP started in 2004. It was the result of the fact that Poland becomes a member of the UE. The EU funds and trade fostered the economic growth, and decreased unemployment rates. From 1989 to 2007 its economy grew by 177 percent, outpacing its Central and Eastern European neighbours as it nearly tripled in size. The last boom was relatively weak and the question may be raised whether the weakness should be attributed to the nature of the recent business cycle or it should be attributed to the changes in the potential GDP.

2. Middle-income trap hypothesis

The middle-income trap occurs when after some years of relatively high rates of growth a poor country's growth rates become low and eventually the country stagnates after reaching middle income levels. Probably the first time the term was used by Gill and Kharas (2007) to describe the apparent growth slowdowns in many former East Asian miracle economies. Then, after the global financial crisis, the term was made popular by Eichengreen, Park and Shin (2012) and Eichengreen, Park and Shin (2013). According to Eichengreen, Park and Shin (2012) a country is in a middle-income trap when it satisfies three conditions: GDP per capita is more than \$ 10 000 US PPP, it had a growth rate of 3.5 for seven or more years, and the fall of the GDP growth rate has gone down by at least 2 percentage points for at least a few years. Eichengreen, Park and Shin (2012) argued that the trap may occur at about \$15,000-16,000 level of GDP per capita (PPP, 2005 prices), in the paper from 2013 they argue there is a possibility of another trap, at \$10,000-11,000 level. They also added that the trap does need to mean a complete leveling-off of the rates of growth but it can also mean a rapid deceleration of the growth rates.

The middle-income trap refers to a country that has realized rapid growth to become a middle-income country but is unable to grow further: it has already used the advantage of cheap labour and other cheap resources (and the easiness of absorption of simple technologies) but the ages has already started to go up, and it is unable to offer better quality and more technology advanced products. The slow-down of the economies (in the absence of technological progress) has been predicted by many standard growth models but

it was rather said that it could happen in richer countries. The concept of the middle-income trap suggests that the slow-down can happen at much earlier stage of development. The traps may be overcome after some time but it indicates that the development (or catching-up) may be quite bumpy and not smooth.

Felipe, Abdon and Kumar (2012) took a sample of 124 countries for which they have consistent data for 1950-2010. They divided the countries into four categories: low-income (40 countries), lower middle-income (38 countries), upper-middle income (14) and high-income countries (32). They have found 35 out of 52 middle income countries today to be in the middle-income trap, 30 countries in the lower- middle-income trap and 5 countries in the upper-middle income. “The trapped countries” are in Latin America (13), the Middle East and North Africa (11), but also in Asia (3) and in Europe (2). The research shows that there is a real threat of the economic stagnation, but that there are also success stories of development.

3. Polish economy during and aftermath of the global financial crisis

In 2009, Poland was the only EU country to avoid a recession. A few factors played an important role: a floating exchange rate regime (Polish currency depreciated in the beginning of 2009), good supervision of the banking sector and quite low – in comparison to other countries – mortgage loans to GDP ratio, relatively sound monetary and fiscal policy responses (with some loosening the fiscal policy during the global crisis), and transfers from the EU. Following strong economic growth of more than 4 percent in 2011, GDP growth slowed to 1.9% in 2012 and further decelerated in early 2013, as renewed fiscal turmoil in the Euro zone weakened business' and consumers' confidence. This in turn caused some stagnation on demand side of the economy, and the investment spending started even to fall (see table 1).

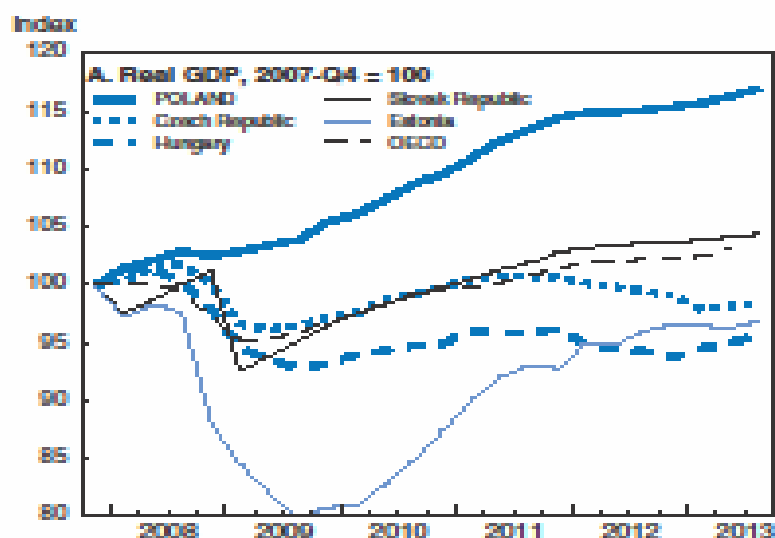
Table 1 The main indicators of the Polish economy before and after the global financial crisis

	Unit	2005	2006	2007	2008	2009	2010
GDP per capita	USD current PPPs	13 786	15 057	16 750	18 025	18 796	19 862
Real GDP growth	Annual growth %	3.6	6.2	6.8	5.1	1.6	3.9
Gross fixed capital formation	% of GDP	6.5	14.9	17.6	9.6	-1.2	-0.4
Government deficit	% of GDP	-4.1	-3.6	-1.9	-3.7	-7.5	-7.9
General government debt	% of GDP	54.1	54.2	50.4	55.5	57.6	61.4
Current account balance of payments	% of GDP	-2.4	-3.8	-6.2	-6.5	-4.0	-5.1
Inflation rate	Annual growth %	2.2	1.3	2.4	4.2	3.8	2.6
Unemployment rate	%	17.9	14.0	9.6	7.0	8.1	9.7
Long-term unemployment:	%	52.2	50.4	45.9	29.0	25.2	25.5

Source: OECD Country Profile: Poland (2014)

As a result of the resistance of the Polish economy to the global financial crisis, the differences in the level of economic development had been gradually diminished; GDP per capita increased from 51.8% of the UE average in 2005 to 56,3% in 2008 and 65, 1% in 2011. During the whole period of the global crisis Polish economy performed much better than the OECD countries, including other former communist (or emerging European) economies (see Figure 1). However, as it is shown by Figure 1, the Polish GDP growth curve has become flatter for the last three years.

Figure 1 Real GDP growth in Poland and in some other countries in Central Europe.



Source: OECD Economic Survey: Poland (2014)

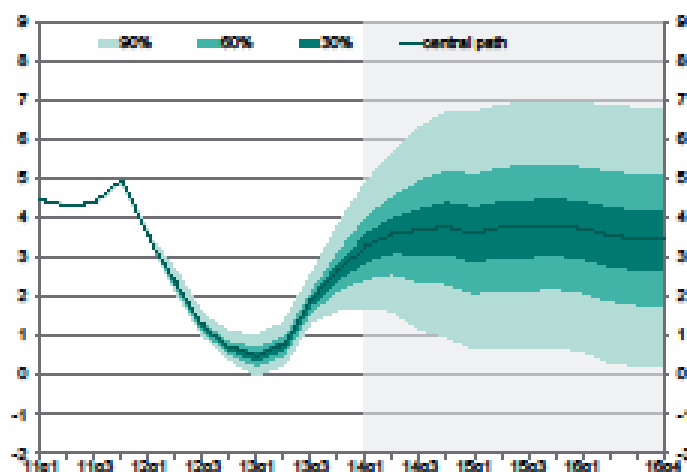
Unfortunately, since 2011 the overall global economic and political climate has started to influence Polish economy the negative way. Following the strong economic growth of more than 4 percent in 2011, GDP growth slowed to below 2% in 2012 and further decelerated in early 2013. In 2012 global economy started to rebound. It raises the question if Poland will keep with this trend or there is a risk that Poland will fall into a middle-income trap.

Table 2 Real GDP indices (100 – quarter in the previous year)

	1 st q.	2 nd q.	3 rd q.	4 th q.
2010	102,7	103,7	104,2	104,7
2011	104,5	104,3	104,4	104,9
2012	103,5	102,4	101,3	100,7
2013	100,5	100,8	101,9	102,7

Source: GUS (2014)

The forecasts for the next three years are a little more optimistic. The central bank of Poland predicts that the GDP growth rate will achieve 3.5-3.6% (see Figure 3). This can be seen as a very good result if you compare it to the situation of, for example, Greece but it is not enough if Poland wants to catch-up with the richest European countries in 20-30 years.

Figure 2 GDP growth rates forecasts

Source: Inflation Report (2014)

4. Obstacles to growth of the Polish economy and the chances to overcome them

Eichengreen, Park and Shin (2013, p. 1) argue that “slowdowns are less likely in countries where the population has a relatively high level of secondary and tertiary education and where high-technology products account for a relatively large share of exports, consistent with our earlier emphasis of the importance of moving up the technology ladder in order to avoid the middle-income trap.”¹⁰⁷ Poland has got one of the highest rate of young people attending universities in the world, but quality of the Polish higher education needs a lot of improvement¹⁰⁸.

Polish spending on research and development is very low – it is still below 1% of GDP¹⁰⁹. The number of patents is low, and Poland is not known because of new innovative products. Poland is not at the bottom of the technological production ladder but very seldom does it export high-tech products. It is the biggest producer of household appliances in Europe, it sells parts for German car industry, and it also a very important producer of furniture.

Table 4 Research & development spending and the number of researchers in Poland

	Unit	2005	2006	2007	2008	2009	2010	20101
Gross domestic expenditure on R&D	Mln USD	2 982	3 107	3 384	3 790	4 301	4 870	5 294
Researchers: full-time equivalent	Per '000 employed	4.4	4.1	4.1	3.9	3.9	4.1	4.0

Source: OECD Country Profile: Poland (2014)

¹⁰⁷ The lack of space does not allow to add comments on the newest literature on the middle-income trap, and the proposed ways to avoid or escape it. Aiyar, Duval, Puy, Wu and Zhang, (2013) provide a good survey about it.

¹⁰⁸ According to *PISA 2012 Results* (2013) there has been observed a substantial progress in primary and secondary education,

¹⁰⁹ At least three big international companies spend more on R&D than the whole Poland.

“The supply of human capital and innovations” are one side of the coin. The other side of the coin is the situation of firms. There are still too many obstacles to start a business, and too many obstacles for firms to develop and absorb new technologies. The *Doing Business* reports show that in spite of some progress a lot of reforms must be introduced (see Table 3)¹¹⁰. Getting credit is the only aspect of the business environment that does not cause a lot of hardship for owners and managers of firms¹¹¹. There has been a lot of progress in improvement of resolving insolvency for the last year, but there is still a lot of room for reforms.

Table 3 Poland in *Doing Business* Ranking 2014 (the ranking for 189 countries)

Starting a business	116
Dealing with construction permits	88
Getting electricity	137
Registering property	54
Getting credit	3
Protecting investors	52
Trading across borders	49
Enforcing contracts	55
Resolving insolvency	37
Paying taxes	113
Overall	45

Source: Doing Business Ranking 2014 (2013)

The EU transfers and the EU integration can help in achieving higher rates of growth in Poland but the most important are institutional reforms both of business environment and of higher education and research institutions.

There is one more important argument for being aware of the possibility of the middle income trap. The reforms which should aim at the improvement of productivity (Poland is becoming less and less competitive as far as the wages are concerned) should be launched as fast as it is possible because Polish population is ageing. Poland has already got a high public debt¹¹², and if the economy slows down the share of government transfers to households will go up, and Poland may face a fiscal crisis.

5. Conclusions

Poland was the only EU country with no fall of GDP during the last global financial crisis but the rates of growth have been very low after the crisis which may indicate that there is a danger that Poland is approaching a middle-income trap. The slow-down of the Polish

¹¹⁰ Similar conclusions can be drawn from *The Global Competitiveness Report* (2013). OECD Economic Survey: Poland (2014) stresses the need to boost employment, strengthen product market competition, and consolidate macroeconomic policies. It seems that it focuses more on medium-term, and not long-term problems of the Polish economy.

¹¹¹ However, it should be added that the interest rates are higher in Poland than in many other countries.

¹¹² See Table 1. Thanks to a different methodology of calculation, the official Polish government estimation of the public debt are lower.

economy can occur because there are some inherent barriers to growth: inefficient justice system, complicated tax code, red tape (especially in the case of construction permits), not very high quality of tertiary education, low innovativeness and adverse demographic trends are among the most important ones. However, the falling into the trap is not inevitable. There has been substantial improvement in transport infrastructure (which was an Achilles heel of the Polish economy for many years) and also some improvement in the business environment. The innovativeness of the Polish economy is low but there are still some hopes that Poland will be able to catch-up with advanced economies and become a real knowledge-based economy.

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MANAGEMENT Session

THE PROCESS OF FINANCIAL RESTRUCTURING IN TIMES OF CRISIS IN ENTERPRISES

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ABSTRACT

A clear, systematic approach to restructuring is indispensable for successful combat over a crisis in a company. Identification of reasons for a crisis, whether and how, it can be remediated.

In recent years, changes in technological conditions, improvements in communication and information technology, trade and financial liberalization have affected the operation condition of business grave competition has started between companies and countries. With increased financial and trade deregulation, markets have been more risky and seen an extent of the convergence among companies and countries. With the contagion effect, shocks and crises has spread from one country to another. As a result of them, companies have been faced with crises. Whatever the causes of crises, either external (macro economic or came from another country/another region) or internal conditions (firm specific level such as weakness of management or the deterioration of the financial structure of companies) they have negatively affected companies. Management, reputation, market share, sales or profitability. For these companies, crises management has been urgent and life-giving requirements.

To recover from the business distress and crisis, companies experience restructuring of their activities. The companies also need restructuring when a division of company performs low than target or this division is not fit the future plans of company. Corporate restructuring encompasses a wide range of actions, such as the transformation of the firms. Organization of asset structure and of business portfolio. The restructuring activities also include operational and financial restructuring. Financial restructuring can take different forms such as expansion strategies, downsizing (exiting) strategies and strategies that can change in ownership structure by using debt.

In this study, we can use the financial restructuring of enterprises in crisis conditions the crisis exit strategies will be examine

Key words: financial liberalization, business, deregulation, companies, Crisis management, Improvements

1. THE CONCEPT OF CRISES IN BUSINESS ENTERPRISES

Due to the fact that the concept of crisis is distinctly defined by the different disciplines, it is difficult to make an integrated definition about crisis. According to Shrivastava, crises are

triggered by a set of elements such as the human, organizational, and technical failures that are in mutual interaction (Shrivasta et al, 1998, p. 297). Laurence Barton defines the crisis as the important and unexpected events, the potential of which is high to produce the negative outcomes, (Guth, 1995, p.125). When crisis is defined in general meaning, it is a phenomenon that will lead an individual or a group to face a negative case, if any attempt is not made to correct it (Dutton, 1986, p.502, Mutlu and büyükbalcı, 2009, p, 118).

While crisis is defined, two keywords taking place in line spaces are of course “unexpected” and “urgent” (Taylor, 2001, p. 47).

Crisis can be defined as a case threatening the integrity, competitive power, and life of business enterprises and the major reasons pushing the business enterprises to crisis are (Akgüç, 1998, p. 947):

- That sales volume is insufficient;
- That the expenditures are high;
- The receivables cannot be collected in time;
- That inventory turnover is slow;
- That unutilized production capacity forms by over investing on real assets.
- Over debts;
- That the possibility of competition is weak;
- Liquidity insufficiency;
- External stocks;

In crisis management, it is necessary to get to bottom of the problem forming crisis. However, whatever its cause is, in the conditions of crisis, business enterprises face a liquidity insufficiency and in this condition, cash becomes a resource rare and unpredictable (Brigham and Ehrhardt, 2005, p.816)Hence, whatever the cause is, the first application that is necessary to be done for overcoming the crisis is to settle the deficiency of cash and to get bottom of the problem. Therefore, the effective cash management plays an important role in being eluded of crises (Aba-bulgu and Islam, 2007, p. 925).

2- MANAGEMENT OF THE CRISIS CONDITIONS AT THE LEVEL OF COMPANY

2.1. FINANCIAL PLANNING

Planning is to determine the targets and aims toward the future and to decide the ways to be followed for reaching these targets (Ülgen and Mirze, 2004, p. 23, Köse and Solakoğlu, 2009, p. 239). With moving from this definition, the financial planning process is as follows:

- analysis of the possibilities of financing investment
- prediction of the future results of the decisions to be made,
- deciding about which alternatives will be applied,
- measuring performance in the direction of the identified aims.

In the periods of crisis, conducting the financial plans extremely matters. The critical elements of the plan should include (Köse and Solakoğlu, 2009, p. 238):

- pro forma cash flow, income table, and balance projections,
- the main assumptions of financial plans,
- the programs associated with managing the existent assets and liabilities,
- project plans for critical assumptions,
- organizational change,
- critical risks and plans for managing the risks,
- reporting mechanism for the existing communication.

3- FINANCIAL RESTRUCTURING IN THE PERIODS OF CRISIS

In business enterprises, in the periods of crisis, the financial restructuring expresses a process, more than one, leading to the changes in the assets, financial structure, and property relations of the business enterprises (Pomerleono and Shaw, 2005, p.12, Yılgör, 2009, p. 328) The reflection of crises at macro level on business enterprises are also the cases jeopardizing the future of business enterprises in the troubles and crises at the level of business enterprise. In these conditions business enterprises, in order to be able to achieve to more manageable structure, use the strategies of financial restructuring as an instrument of getting out of crisis and mostly appeal to the sale of assets (Cao and otr, 2008, p. 69).

In business enterprises, in general, the processes of financial restructuring can be generalized as determined below (Gaugen, 1999, p. 405).

- with conducting the necessary financial analyses and evaluating the alternatives, making decision about the financial restructuring, and identifying which strategy is convenient;
- forming the restructuring plan, and with the department or participation of the business enterprise that is subject of restructuring, making the necessary interviews;
- approving of the restructuring plan by the shareholders;
- making the necessary legal notations and registrations;
- completing of the procedure.

4-IN THE PERIODS OF CRISIS, DOWNSIZING STRATEGIES IN RESTRUCTURING

In the financial restructuring of business enterprises, in the scope of downsizing strategy, the partial asset sale, distribution of assets of business enterprises or a unit of business enterprise to the existing shareholders, and the procedures of public offering of a certain part of department of the business enterprise will be considered (Yılgör, 2009, p. 328).

4.1. PARTIAL ASSET SALE

Partial asset sale is the sale of some assets, a participation, a department, or production line of the business enterprise to a purchaser outside. For the business enterprise or department of the business enterprise that is sold, a payment is made in cash or in the form of readily cashable securities, or a combination of both of them. Just as the cash obtained as a consequence of sale can be used in financing the new assets, they can also be used for the share payments to be made to the shareholders or repurchasing the stocks (Yilgör, 2009, p. 330).

4.2. DISTRIBUTING THE SHARES OF THE ASSETS OR A UNIT OF THE BUSINESS ENTERPRISE TO THE EXISTING SHAREHOLDERS

The procedure of distributing the shares of the assets or a unit of the business enterprise to the existing shareholders, putting the irrelevant departments with the main activities out of operation, depending on the causes such as enabling the managers to focus on the main branch of activity; and eliminating the need for transferring resources to the departments and participations, especially in the large enterprises, makes an effect increasing the productivity, effectiveness, and the firm value in the business enterprises in the crisis conditions (Pin, 2006, p.978).

5. ARRANGEMENTS CHANGING THE STRUCTURE OF PROPERTY WITH THE RESOURCES BASED ON BORROWING

5.1. BUYING BY BORROWING

Buying by borrowing is to buy all of stocks or assets by financing them with the resources obtained via borrowing. Those acquiring a business enterprise or a unit of business enterprise by using loan target an increase on the performance, activity areas, and cash flow of business enterprise (Yilgör, 2009, p. 330),

5.2. PLAN OF MAKING THE EMPLOYEES PARTNER

The plan of making the employees partner aims to enable the employers to form an instrument for their employees for them to be able to invest on the stocks; to provide liquidity for the shareholders of non-public enterprises; to form a partial market for the stocks of company; and to provide the employers with the tax advantages (Rezaee,2001, p. 284)

5.3. REPURCHASING THE STOCKS

Repurchasing the stocks is being bought of the stocks that are treated in the market by the business enterprise in exchange of cash. Repurchasing the stocks and premium payments are of the methods a business enterprise will refer to for it to be able to make a

payment to its shareholders. While the premium is accepted as a continuous cash flow to be made to the shareholders, repurchasing the stocks is considered a temporal cash flow (Yılgör, 2009, s, 330).

6.CONCLUSION

Crisis is a case threatening the integrity, competitive power, and life of business enterprises. Crises can be resulted from the reasons such as managerial vulnerability, planning faults etc. However, whatever its reason is, business enterprises, in turn, face a cash deficiency and in this period, cash becomes a resource rare and unpredictable.

In the periods or crisis, for meeting the cash the business enterprise needs, the actions creating cash are taken. Shortening the maturity of receivables, the potential to create cash can increase. For shortening the maturity of receivables, besides the policies of applying discount for the early payments, eliminating the customers experiencing problem in paying for their debts, it should be concentrated on the customers regularly performing their payments. Shortening the durations of stock holding and supply, cash need of business enterprises can be reduced. For this purpose, supplies can be made in small amounts and in shorter times. Also determining the stocks whose turnover rate are low, the share of these should be decreased.

In order to persuade the investors having a potential both to understand the causes and size of crisis and to determine cash need; and both to balance cash flow and to provide extra resource to the firm to that the firm is worth to be invested on, the financial plans in detail should be made. For this purpose, financial plans forming the necessary roadmap for the business enterprise to achieve its previous financial health are developed.

Plans and budgets are the works carried out to shape the future, beginning from today. The future is a completely unclear environment; especially in the period of crises, this uncertainty leaves its place to chaos. Therefore, in order to get out from chaos in the conditions under consideration, the success chance of solutions that will be produced according to an only possible case is weak.

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ACCRUALS ANOMALY: A SURVEY OF THE METHODS USED TO MEASURE ACCRUALS

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ABSTRACT

Through this paper I intend to bring to forefront a reexamination of the main methods and models used to determine accruals, in the accruals anomaly literature. The literature on accruals anomaly (Sloan, 1996) tests the theory that investors fixate on earnings in the process of establishing stock prices, failing to perceive the different persistence of accrual and cash flow components of earnings. Thus, accrual component of earnings is less persistent than cash flow component of earnings and higher accruals lead to abnormal low stock returns and vice versa. As this relation may indicate an improper use of accruals in forecasting future earnings, is imposed the understanding of the significance of the accruals. The interest in accruals arouse from the attempt of explaining earnings quality by using a broader definition of accruals. An important stream of research in this literature is the use of a proper measure of accruals. The central point of this research is based incisively on the Sloan (1996) definition. This assumes that accruals are changes in the current net operating assets. Further, other methods developed involve: aggregate change in current and non-current net operating assets (Richardson, et al. 2005), cumulative accruals measure (Hirshleifer, et al. 2004) and change in net operating assets (Richardson et al. 2006a). The literature models these accruals in order to determine abnormal or discretionary accruals. Abnormal accruals are most often used in literature as a proxy for earnings management. Models used to estimate normal and abnormal levels of accruals start with Jones (1991) model and continue with modified Jones model, performance matched procedure (Kothari et al. 2005), Dechow and Dichev (2002) approach and discretionary estimation errors of Francis et al. (2005). The main purpose of this survey is to discuss the variations and the consequences of these methods and models in the literature of accruals anomaly. The proper understanding of accruals anomaly, considered by LaFond (2005) a general phenomenon, could improve investors' forecasting and lead to an increase in economic growth and development of capital markets.

Key words: accruals, accruals anomaly, working capital, capital market, financial information, investors

JEL codes: M21, M41

1. Introduction

In this paper I review the literature on accruals anomaly. Although, there are several papers which have already reviewed this topic, the purpose of this survey is to complement them. Accruals anomaly, originated with Sloan (1996) study, is defined as the relation between accruals and stock returns. The approach I adopt for this review involves a survey on the literature with focus on the main methods and models used to compute or model accruals.

The literature on accruals anomaly (Sloan, 1996) tests the theory that investors fixate on earnings in the process of establishing stock prices, failing to perceive the different persistence of accrual and cash flow components of earnings. Accrual component of earnings is less persistent than cash flow component of earnings and higher accruals lead to abnormal low stock returns and vice versa. As this relation may indicate an improper use of accruals in forecasting future earnings, is imposed the understanding of the significance of the accruals. The interest in accruals arose from an attempt to explain earnings quality by using a broader definition of accruals.

The use of a broader definition for accruals represents an extension of Sloan (1996) study in the accruals anomaly literature. The central point of this research is based incisively on Sloan (1996) definition. This assumes that accruals are changes in current net operating assets. During the time, accruals definition had a continuing evolution. Either considered a component of earnings, either a determinant of earnings persistence, the evolution and the significance of this concept is incontestable. Starting with Sloan (1996), Healy (1985) and Jones (1991) it was defined as non-cash working capital and depreciation. But, since, the revolutionary appearance of the cash flow statement and the controverted study of Hribar and Collins (2002) which claim that the balance sheet method may diminish the results, a new era of the accruals definition started. Hence, accruals are computed as difference between earnings and cash flow. Further, based on the assumption that all balance sheet accounts are products of the accrual accounting system, Richardson et al. (2005) introduce a more complex measure of accruals based on the change in net operating assets other than cash.

Accruals determined through these methods are used then in abnormal accruals models. Models used to estimate normal and abnormal levels of accruals start with Jones (1991) model and continue with modified Jones model, performance matched procedure (Kothari et al. 2005), Dechow and Dichev (2002) approach and discretionary estimation errors of Francis et al. (2005).

The main purpose of this survey is to establish the role of accruals on the capital market and the possible effects caused by an improper understanding of the accruals information. Understanding the informational content of accruals involves knowledge about accruals methods and their modeling to generate abnormal accruals. This means choosing the proper measure and the best model to determine accruals. The second purpose of our survey is to make an analytical comparison between these measures and models to facilitate decision making.

The paper is organized as follows. Section 2 defines accruals, Section 3 provides an overview of the broader measures of accruals, Section 4 review the principal abnormal accruals models and Section 5 concludes.

2. What are accruals?

Sloan (1996) makes an interesting affirmation by arguing that when earnings are composed predominantly by accruals, some of the anticipated earnings may not be accomplished. I consider that this is the point that wakes up the interest of many users. Accruals can influence the quality of earnings (Sloan, 1996). When accrual component of earnings is higher than cash flow component of earnings, there is an overvaluation of earnings. Also,

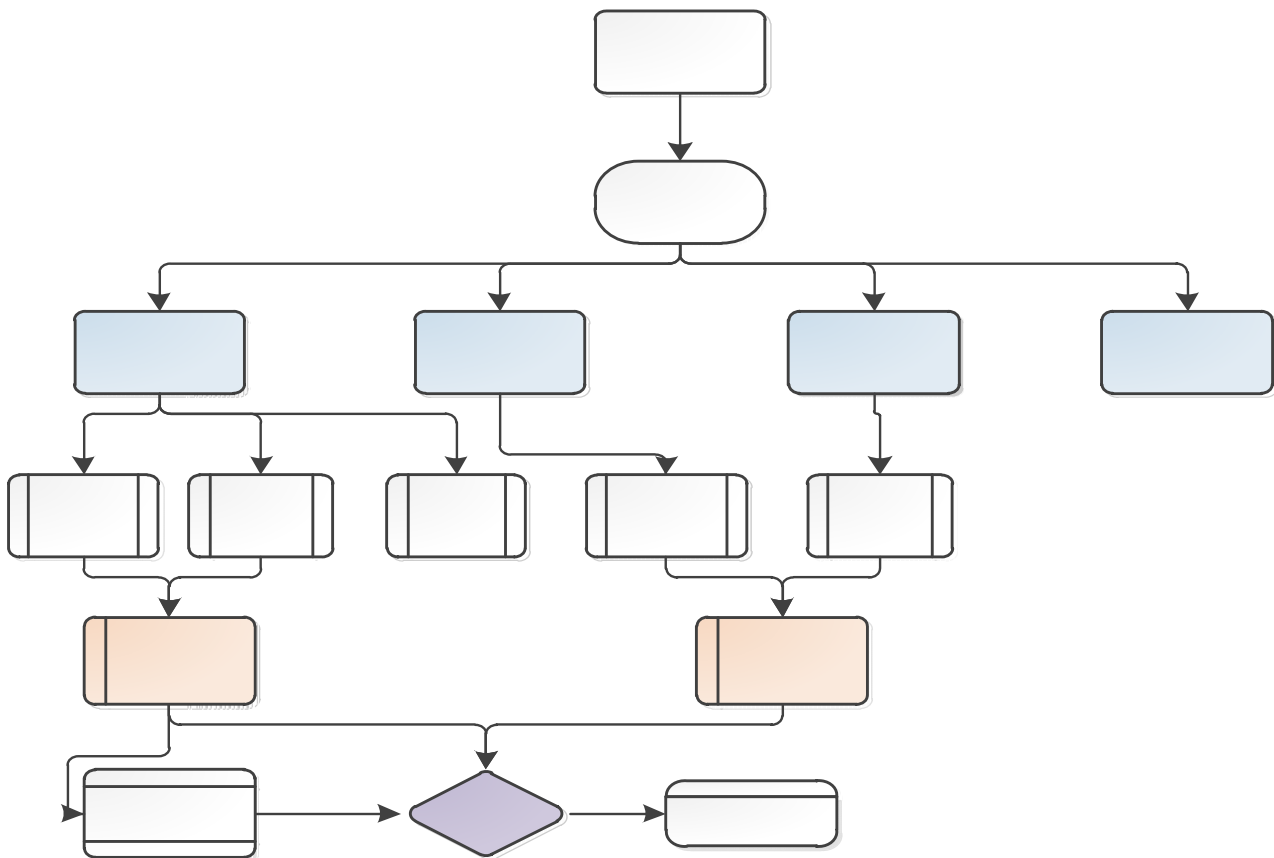
earnings quality may be compromised. Hence, the information that investors perceive may be of lower quality (Hung, 2001).

Accruals are considered to be “the substance of accounting valuation” and the power that transforms accounting system in a source of information (Christensen and Demski, 2008). Searching for the proper definition for accrual, I found either to simply either to complicate definitions so, I formulate my own definition, more exhaustive and comprehensible.

Accruals are the product of an accrual accounting system, representing anticipated future benefits for investors and managers, recorded as net operating assets. Accruals as a component of earnings are less persistent than cash flow component of earnings, generating abnormal stock returns.

Accruals definition can also be visualized in a graphical form in Fig. 1. Here is presented in detail the process of generation of accruals. It can be observed that accruals are produced in an accrual accounting system. For its determination are used elements from the balance sheet. Other methods involve information from the income statement and the statement of cash flow. Accruals have two main components, a component related to assets and other related to liabilities. Therefore, accruals represent anticipated future benefits recorded as change in net operating assets. Also, accruals play a significant role in the generation of abnormal accruals (Xu and Lacina, 2009) and also allow for earnings management (Leippold and Lohre, 2010).

Fig.1 The process of accruals determination



Source: projected by author

Even if both accruals and cash flows are components of earnings, Christensen and Demski (2008) make a significant distinction between them. Thus, while cash flow is the one considered a source of information, accruals are the one which carry the information over and above what cash flow has conveyed.

3. The broader definition of accruals

There are several methods used in the literature to measure accruals. These are divided about the source of information in balance sheet methods and cash flow methods. The most famous is Sloan (1996) balance sheet method defined as change in current net assets. The other methods are considered as extensions of this model. These are: change in current net assets (Sloan, 1996), aggregate change in current and non-current net operating assets (Richardson et al. 2005), cumulative accruals measure (Hirshleifer et al. 2004) and change in net operating assets (Richardson et al. 2006a). The cash flow method assumes computing accruals as the difference between earnings and cash flow. Table 1 provides a brief summarize of these methods. Further is provided a full description of these models and a comparative analysis between them.

Table 1. The broader definition of accruals

Author/Model	Method	Observations
Sloan (1996)	<i>Change in current net operating assets</i>	<i>Non-cash working capital minus depreciation</i>
Richardson et al. (2005)	<i>Aggregate change in current and non-current net operating assets</i>	<i>Consists from 3 parts: current net operating assets, non-current net operating assets and net financial assets</i>
Hirshleifer et al. (2004)	<i>Cumulative accruals measure – net operating asset level (NOA)</i>	<i>Net operating accruals are defined as the sum between cumulative operating accruals and cumulative investments</i>
Richardson et al. (2006a)	<i>Change in net operating assets</i>	<i>Include current and non-current accruals but eliminate financing accruals</i>
Hribar and Collins (2002)	<i>Cash flow method – Traditional method</i>	<i>Difference between earnings and cash flow</i>

Source: adapted by author

3.1. Sloan (1996) method – Current net operating assets

Accruals are defined by Sloan (1996) as anticipated future benefits recorded as an increase in non-cash assets in a period. The model proposed by Sloan (1996) to determine accruals involve the balance sheet method and is based on changes in current assets and current liabilities. Thus, accruals represent the change in current net operating assets. In other words, accruals are changes in non-cash working capital minus depreciation.

$$\text{Accruals} = (\Delta CA - \Delta \text{Cash}) - (\Delta CL - \Delta STD - \Delta TP) - Dep$$

Where:

ΔCA = change in current assets

ΔCash = change in cash/cash equivalents

ΔCL = change in current liabilities

ΔSTD = change in debt included in current liabilities or short-term debt

ΔTP = change in income taxes payable

Dep = depreciation and amortization expense

In table 2 are synthesized the steps that should be followed in order to determine accruals. The first steps include the computation of current assets and current liabilities. From these components are excluded cash, short-term debt and taxes payable. Cash is eliminated as accruals measure anticipated future benefits and cash represent real benefits. Debt included in current liabilities is excluded because is related to financial transactions and not to operating transactions. Taxes payable are excluded due to consistency with the definition of earnings.

Table 2. Phases in accruals computation (Sloan, 1996)

Phases	Formula
1. Current operating assets	<i>Cash & Short-term investment + Accounts receivable + Inventories + Other current assets</i>
2. Current operating liabilities	<i>ST debt + Accounts payable + Taxes payable + Other current liabilities</i>
3. Current net operating assets	<i>Current operating assets – Current operating liabilities</i>
4. Accruals	<i>($\Delta\text{Current assets} - \Delta\text{Cash \& Short-term investment}$) – ($\Delta\text{Current liabilities} - \Delta\text{Short-term debt} - \Delta\text{Taxes payable}$) – Depreciation</i> <i>= $\Delta\text{Non-cash current asset} - (\Delta\text{Current liabilities} - \Delta\text{Short-term debt} - \Delta\text{Taxes payable}) - \text{Depreciation}$</i>

Source: adapted by author from Sloan (1996)

All variables are scaled by total assets as a measure of firm size, to make easier the comparisons between the magnitude of earnings performance and relative magnitude of accrual and cash flow component of earnings. Total assets are an appropriate book measure of the investment base used to generate earnings and measured as the average of the beginning and end of year book value of total assets.

3.2. Richardson, Sloan, Soliman and Tuna (2005) method – aggregate change in current and non-current net operating assets

Richardson, Sloan, Soliman and Tuna (2005) develop the definition of accruals by adding to the change in current net operating assets (used by Sloan, 1996), the changes in non-current net operating assets and the changes in net financial assets. They consider that this formula is a more comprehensive measure of accruals. The efficiency of this model seems to be confirmed by the empirical results, providing stronger results than the Sloan model. This

may happen because the model contains estimates of long-term future benefits. The authors also consider that ignoring non-current accruals may determine noisy measures of accruals and cash flows.

This model consists from 3 parts: current net operating assets, non-current net operating assets and net financial assets. Zach (2006) defines these three elements as: working capital accruals, investing accruals and financing accruals. The model proposed by author to compute accruals is:

$$\text{Accruals} = \Delta \text{Non-cash working capital} + \Delta \text{Non-current net operating assets} + \Delta \text{Net financial assets}$$

In table 3 are presented in detail the steps needed to follow in order to compute accruals.

Table 3. Phases in accruals computation (Richardson et al. 2005)

Phases	Formula
1. Non-cash working capital (WC)	<i>Current operating assets (COA) – Current operating liabilities (COL)</i>
a. Current operating assets	<i>Current assets (CA) – Cash & Short-term investment</i>
b. Current liabilities	<i>Current liabilities (CL) – Debt in current liabilities (DCL)</i>
2. Non-current net operating assets (NCO)	<i>Non-current operating assets - Non-current operating liabilities (NCOA) (NCOL)</i>
a. Non-current operating assets	<i>Total assets – Current assets – Investment and Advances</i>
b. Non-current operating liabilities	<i>Total liabilities – Current liabilities (CL) – Long-term debt</i>
3. Net financial assets (Fin)	<i>Financial assets (short and long term investment) (FinA) – Financial assets (FinL)</i>
a. Financial assets	<i>Short-term investment + Long-term investment</i>
b. Financial assets	<i>Long-term debt + Debt in current liabilities + Preferred stock</i>
4. Net operating assets	<i>Non-cash working capital (WC) + Non-current net operating assets (NCO)</i>
5. Accruals	<i>$\Delta WC + \Delta NCO + \Delta Fin$</i>

Source: adapted by author from Richardson et al. (2005)

This measure is different by Sloan (1996) measure by incorporating non-current operating and financial assets and liabilities. Also, Sloan (1996) excludes taxes payable and treats depreciation expense as a current accrual.

3.3. Hirshleifer, Hou, Teoh and Zhang (2004) method – Cumulative accruals measure

Hirshleifer et al. (2004) consider net operating assets as a better predictor for future returns and a better proxy for investors' misperceptions. Net operating accruals (NOA) are defined as the sum between cumulative operating accruals and cumulative investment.

$$NOA_T = \sum_{t=0}^T Accruals_t + \sum_{t=0}^T Investment_t$$

The method proposed by the authors involves the use of aggregate accruals as a stimulant for earnings quality. Although, Sloan (1996) results' support just the use of previous year, the lower persistence of accruals appears to largely manifest over the next 1 to 3 years. Hirshleifer et al. (2004) try to demonstrate that the level of net operating assets scaled by previous year's total assets is also in a negative relation with future returns. The level variable is considered by authors as superior to the change variable because it captures cumulative past changes not just the most recent annual changes. All regressions use the level of net operating assets (NOA) deflated by lagged total assets ($Total\ assets_{t-1}$), as the measure of the level of NOA. Also, firms are ranked in portfolios after the NOA level. Authors use the accruals measure of Sloan (1996) only to compute cash flow. NOA measure is:

$$NOA_t = \frac{NOA_t}{Total\ assets_{t-1}}$$

Table 4. Phases in NOA computation (Hirshleifer et al. 2004)

Phases	Formula
1. Operating assets	<i>Total assets – Cash & Short- term investment</i>
2. Operating liabilities	<i>Total liabilities – Short term debt – Long term debt – Minority interest – Preferred stock – Common equity</i>
3. Net operating assets	<i>Operating assets – Operating liabilities</i>

Source: adapted by author from Hirshleifer et al. (2004)

Nevertheless, Richardson et al. (2006b) remark that Hirshleifer et al. (2004) actually divide aggregate accruals in the current year by aggregate accruals in the previous year which is the same with the measure of accruals for one year. Thus, when "a level is deflated by a lagged level is equivalent with a change". Richardson et al. (2006b) consider that Hirshleifer et al. (2004) measure doesn't capture the cumulative past difference between earnings and cash flow because it eliminates past changes in assets components of NOA. Also, the focus on NOA may indicate a focus on earnings and ignore accruals and cash flow. Richardson et al.

(2010) state that this measure is an algebraic transformation of ΔNOA measure from Richardson et al. (2005) combined with operating liability and financial assets.

3.4. Richardson, Sloan, Soliman and Tuna (2006a) – net operating assets

Richardson et al. (2006a) follow a model where accruals are measured as change in net operating assets deflated by net operating assets from the previous year. Net operating assets are the difference between operating assets and operating liabilities. Total operating accruals are the sum of the working capital and non-current operating accruals. Fairfield et al. (2003) consider non-current operating accruals as a form of growth and only working capital are considered accruals. Richardson et al. (2006a) definition follows Richardson et al. (2005) by incorporating non-current operating accruals but exclude financing accruals. Sloan (1996) doesn't include non-current operating assets and liabilities in his definition. Similar with Richardson et al. (2005) are not eliminated taxes payable and depreciation from the net current assets measure. This method of accruals should provide an increase in earnings quality.

$$\text{Net operating assets} = (\Delta \text{Current Assets} - \Delta \text{Cash \& Short-term investments} + \Delta \text{Non-current operating assets}) - (\Delta \text{Total liabilities} - \Delta \text{Debt in current liabilities} - \Delta \text{Long-term debt})$$

The formula used for accruals become:

$$\text{Accruals}_t = \frac{\Delta NOA_t}{NOA_{t-1}}$$

Table 5. Phases in NOA computation – (Richardson et al. 2006a)

Phases	Formula
1. Operating assets	<i>Current operating assets + Non-current operating assets</i>
a. Current operating assets	<i>Current assets (CA) - Cash & Short-term investments</i>
b. Non-current operating assets	<i>Total assets – Current assets (CA) – Investment and advances</i>
2. Operating liabilities	<i>Current operating liabilities + Non-current liabilities</i>
a. Current operating liabilities (COL)	<i>Current liabilities - Debt in current liabilities</i>
b. Non-current liabilities (NCOL)	<i>Total liabilities – Current liabilities – Long-term debt</i>
3. Net operating assets	<i>Operating assets - Operating liabilities</i>

Source: adapted by author from Richardson et al. (2006a)

3.5. Cash flow statement method

A very common accruals measure in the literature is based on the cash flow statement. The cash flow method has gained more interest since the controversial work of Hribar and Collins (2002). They demonstrate that the balance sheet method may affect earnings managements' tests by causing misperceptions. Cash flow method is more often used in the literature (Leippold and Lohre, 2010) as a sensitivity test for the balance sheet method. Kothari et al. (2006) use both cash flow and balance sheet methods in order to account for measurement errors. However, results are similar. Hafzalla (2010) supports that cash flow method "excludes the effect of acquisitions and foreign currency translation adjustments".

Hribar and Collins (2002) propose two alternative methods to the balance sheet method. The first, also called the traditional method, is determined as the difference between earnings and cash flow from operations scaled by total assets.

$$\text{Accruals} = \text{Earnings} - \text{Cash flow}$$

Earnings represent net income before extraordinary items and operating cash flow is cash from operating activities. All variables are deflated by total assets (average total assets, lagged total assets, beginning total assets). This method is used by Kraft et al. (2006), Hafzalla (2010), Collins and Hribar (2000), Xie (2001) and Pincus et al. (2007).

The second method proposed by Hribar and Collins (2002) include changes in non-cash working capital account plus depreciation. This method is more comparable with the balance sheet method.

$$\text{Accruals} = -(\Delta \text{Accounts Receivable} + \Delta \text{Inventory} + \Delta \text{Accounts Payable} + \Delta \text{Tax payable} + \Delta \text{Other assets} + \text{Depreciation})$$

These elements are taken from the cash flow statement and "are not affected by non-operating changes in these accounts" (Hribar and Collins, 2002).

3.6. Comparative analysis between the accruals methods

After the detailed presentation of accruals methods I consider necessary a comparative analysis between these models (table 6). I analyze the methods based on the balance sheet data as they are more comparable and the differences and similitudes are highlighted easier. The analysis is structured firstly after the measures applied and the components included. Next, are presented some advantages and disadvantages for these methods.

All the accruals methods are based on a difference between assets and liabilities. While Sloan (1996) considers accruals as current net operating assets, Richardson et al. (2005) include in their model non-current net operating assets and financial net assets. Richardson et al. (2006a) use only current and non-current net operating assets, eliminating financing elements. And, Hirshleifer et al. (2004) consider a cumulative measure for accruals as net operating assets. Nevertheless, Hirshleifer et al. (2004) model is just a transformation of Richardson et al. (2005) model with elements of operating liability and financing assets. Also, this is the only model that uses the level of the variables and not the change of the variables as others do. However, Richardson et al. (2006b) demonstrate that, a level variable deflated by a lagged variable is a change variable. Sloan (1996) and Richardson et al. (2005) deflate accruals by average total assets while, Hirshleifer et al. (2004) use lagged total assets and Richardson et al. (2006a) use lagged operating assets (table 6).

Sloan (1995) model estimates short-term benefits due to the nature of net current assets. All other models estimate long-term benefits because are included non-current net assets. This aspect of short and long term estimation is intriguing because current assets tend to reverse quickly while non-current assets will reverse in a longer period. According to investors' expectations, some of them may be interested in anticipated benefits that will reverse quickly and not in anticipated benefits that will take longer to reverse and may depreciate in this time. Thus, one model for determining accruals may not be so conclusive for some investors that it can be for others. This depends also on the type of investors and on what period they want to invest.

Although Sloan (1996) is the most used model, it is also very controverted because it doesn't include non-current assets. Richardson et al. (2005) model cast doubt from my point of view because it includes financing elements and these are not proper anticipations of future benefits. Also, Hirshleifer et al. (2004) model seems to be a wrong decision as it includes the level variables and according to Richardson et al. (2006b) the focus on NOA may indicate a focus on earnings and ignore accruals and cash flows. Finally, Richardson et al. (2006a) model captures both current and non-current net operating assets, deflated by lagged operating assets. This model is appropriate for long-term investors while Sloan (1996) model is proper for short-term investors.

Balance sheet methods for computing accruals are the most common in the literature. The use of the cash flow method has become more popular since the work of Hribar and Collins (2002). They provide evidence that the balance sheet method can affect earnings management tests. This method is most frequently used as a sensitivity test or when are not enough data to compute accruals. Sensitivity tests are robust regarding both the balance sheet method and the cash flow method.

Table 6. Comparative analysis between the balance sheet methods

Model	Sloan (1996)	Richardson et al. (2005)	Hirshleifer et al. (2004)	Richardson et al. (2006a)
Measure	Current net operating assets	Current and non-current net operating assets (include financing elements)	Net operating assets (operating assets – operating liabilities)	Current and non-current net operating assets
Differences	Doesn't include non-current operating assets. Exclude taxes payable. Treats depreciation as current assets.	Include current net operating assets, non-current net operating assets and net financial assets. Assets and liabilities are classified as operating and financing.	Is a transformation of Richardson et al. (2005) measure with elements of operating liability and financing assets. Include both current and non-current accruals. Net operating assets include current and non-current operating assets, either are not computed separated.	The sum of working capital and non-current operating assets. Doesn't include financing accruals. Follows Richardson et al. (2005).
Variable use	Change	Change	Level	Change
Deflation	Average total assets	Average total assets	Lagged total assets	Lagged operating assets
Estimation of future benefits	Short term benefits	Long term benefits	Long term benefits	Long term benefits
Reversals	Quickly	Longer	Longer	Longer
Issues	Could be a noisy measure of accruals and cash flow	Include financing elements	A level deflated by a lagged variable is change. Focus just on NOA, ignore accruals and cash flow	Deflated by lagged operating assets

Source: projected by author

4. Abnormal accruals models

The purpose of accruals models is to capture a positive correlation between the measures of abnormal accruals and accruals level. This is equivalent with extreme accruals having extreme abnormal accruals (Dechow et al. 2010).

The accruals models are based on the assumption that abnormal accruals will reduce the benefits of decisions (Dechow et al. 2010). These models generate normal and abnormal accruals. Abnormal accruals, also named discretionary accruals are detected from the modeling of normal accruals. Normal or nondiscretionary accruals are connected with the fundamental performance of firms and represent the expected accruals, given firms' operations and conditions. When normal accruals are modeled correctly then, abnormal accruals will represent distortions of lower quality (Dechow et al. 2010). Results from the previous studies (Chan et al. 2006; Xie, 2001) confirm that nondiscretionary accruals don't predict future returns and that discretionary accruals contribute to the predictability of returns.

If abnormal accruals have a lower coefficient, this suggests that abnormal accruals are less relevant than other components of earnings but are not insignificant in the process of forecasting future earnings (Dechow et al. 2010). Dechow et al. (1995) make some useful observations related to the specification and the power of the abnormal accruals models. Thus, they remark that all the models generate: well-specified test statistics if are applied to random samples and tests of low power for earnings management. Also, all models are misspecified if are tested to samples with extreme financial performance.

Abnormal accruals models can be estimated either at firm specific (time-series) regressions or industry (cross-sectional) regressions. The firm level estimation imposes sample

survivorship biases while the industry classification may produce larger residuals (Dechow et al. 2010) and has less restrictive data requirements (Cheng et al. 2012).

These models usually mitigate errors of Type I and Type II. Type I errors is classification of accruals as abnormal when they are a representation of fundamental performance. Type II errors is classification of accruals as normal when they are abnormal.

There are some authors (Dechow et al. 2010) that cast doubts regarding the significance of abnormal accruals: whether they are a reflection of distortions or they are a wrong specification of accruals models. Meanwhile, others (Dechow et al. 2012) question the integrity of the accruals models. There are some opinions (Young, 1999; Meuwissen et al. 2007) that consider that accruals models can have misspecification problems, especially in an international context or that have a low predictive accuracy (Meuwissen et al. 2007). However, Dechow et al. (2012) note that certain concerns regarding the impossibility of these models to capture nondiscretionary accruals, has led to supplementation with performance-matching procedures.

In previous studies, discretionary accruals are used as a proxy for opportunistic earnings managements. If exists earnings management, discretionary accruals should contribute to accruals effect more than nondiscretionary accruals (Chan et al. 2004). The best model to separate accruals components and detect earnings management is the one that can identify stronger discretionary accruals and weaker nondiscretionary accruals effects than other models, according to Chan et al. (2004).

The most important abnormal accruals models are summarized in table 7.

Table 7. Summary of abnormal accruals models

Accrual model	Theory	Notes
Jones (1991) model	Accruals are a function of revenue growth and depreciation is a function of PPE. All variables are scaled by total assets	Correlation or error with firm performance can bias tests. R^2 is around 12%. Residual is correlated with accruals, earnings and cash flow
Modified Jones model (Dechow et al.,1995)	Adjusts Jones model to exclude growth in credit sales in years identified as manipulation years	Provides some improvement in power in certain settings (when revenue is manipulated)
Performance-matched model (Kothari et al., 2005)	Matches firm-year observation with another from the same industry and year with the closest ROA. Discretionary accruals are from the Jones model (or Modified Jones model)	Can reduce power of test. Apply only when performance is an issue
Dechow and Dichev (2002) approach	Accruals are modeled as a function of past, present, and future cash flows given their purpose to alter the timing of cash flow recognition in earnings	$\sigma(\epsilon_t)$ or absolute ϵ_t proxies for accrual quality as an unsigned measure of extent of accrual "errors." Focuses on short-term accruals does not address errors in long-term accruals
Discretionary estimation errors (Francis et al., 2005)	Decomposes the standard deviation of the residual from the accruals model into an innate component that reflects the firm's operating environment and a discretionary component that reflects managerial choice	Innate estimation errors are the predicted component from $\sigma(\epsilon_t)$ regression

Source: Dechow et al. (2010)

4.1. Jones (1991) model

Jones (1991) model represents a function of change in sales and the level of gross property, plant and equipment (hereafter PPE). The change in sales is a control for the firm growth as working capital is related to sales. And PPE control for depreciation expenses contained in accruals (Chan et al. 2004). All variables are deflated by lagged total assets.

It estimates both normal and abnormal accruals. Normal accruals are the predicted values and abnormal accruals are the residuals. This is equivalent with normal accruals representing expected accruals given firm's growth and abnormal accruals representing unexpected accruals (Chan et al. 2004).

$$Acc_t = \alpha + \beta_1 \Delta REV_t + \beta_2 PPE_t + \varepsilon_t$$

Acc - accruals

ΔREV - change in sales revenue

PPE - gross property, plant and equipment

α, β_1, β_2 - estimates of the model coefficients in year t

Jones model provides evidence about the correlations of accruals with sales and PPE. However, these correlations have a low explanatory power. They are able to explain just 10% from accruals variation. The explanation for the low explanatory power may rely in the excessive discretion of managers over the accrual process (Dechow et al. 2010). Nevertheless, this model presents some higher positively correlations of residuals and total accruals. Also, residuals are positively correlated with earnings performance and negatively correlated with cash flow performance (Dechow et al. 1995). According to Dechow et al. (2010) this may be a sign of a high Type I error rate. Further, Dechow et al. (2011) highlight the possibility of Type II errors when residuals are used as a proxy for the lower quality of accruals regarding earnings management. They support that discretionary accruals are less powerful than total accruals in detecting earnings management in SEC enforcement releases. In addition, Xie (2001) documents that residuals have lower predictive ability for one year-ahead earnings than nondiscretionary accruals.

The abnormal accruals from this model are often used as a proxy for managerial discretion. But, Healy (1996) and Bernard and Skinner (1996) consider that these abnormal accruals also capture unusual nondiscretionary accruals and unintentional misstatements.

Even if is the most popular abnormal accrual model, the literature rises some concerns regarding its accuracy. For example, Dechow et al. (1995) and Guay et al. (1996) consider that discretionary accruals are imprecise as estimated coefficients have a large variation. Nevertheless, Jones model displays the higher explanatory power related to other models used in detecting earnings management (Chan et al. 2004). Moreover, Healy (1996) and Bernard and Skinner (1996) highlight that discretionary and nondiscretionary accruals are not proper separated due to the omitted variable problem.

4.2. Dechow et al. (1995) - Modified Jones Model

The modified Jones model is proposed by Dechow et al. (1995). This model attempts to reduce Type II error of the original model by adjusting for growth in credit sales. The purpose of this model is to increase the power of the test even it can be met Type I errors (Dechow et al. 2010). The model assumes that changes in credit sales are related to earnings management. The modified Jones model has greater power than the Jones model in detecting earnings management according to Dechow et al. (1995).

$$Acc_t = \alpha + \beta_1(\Delta REV_t - \Delta Rec_t) + \beta_2 PPE_t + \varepsilon_t$$

Acc – total accruals

ΔREV – change in sales revenue

ΔRec - change in accounts receivables

PPE - gross value of property, plant and equipment

Kraft et al. (2006) consider that this test can be considered as a special case of Sloan (1996) earnings` fixation explanation where investors are not aware of the nature of discretionary accruals. Xie (2001) tests if Sloan mispricing is attributable to abnormal or normal accruals. Results confirm that investors misprice discretionary accruals and this may cause abnormal returns in year t+1. Abnormal accruals are the residuals from the models and normal accruals are the difference between total and abnormal accruals. Modified Jones model has been also exposed to few changes by several researchers.

4.3. Dechow and Dichev (2002)

This model implies an estimation of past, current and future cash flow, as additional relevant variables in explaining nondiscretionary accruals. This is argued by the relation between accruals and cash flow. “Accruals anticipate future cash flow and reverse when accruals are received or paid” (Dechow et al. 2010). This model use only short-term working capital accruals. Nevertheless the power of this test is higher than of the modified Jones model. The standard deviation of the residuals is used as proxy for earnings quality in Dechow et al. (2010). According to Dechow et al. (2010) the power of the test will reduce, because this model is unsigned “when the researcher predicts accounting distortions in a particular direction”. All variables are scaled by average total assets. Dechow and Dichev (2002) is based on the residuals from the industry-level regressions (Dechow et al. 2011).

$$\Delta WC = \alpha + \beta_1 CFO_{t-1} + \beta_2 CFO_t + \beta_3 CFO_{t+1} + \varepsilon_t$$

WC - non-cash working capital

CFO- operating cash flow

4.4. Kothari et al. (2005) – Performance-matched procedure

Kothari et al. (2005) propose a new model called “performance-matched procedure” where subtract discretionary accruals estimates from the Jones model by using control firms matched by industry and ROA. This model is an attempt to mitigate the doubts between performance and the residuals from the previous models (Dechow et al. (2010).

$$DisAcc_t - \text{Matched firm's } DisAcc_t$$

Kothari et al. (2005) model supposes the identification of a firm from the same industry with the closest level of ROA with the sample firm (Dechow et al. 2010). There are two ways to control for performance. First, is the introduction of ROA variables as an additional independent variable. Second, is the matching of the firm-year observation of the treatment firm with the observation of the control firm from the same industry with the closest ROA (Jones et al. 2008). Then it deducts residual from those of the sample to generate “performance-matched” residuals (Dechow et al. 2010). The model uses discretionary accruals from the Jones and modified Jones modes. Then, apply a test statistic that is determined as “the equal-weighted sample mean discretionary accrual divided by an estimate of its standard error” The test statistic is:

$$\overline{DA} / (s(DA) / \sqrt{N}) \sim t_{N-1}$$

DA - discretionary accrual

\overline{DA} - mean of discretionary accrual

s(DA) – estimated standard deviation of \overline{DA}

N- sample size

Dechow et al. (2012) observe two limitations for this method. These are: the misspecification is mitigated only if the researcher matches on the relevant correlated omitted variable and the test power is reduced if standard error of the test statistic is increased.

4.5. Discretionary estimation errors - Francis et al. (FLOS) (2005)– an extension of Dechow and Dichev model.

Francis et al. (2005) model is an extension of Dechow and Dichev (2002) by adding growth in revenue and gross property, plant and equipment. This model is a function of firm characteristics identified in Dechow and Dichev (2002). Residual’s standard deviation is decomposed in innate estimation errors and discretionary estimation errors. If standard deviation is higher, then accruals quality is lower and vice versa. Estimation of the model is accomplished at industry-year.

$$Acc_t = \alpha + \beta_1 CFO_{t-1} + \beta_2 CFO_t + \beta_3 CFO_{t+1} + \beta_4 \Delta Rev_t + \beta_5 PPE_t + \varepsilon_t$$

4.6. Comparative analyses between abnormal accruals models

The analysis of abnormal accruals models is presented in table 8. This analysis highlights the strengths and the limits, the determinants used, the measures for abnormal accruals and the deflation variable.

The most common and used models for abnormal accruals are Jones (1991) and modified Jones models. These models are modeling accruals to determine abnormal accruals. Dechow and Dichev (2002) and Francis et al. (2005) models are functions of past, present and future cash flow. And Kothari et al. (2005) is a performance matched procedure based on the residuals from the Jones (1991) and modified Jones models. As these models are predisposed of Type I error and Type II error, the modifications applied have the purpose to mitigate these errors. Every model desires to eliminate the doubts related to its accuracy. The current evidence suggests that Jones model has the higher explanatory power, although this power is actually lower. In general, abnormal accruals are represented by the residuals from these models. Variables are deflated by lagged total assets (Jones and modified Jones models) or average total assets (Dechow and Dichev, 2002 and Francis et al. 2005). The most used determinants for non-discretionary accruals are change in sales and gross property, plant and equipment.

Many papers (Guay et al. 1995; Cheng and Thomas, 2006; Beneish and Nichols, 2006) use multiple abnormal accruals models to check which of them have the greater explanatory power. Guay et al. (1995) use five discretionary models to test the relation between earnings components. Results confirm the capacity of the discretionary accruals model to “isolate discretionary accruals”. Hence, Jones and modified Jones models generate discretionary accruals consistent with performance and opportunistic smoothing of earnings. The main conclusion that can be dropt is that Jones and modified Jones models have the ability to identify discretionary accruals. Cheng and Thomas (2006) test whether accruals anomaly is a part of the overall value-glamour anomaly, using the modified Jones model and rank models. Overall, these studies support that the best model is Jones model. But, Dechow et al. (2011) make a contrary observation that the modified Jones model and the performance-matched Jones model are not as strong as the Dechow and Dichev model.

Table 8. Comparative analyses between abnormal accruals models

Model	Jones (1991)	Modified Jones (Dechow et al. 1995)	Dechow and Dichev (2002)	Performance- matched procedure (Kothari et al. 2005)	Discretionary estimation errors (Francis et al. 2005)
Function	Change in sales and gross property, plant and equipment	Adjust for growth in credit sales	Past, current and future cash flows	Subtracts discretionary accruals from Jones model, using control firms matched by industry and ROA	Is an extension of DD, adding growth in revenue and gross property, plant and equipment
Limits	Low explanatory power Possible Type I and II error	Still can be met Type I error	Reduced power because the model is unsigned. Doesn't address errors in long term accruals	The test power is reduced if standard error of the test statistic is increased.	Doesn't investigate if these adjustments eliminate Type I error and Type II error
Strengths	Explanatory power is higher than other models	Reduce Type II error	Higher power than Jones model	Mitigate the doubts between the performance and residuals	Control variables should increase the power of the test
Abnormal accruals	Residuals	Residuals	Residuals reflect accruals not related to cash flow	Residuals from the Jones and modified Jones model	Residuals are decomposed in innate estimation error and discretionary estimation error
Determinants of non-discretionary accruals	<i>Change in revenue</i> $(\Delta REV_{i,t})$ <i>Gross property, plant and equipment</i> $(PPE_{i,t})$	<i>Change revenue-Change in account receivables</i> $(\Delta REV_{i,t} - \Delta Rec_{i,t})$ <i>Gross property, plant and equipment</i> $(PPE_{i,t})$	<i>Past, present and future cash flows</i> $(CF_{i,t-1}; CF_{i,t}; CF_{i,t+1})$	-	<i>Past, present and future cash flows</i> $(CF_{i,t-1}; CF_{i,t}; CF_{i,t+1})$ <i>Change in revenue</i> $(\Delta REV_{i,t})$ <i>Gross property, plant and equipment</i> $(PPE_{i,t})$
Deflation	Lagged total assets	Lagged total assets	Average total assets	-	Average total assets

Source: projected by author

5. Conclusions

In this survey I highlight the main advances in accruals anomaly. A key point is that the proper understanding of the accruals persistence could enhance earnings quality. Higher accruals could be a sign of alarm that earnings could be overestimated. This means that accruals may not reverse and is less probable that it would be converted into cash.

Considered by LaFond (2005) a general phenomenon, the proper understanding of accruals anomaly, could improve investors forecasting and lead to an increase in economic growth and development of capital markets. As a policy implication I recommend taking into account accruals persistence, as this impacts significantly earnings quality. This also involves attention to accounting methods used to record current net assets. The proper measure for accruals depends on the strategies assumed. The most used is Sloan (1996) method although it only anticipates short term benefits. For a measure that anticipates long term benefits the proper would be Richardson et al. (2006a). Regarding abnormal accruals models, these are very converted as neither one offers in reality a high explanatory power, although Jones model records the robust results.

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STRATEGIES FOR CRISIS MANAGEMENT OF ENTERPRISES AND AFTER CRISIS MANAGEMENT RESTRUCTURING

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ABSTRACT

Crisis endangers the realization of organization's top level objectives, financial resources, while damaging relationships with social stakeholders, and requires a planned effort to fix all these relations.

Experiencing serious problems of economic resources is limited, and share in today's world, is a very low tolerance for wasting and losses in business culture and understanding emerged. In these circumstances the use of the new era of economic players must have superior capabilities and resource planning. No, don't be an economic actor, impressing, using bad sources and available resources and values, have the luxury of not losing due to errors. With this regard is of great importance to maintain and sustain .In this context, the likelihood of anticipating and managing assets that lost increased crisis periods, it is the nature of a matter management.

Business enterprises have a very important place in the society. They use a wide variety of resources, create wealth and hold an important amount of power in their hands .Business enterprises

Are closely related not only to economics, but also to development of societies, socio cultural changes and technological advances.

If the necessary precautions are not taken and the companies do not act fast enough, unexpectedly emerging crises may severally affect the companies and the societies and all the related systems they live in both physically and psychologically. To be prepared for the upcoming crisis and to be able to act fast enough will only be possible through maintaining a powerful organizational integrity.

The purpose of this study, crisis management strategies, and after the crisis is to provide information on issues of reconstruction.

Crisis management strategies are developed and implemented to make sure that the business enterprise survives the process of crisis. The enterprise may need a thorough rehabilitation after recovery from a crisis. For this reason, the final part of the study explains the restructuring process after recovery. This section provides information on how the business enterprise, after locating its losses in connection with the crisis, should manage the post crisis restructuring process and what strategies it should employ to deal with problem. The study will finally provide an evaluation and conclusion.

Key Word: Crisis management, business management, restructuring, crisis process, crisis management strategies, enterprise.

1. THE CONCEPT OF CRISIS IN BUSINESS ENTERPRISES

Economical and sector crisis have many negative effects on small enterprises. From the aspect of small enterprises, one of the most effective ways of dealing with the crisis is to be able to plan strategically and to analyze the events strategically. Because of the structure of small enterprises; the Owners or the managers of small enterprises, who have to take up the responsibility of making decisions through crisis, should have strategically planning perspective and they should be able to analyze the environment to close with the minimum loss. Crisis is the time of danger, but at the same time, they can be used as opportunities. Organizations are able to benefit from crises if they are ready for it and when they apply their strategies as fast as possible. As a result, crisis can be defined as a period through which the organizations and administrations are tested (Patan, 2009, p, 8).

Problems and changes in the organization and sudden changes around the organization affects crisis significantly. Events inside the organization and environmental factors affect each other. Crisis in the organization causes other sudden crisis step by step through problems such as ineffectiveness of the management, low-motivation and staff problems (Patan, 2009, p, 8). Strategic management of an organization is about managing the organization entirely. Crisis is the developments that affect all organization. For that reason crisis management should be integrated with the strategic management. Developments, which came out before, during and after the crisis must be solved by strategic solutions

Due to the fact that the concept of crisis is distinctly defined by the different disciplines, it is difficult to make an integrated definition about crisis. According to Shrivastava, crises are triggered by a set of elements such as the human, organizational, and technical failures that are in mutual interaction (Shrivasta et al, 1998, p. 297). Laurence Barton defines the crisis as the important and unexpected events, the potential of which is high to produce the negative outcomes, (Guth, 1995, p.125). When crisis is defined in general meaning, it is a phenomenon that will lead an individual or a group to face a negative case, if any attempt is not made to correct it (Dutton, 1986, p.502, Mutlu and büyükbalcı, 2009, p,118).

While crisis is defined, two keywords taking place in line spaces are of course “unexpected” and “urgent” (Taylor, 2001, p. 47).

2. SCOPE OF CRISIS AND ITS RESOURCES

Crisis can appear as a result of many factors. The events resulting in crisis can be collected in the seven groups (Pollard and Hotho, 2006, p.723, Asunakutlu and Dirlik, 2009, p. 37).

1. Economic: working problems, falls in stock markets, economic collapse, changes in trade policies, rapid falls in profitability.
2. Informational: data loss, data destruction, loss of records etc.
3. Physical: loss of important factories and plants, losses, and long termed collapse, product failures, factory accidents, long termed quality problems.
4. Human resources: death of an important personnel, vandalism in business enterprise, corruption, resignations.
5. Reputation: negative rumors, reputation loss, firm logo and forgery associated with website etc.

6. Psychopathic Actions: product forgery, terrorism, criminal events, kidnapping, etc.
7. Natural disasters: fire, flood, sever storm, earthquakes.

The sources of crisis in the business enterprises are examined under two headings as in – business (internal) factors and out- business (external) factors. In this context, the internal factors can be put in order as follows (Bozgeyik, 2004,p.60, Özalp, 2004,p.245).

- Not recognizing, following himself/herself, his/her competitor, product, and sector
- Not paying attention the technology, trends, customer demands, suggestions, and complaints,
- Not allocating any resource (based on both material capital and intellectual capital) or unnecessary wastage
- Not being able to comprehend the distinction of the local, regional, and global competition from each other, not performing the necessary changes
- Staying out of the change, development, and innovations; considering that everything stayed as in the past
- Updating the previous methods of making business, and making it compatible with the eyes.

On the other hand, the external factors can be expressed as follows (Can, 2005, p, 389, Özalp, 2004, 2004, p,243).

- Economic structure and general economic uncertainties,
- Technological developments,
- Social and cultural factors,
- Legal and political arrangements,
- International environment and foreign relationships,
- Natural disasters,
- The factors associated with the market and competitive conditions,
- The factors associated with the financial agencies,
- The factors associated with syndicate institutes,
- The factors associated with the sellers and environment of supply.

3. THE STATE OF BUSINESS ENTERPRISES IN THE PERIOD OF CRISIS

The crises in business enterprises can be evaluated as extraordinary cases arising from the organizational structure, economy, or technology and doing harm the human life, natural and social life. Crises are the chaotic and complex cases that will be faced in the life of organizations and societies and cause the functional impairments in the managerial processes and largely shake of the organizational order. There is no method to completely prevent the possibility of crisis. When a natural disaster is under consideration, to predict it and to be able to predict its results are impossible at least today. Justus crisis can be resolved in a short time, depending on their effects and dimensions, their being resolved maybe long termed (www.maximumbilgi.com, 2008).

4. CRISIS MANAGEMENT

Crisis management, by determining the warning systems for preventing a possible crisis, can be expressed as a process including the activities to identify and implement the necessary precautions for establishing the mechanisms to protect and prevent that serve to eliminate an existing crisis or reduce its effects to minimum (Ataman, 2001, p, 255)

- Crisis management is a complex process consisting of phases more than one.
- Crisis management enables the organization to be ready for crisis.
- The principles of crisis management are similar to those of strategic management.
- Crisis management is a specific sort of management
- Crisis management enables the crisis to be eluded with the minimum loss and damage

5. MANAGERIAL STRATEGIES IN CRISIS MANAGEMENT

The methods applied by the business enterprises in the process of crisis will be described as follows.

5.1. STRATEGIES TOWARD THE MATERIAL RESOURCES IN THE PROCESS OF CRISIS

The material resources (building, machinery, equipment, tools, raw material etc.) the business enterprise has should be managed much more carefully in the period of crisis in terms of sustainability, compared to the normal times. For this purpose, the business enterprise should use the resources of interest economically so that it can mitigate the press created by crisis. For preventing the loss of material resources, serious precautions of savings should be taken; however, depending on the conditions, turning some part of the available dispensable elements into cash should be provided. The components of material resource of the business enterprise take place among the critical factors of achievement. If the main ability providing the competitive understanding of business enterprise is any of the material resources, in case of crisis, these material resources should not be ever made the issue of saving and for not being damaged of the business enterprise, the necessary actions should be taken (Dirlik, 2009, p.37).

5.2. IN THE PROCESS OF CRISIS, STRATEGIES TOWARD THE FINANCIAL RESOURCES

In the times of crisis, the prior strategy from financial point of view is to have the resources that will provide the sustainability in a stable way and to strengthen the potential of creating cash in a short time. Maintaining the cash position and providing the liquidity balance from strategic point of view should be determined as a main preference. Another strategy that the business enterprise should follow from financial point of view is to maintain the balance of short term –long term and to go toward the way of switching the short termed financial liabilities to the long termed ones (Asunakutlu and Dirlik, 2009, p. 37).

5.3. IN THE PROCESS OF CRISIS, THE STRATEGIES TOWARD THE RESOURCES OF CUSTOMER

In a particular industrial branch or in a market, the behaviors of buyer and seller determine the achievement of business enterprise. These behaviors depend on the structure of market. The structure of market is also naturally affected from the main conditions of supply and demand. These mutual interactions require reevaluating the relationships of business enterprise, market, and customer in the periods of crisis. The correctly defined market conditions, the expectation of customer in the period of crisis, and the conditions the business enterprise is in will be the main determinative of customer strategy to be preferred (Brauchlin and Wehrli, 1994, p. 59).

5.4. THE STRATEGIES TOWARD THE HUMAN RESOURCES IN THE PROCESS OF CRISIS

In the process of crisis, the business enterprises go toward labor force they view as the highest cost item for saving. Layoff of worker appears as a result of this tendency. Application of layoff causes a great loss of motivation and morale; however, the periods of crisis are periods, when the most solidarity and cooperation are needed. In response to the saving that are desired to be obtained via lay off, when the possible losses are considered, the option of layoff of personnel is a method that is necessary not to be appealed, if not most obligatory (Asunakutlu and Dirlik, 2009,p.50).

5.5. IN THE PROCESS OF CRISIS, STRATEGIES ASSOCIATED WITH THE ORGANIZATIONAL STRUCTURE

In the period of crisis of business enterprises, the most significant decision to be able to be made and be important is to realize a large scaled structuring. In addition to these, in order to be able to prevent the negative influences of the cases of crises, they should feature to forming an organizational structure that is flexible and learns (Asunakutlu and Dirlik, 2009, p.52).

6. POST-CRISIS RESTRUCTURING

6.1. POST-CRISIS PHASE AND ORGANIZATIONAL LOSSES

In the process of overcoming the crisis, the main target of strategic actions is to ensure the achievement potential of business enterprise. In this scope, there is a need for optimizing the portfolio of product - market, aligning the organizational structure, establishing the support system, and the capacity of staff. Overcoming the crisis can be possible with the correctly selection and application of crisis strategy, After overcoming the crisis, a new period will begin for the business enterprise. In the post-crisis phase, the business enterprises differed lees or more, but absolutely in a certain measure, than pre-crisis period. Crisis is a costly but teaching experience for employees and managers (Sumer and Perrnsteiner, 2009, p.53).

6.2. STRATEGIES OF POST CRISIS ORGANIZATIONAL STRUCTURING

The first thing to be done after crisis is to hold a meeting toward the analysis of case. In the agenda of this meeting, determining the post- crisis activity scale and aim of business enterprise generally takes place. For determining the post-crisis activity scale, first of all, the case the business enterprise is in should be analyzed. After determining the activity scale, in the direction of scale, the aim of business enterprise should be identified. While turning to the pre-crisis managerial structure, particularly, the people that took place in the phase of crisis should be thanked for; if there are some faulty points, the individual criticism should be made. On the other hand, changing the central structuring in the period of crisis, decentralization should be passed and participation in the decisions should be provided (Tüz, 2004, 122).

6.3. POST-CRISIS CHANGE STRATEGIES

When the specific conditions of the post-crisis period are considered, the need of change of the business enterprise is unavoidable. Evaluation of the post-crisis organizational psychology should be the starting point of organizational change process. Then, that the new organizational structure is more flexible, and its being able to adapt the organizational changes in the shorter time takes place among the post-crisis changes. Another issue requiring the post-crisis change is the managerial approach. The periods of crisis are the periods requiring to inherently make rapidly decision (Tüz, 2004, p.122).

7. CONCLUSION AND DISCUSSION

The global competitive environment is full of the factors that will enable the crises and every kind of change to be able to trigger the crises to emerge. This case will gain a great importance for the business enterprise after crisis. In the world of today, that the fast communication, rapidly forming markets, and short timed job designs are valid; and the fast transformation experienced in the markets lead to business enterprises to enter an intensive competitive environment and to face the crisis.

In the process of crisis, customers, for business enterprises, are evaluated as much more important than usual. Customers' giving up consuming in the periods of crisis or their delaying their consumptions direct the business enterprises to take specifications.

In the period of crisis, business enterprises experiences losses, depending on the condition of crisis. These losses can occur in the organizational level, in the position of market, and at the level of customers. The aim of business management, eliminating the losses of interest, is to take actions; to arrange the organizational structure to help the losses recover; and to realize the management of change.

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INTANGIBLE CAPITAL Session

IMPROVING COMPETITIVENESS OF SERBIAN FIRMS: THE ROLE OF INTANGIBLE CAPITAL

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ABSTRACT

The paper presents some initial analyses after a survey conducted in a set of Serbian firms. Although initial, the results show some interesting tendencies within the Serbian firms and represent a broad picture on understanding the importance of intangibles in improving firms' competitiveness. The three aspects of intangible capital are analysed: internal relationships and human capital, external relations and marketing and finally, innovation and R&D including the developments in IT sector. It appears that internal relations are relatively underdeveloped jeopardising an efficient fulfilment of the firms' objectives. Thus, decision making processes in many cases are not properly designed and leave an excessive role to the owner as an exclusive decision maker. Also, the position of workers is poor particularly regarding their rights to be informed, make proposals or participate in decision making and even some traditional workers rights are frequently neglected (unions, collective bargaining etc.). On the other hand the higher level of workers satisfaction and loyalty to the firm emerge under better internal relations. Regarding external relationships and marketing practices the results show that this element of intangibles is steadily improving but still is at a lower level than necessary. An essential progress has been remarked within the exporting firms and/or other firms that develop international businesses. We understand this fact as a consequence of a special form of spillovers of international business practices. Regarding innovations many firms claim innovative practices but still at a rudimentary level. Better practices are found among the firms that are exporters and those in manufacturing industries and yet among the foreign firms. However, foreign firms in some cases neglect R&D if they act as a part of larger international companies. This finding points at a lower technological level of production that has been established in the country by means of FDI while major R&D activities are organised in home countries of foreign investors. The finding is in accordance with other research results that found a lower level of spillover effects of FDI in transition economies than it was expected at the beginning of transition process. In concluding remarks we propose some policy measures that could incite local firms' investments in intangible capital.

JEL Classification: O32, O34, M21

1. Introduction

It is well known that Serbia is a transition laggard. Since October 2000 when important political changes took place in the country, some speeding up of the reforms was expected. Indeed, the country was directed towards relatively fast institutional adjustments during the 2001 and 2002 in the field of market liberalisation and privatisation. However, apart from slowing down the reforming processes during the subsequent years, Serbian economy suffered also from some well identified deficiency of transition projects like sluggish enterprise restructuring, poor competition policies and above all lack of proper industrial policies and corresponding definition of growth models in use (see in detail Cerovic *et al.* 2012). This has resulted in a slower recovery from the devastating legacy of the 1990s, fast decrease in manufacturing output share in GDP and long lasting decline of the employment rate, which altogether was followed by a remarkable public discontent. Moreover, in the year 2012 Serbia has deteriorated its anyway low competitiveness and has become the least competitive country among the countries emerged from former Yugoslavia (World Economic Forum, 2013).

Under these circumstances we found challenging to analyse what was the prevailing attitude of those firms that have been established in that period and/or have managed to survive and do businesses until and during the period of global crisis (since 2008). Our basic position was that firms' restructuring should be a major change after market oriented reforms and privatisation. Also, we expected that these changes should lead to more efficient and more productive performance of the firms in question and their more sound business policies and/or strategies particularly in developing their competitive abilities. In a country that was for years practically cut off the major flows in investments, technology progress and business appearance in the world markets and was additionally lacking capital endowments it could be reasonable to make an effort in developing more available resources such as social capital, internal relations, knowledge, management and marketing skills as well as some other fields that were usually seen as intangible capital of a firm. However, it is also well known that such a kind of competitive capabilities of a firm can be lost unless properly understood among corporate governance actors and firms' management as an internal and accessible source of higher efficiency and competitiveness.

Although the resulting competitiveness in development of social, informational and relationship capital and in information technology, innovation, research, marketing activities and branding, proper organisation and human resource management is undoubtedly confirmed at both macro and micro level,¹¹³ we found challenging to analyse the matter in a country like Serbia that is coming out from a tremendous decline in economic results (although never particularly advanced) and yet is burdened by various kind of pressures to accomplish transition reforms with no specific features that could ease the entire process. Namely, our aim is to analyse in what way the development of intangible assets was recognised within the firms and – according to the results obtained – to suggest some policy measures the government should adopt in foster development of this component of competitive capabilities.

The paper is a part of a joint project taken by the Faculties of Economics in Ljubljana and in Belgrade and represents the first findings obtained after a survey conducted in a sample of

¹¹³ For broader literature survey see section 2.

Serbian firms. We shall concentrate on several important features that can give a preliminary picture of how and to what extent the importance of intangible capital has been recognised in Serbian enterprises. We shall particularly discuss the issues connected with internal relation within the firms and upgrading human capital – both seen as a part of social capital accumulation, further on we shall examine the external relations of the firms with other economic agents they are linked with and finally shall make some observations regarding innovation processes.

The paper is organised in seven sections. After the introduction (section 1), in section 2 we present a brief literature survey aimed to point out the most important findings regarding the impact of intangible capital on competitiveness while section 3 informs on basics of methodology used in the project. Section 4 presents some major findings regarding internal relations and human capital accumulation and section 5 is devoted to analysing brand capital and external relations of the firms. In section 6 some data on innovation practices will be analysed and in the last section (7) we shall make basic conclusions and give some recommendations regarding policy measures.

2. Literature review

Terms like knowledge, networks, innovation, brand, reputation, intellectual and social capital are the key words of modern business. They describe various forms of corporate intangible assets that are becoming the major drivers of competitive advantage and growth. Developments of communication technology, business networks and alliances, continuous innovations, as well as rapid internationalisation bring on important changes in global businesses. Organisations are aware that technology-based competitive advantage is just temporary whereas sustainable competitive advantage is being determined by intangible resources they possess (Johanson *et al*, 2001). Instead of conventional factors like land, labour and capital the main sources of contemporary competitive advantage are knowledge, innovations, brands, reputation, customer loyalty, high-quality production processes, business networks. We are witnesses of a new phase in economic development, characterised by soft, intangible, non-financial factors (Lev and Zambon, 2003).

Intangible assets can be defined as identifiable non-monetary assets without physical substance that is, as a non financial asset that is source of future economic benefit, without physical embodiment (Lev, 2001, p. 5). Numerous different terms are used as synonyms for this kind of intangibles such as capabilities, strategic assets, organisational competences, basic competences, knowledge asset, intellectual capital, social capital. Regardless of the used term, all intangibles have some similar characteristics:

- they lack physical existence, although some intangibles can be stored on CD (software) or in some legal documents (intellectual property rights),
- all intangible objects are renewable after they have been used,
- while being used they have an ability to increase in quantity and especially in quality.

Lev (2005) emphasises an additional characteristic of intangibles: they are non-tradable resources, since there are no organised and/or transparent markets for trading these assets. In comparison with tangible assets, like financial or physical resources, intangibles are less

flexible, hard to accumulate and not easily transferred, so they are barely imitable by competitors (Perrini and Vurro, 2010). Due to mentioned characteristics and based on resource based view it is evident that intangibles have a potential to provide long-term differentiation and to become an important source of sustained competitive advantage of firms and their superior performance.

The literature provides different methods of classifying intangible assets. The most commonly accepted categories of intangibles seem to be: (a) human capital, (b) organisational capital and (c) relational capital. Human capital includes skills, talent, experience and knowledge of employees, their creativity, leadership skills and other competencies. Organisational capital refers to all organisational capabilities needed to meet market requirements. It includes brands, intellectual property, organisation strategy, culture, processes, structure, reputation and image of a firm. It can be defined as the institutionalised knowledge and codified experience stored in databases, hardware and software, culture, routines, patents, brands, intellectual property rights, and structures. Relational capital mainly covers relationships of an enterprise with its external and internal stakeholders, such as buyers, consumers, investors, suppliers, government institutions, research and education institutions, marketing agencies, business partners, media, managers and employees. In this paper we shall endeavour to follow this taxonomy of intangibles in analysing practices of Serbian enterprises in regard to intangible capital and shall make just minor variations according to the data and phenomena we were able to observe.

In academic literature, since 1990s one can recognise a remarkable interest in intangibles. One of the main problems in understanding and assessing the importance of intangibles appears to be lack of financial information and empirical data, due to difficulties in measurement of intangible assets, as well as absence of generally accepted theoretical framework. Intangible asset literature is predominantly conceptual, aiming at establishing adequate theoretical background. Empirical studies are rare, with great differences in methodology and even in definitions of intangible assets. On the other hand, some of the available analyses study intangible capital at the micro (firm) level and some at the macro (national) level.

Regarding those studies that analyse firm level, one can divide them in two main groups: (i) studies that address value of firms' intangibles together with the accounting practices and methodologies of intangible assets measurement and reporting; (ii) studies that emphasise the relationship between intangible assets and firms' performance.

In most of studies from the second group one can find strong empirical evidence in regard to positive impact of intangibles on competitive advantage and company's performance, in both – developed and emerging countries. Thus, for example, empirical evidence in emerging countries can be tracked through cases of Indonesia (Hidayati *et al.*, 2012), Taiwan (Tseng and Goo 2005), Albania (Prasnikar, *et al.* 2012), Slovenia (Prašnikar, ed., 2010), and Brazil (Dutz, 2012). Using Tobin's q as a measure for intangible assets, authors of the study on Indonesia, found that intangibles had a significant impact on firm's competitive advantage and market value that was more intensive in manufacturing than in non-manufacturing companies (Hidayati *et al.*, 2012).

In the study of Taiwan enterprises, Tseng and Goo (2005) used also Tobin's q , and Value Added Intellectual Coefficient, as a measure for intangibles, and found a positive relationship between intellectual capital component and corporate value. Taiwan is an important example representing an emerging knowledge economy: a favourable international competitive position of Taiwan's firms is based on R&D, technology and human resources, while Taiwan's economy is characterised by a high share of companies in technology intensive sectors.

The main conclusions of the study on Albania that was conducted in 2011 and focused on six specific aspects of intangible capital (Prasnikar, *et al.* 2012) could be summarised as follows: (a) relational, informational and information technology capital of Albanian firms affects productivity; (b) innovation and R&D are not the key success factors for Albanian firms, due to a very low level of innovation expenditure (0,2% of GDP); (c) organisational flexibility has no relationship with productivity, while average productive companies have more loyal employees and they invest more in systematic knowledge transfer.

As to the developed countries the most of firm level studies have been performed in the USA. The main findings are that intangible resources are drivers of value creation, especially in an R&D organisation (Pike *et al.* 2005). Also, a positive relationship between investments in intangible capital and market value of firms was found (Brynjolfsson *et al.*, 2002). Some analyses address specific types of intangible resources, providing firm empirical support to hypotheses that human, social and organisational capital, as components of intellectual capital, are related to organisational performance and play a significant role in determining firm performance (Youndt and Snell, 2004).

According to Global Intangible Tracker around 65% of firms' value in the world refers to intangible assets, with great differences among different industries (Global Intangible Tracker 2007). The highest share of intangibles is found in advertising, internet and software sectors, biotechnology, cosmetics and health services.

Macro level studies analysing intangible capital are mainly focused on investments in intangibles and their impact on economic growth and/or productivity. Estimations of World Bank show that 78% of world wealth is due to intangible capital, 59% in developing and 80% in OECD countries (Roth and Thum, 2010). According to some analyses investments in intangibles, as a percentage of GDP, are at the highest level in the USA and Canada, reaching around 12%, while in Europe the largest investments are in the UK, 11% of GDP (Roth and Thum, 2010 and Kuznar, 2012). In EU countries evidence show that investments in intangibles are not so high as in USA, while the lowest rate is in Mediterranean countries (Kuznar, 2012). According to the OECD data, total intangible investments (as a percentage of the GDP) range between 6% and 11%: Austria, Japan and Italy score lower rates, while the Scandinavian countries, France and the US score high ones (Croes, 2000). Regarding East and Southeast Europe estimations for Czech Republic (6.45%) and Slovakia (4,53%) are considerably lower than for Germany and France, but higher than for Italy and Spain; Greece is a big outlier, with the lowest level of intangible investments, 1.6% of GDP only.

Overall, capital investments in intangible assets grow faster in comparison with investments in tangible ones. All OECD countries show a higher growth rate of intangible compared with tangible investments, especially the Scandinavian countries (Croes, 2000). Two countries, the USA and the UK, show a higher ratio of intangible investment as percentage of GDP

relative to tangible capital, while in Czech Republic, Spain, Italy, Slovakia and Greece intangible investments are still relatively low (Van Ark, *et al.* 2009).

In literature one can find a variety of data regarding intangible investments, due to different methodologies used and various indicators for intangible assets. Although some international standardisation of indicators seems necessary for comparative analysis, there is a lack of general consensus on what should be counted as to be an intellectual asset. Empirical studies of intangibles for a long time have been oriented to R&D and intellectual property and later on other intangibles have been introduced, such as brands and reputation, information technology and human capital. The OECD study analyses data on five aspects of intangibles: R&D and innovation, payments for foreign technology, software, education and marketing (Croes, 2000). Corrado *et al.* (2009) established a methodology that is widely adopted in newer economic analyses. Intangible assets have been classified under three broad categories: (i) computerised information, (ii) innovative property and (iii) economic competencies. Though a series of economic or business models have been constructed that include different sorts of intangibles, some quandaries still remain about which items should be included in analyses of intangibles, and how to measure them, either on macro or micro level.

In macro level studies exploring links between intangibles and economic growth and/or productivity we may highlight several important contributions. Positive relationship between intangible capital investments and labour productivity growth is confirmed in a variety of countries (the EU 15 countries, Roth and Thorm, 2010, in eleven developed countries, Van Ark, *et al.* 2009, Corrado *et al.* 2013, Corrado *et al.* 2012). The contribution of intangibles to labour productivity growth ranges from about 10 to 40 percent (Van Ark, *et al.* 2009).

Most of authors highlighted the importance of incorporating intangible capital into national accounting framework so that a real assessment on investments in tangible and intangible assets could be obtained. It is widely recognised that the national accounts framework based on investments in physical assets only, gives a partial insight into growth, investment and productivity, while if intangible investments are considered, they are often focused exclusively on scientific R&D, that accounts for less than 10 per cent of all intangible investments by businesses (Roth and Thorm, 2010). The strongest argument for national accounting framework adjustment came from developed countries, like UK and USA. These countries currently have more intangible than tangible investments, while other EU countries are following those practices (Corrado *et al.*, 2013). There are other approaches to the issue such as in an interesting contribution (Nelson, 2006) that shows how intangible investments from the past can explain some anomalies in a conventional financial model regarding returns in certain industry groups and index returns in stock exchange.

Macro level studies can be summarised by a general conclusion that intangible capital, as a driver of national productivity and economic growth became a major challenge for national governments to develop proper policies that will foster investments in intangibles and in doing so to ease the allocation of resources to their most productive use. Also they should develop and adopt new national accounting systems based on the recognition of the role of intangibles that would provide quality information and so enhance investments effectiveness.

3. Research methodology

The survey was conducted within a sample of 41 Serbian firms in 2013. The paper draws on a methodology advanced by Prašnikar *et al.* (2012) that was applied to similar analysis on Albanian firms as well as firms in Slovenia and partially in Bosnia and Herzegovina (more precisely in the Republic of Srpska).

Due to limited resources, the sample was chosen using the snowball method so as to represent the most typical structure of Serbian firms by industry (but non-randomly chosen). Some structural elements of the sample are presented in the table below.

Table 3.1 Sample structure:

	Number of firms
Total	41
Manufacturing (and similar)	26 (63%)
Services	15 (37%)
Foreign owned	10 (24%)
Domestic owned	31 (76%)
Small (< 50 employees)	15 (37%)
Medium (50<employees<200)	15 (37%)
Large (>200 employees)	11 (26%)
Exporters (at least 5% of production)	26 (63%)
Non-exporters	15 (37%)

As can be seen from the table the sample consisted of 26 manufacturing firms (63%), while 37% of the sample (15 companies) is from service activities. There are 24% (10 units) of the sample companies owned by foreign capital, while the major part of the sample (76%) is represented by domestically owned companies.

The sample also intended to well cover all kinds of firms' size structure; small (less than 50 employed) and medium (from 50 to 200 employed) companies are 37 percent of the sample each, while share of large companies is 26 percent of the sample. Indeed, the actual structure of Serbian economy is different with more smaller and medium firms as well as with less manufacturing firms. However, our sample was intentionally biased covering higher percentage of big and/or manufacturing firms since our interests were predominantly oriented to these types of companies. The similar could be applied to the firms that are engaged in export and in contrast to those that sell exclusively in domestic market.

In order to become familiar with the questionnaire, a company first received it by mail. The questionnaire was then answered by a company's CEO, financial or HR manager. In some cases, researchers from the Faculty of Economics in Belgrade complemented the received questionnaires with the data from the Serbian Business Registers Agency. The analysis conducted relies mostly on descriptive statistics. Whenever possible we have identified certain statistical correlations and/or at least tested statistical significance of our findings. Our analysis relies mostly on descriptive statistics, accompanied with correlations and simple statistical testing, when it is possible.

4. Internal relations and human capital

The issue of internal relations within a firm particularly those related to labour and the communication between managers and owners is of a special interest in Serbia. Firstly, discussing labour relations the issue could be specific having in mind self-management legacy. Secondly, both labour and managers-owners relations could be specific due to the relatively fast property rights change in a dozen of past years. The answer to these quandaries might shed some light on what are institutional changes that really have happened during Serbian privatisation process and what kind of internal relations has been build over the period.

4.1. Wages and employment

In discussing these matters we shall start from some purely economic data concerning wages. Within this group of questions we have remarked that a big majority of firms did not know to properly answer whether the wages are above the level indicated by collective contracts. This is due to the fact that they actually do not follow guidelines from these contracts, which is also connected with the later responses on trade unions that exist only in few firms (we shall comeback to this problem below). However, this information is to explain why in the table 4.1 concerning wages we disregard this question.

In analysing workers pay we grouped the firms according to several criteria and in particular: whether a firm is in manufacturing or in services, whether the firms are foreign or domestic owned (FOF-s and DOF-s respectively), whether they belong to a group that earn higher (21 firms) or lower (20) profit per worker, whether they are exporters (ExF who earn from exports at least 5% of their revenues) or not (NExF) and finally, according their size in regard to a number of employees. The main results are presented in the Table 4.1 below

Table 4.1 Wages, year 2012

Firms	Wages higher than in less successful firms targeting the same labour market	Among better paid in the entire economy
Full sample	23 (56%)	14 (34%)
Manufacturing (and similar)	18 (72%)	11 (44%)
Services	5 (33%)	3 (20%)
Foreign owned (FOF)	7 (70%)	5 (50%)
Domestic owned (DOF)	16 (52%)	9 (29%)
Profit per worker – high	11 (52%)	8 (40%)
Profit per worker – low	11 (58%)*	5 (26%)*
Exporters (ExF)	17 (65%)	10 (38%)
Non-exporters (NExF)	6 (40%)	4 (27%)
Small (< 50 employees)	5 (33%)	4 (27%)
Medium (50<employees<200)	8 (53%)	4 (27%)
Large (>200 employees)	10 (91%)	6 (55%)

* One firm omitted due to bankruptcy (high loss, one employed, formerly large manufacturing firm)

It is evident from the table that the majority of firms in our sample declare their workers are better paid in regard to their competitors in the labour market (56%) and yet more than a third of all firms claim their employees receive higher wages comparing the entire country. This characteristic of a sample comes from the fact that we deal with active firms that is, survivors after the crisis and transition and privatisation related events.

Secondly, we may remark that in manufacturing wages seem to be higher than in services which is a surprise but could be an effect of changing policy orientation that was implicitly favouring services during first years of transition. The idea of a new growth model could impact the labour market making the demand for manufacturing workers higher than before while services are pretty saturated in terms of labour force.

It is also evident that higher percent of FOF pay higher wages than DOF while an important difference among firms was found in regard to export activities: almost two thirds of ExF claim their workers are better than in competing firms and almost two fifths (38%) they receive wages considerably higher than others in the economy whereas only 40% and 27% of NExF claim similar situation (respectively). Some difference appears when the group of large firms is compared with smaller ones: a vast majority (91%, small just 33%) of big firms claim better wages than competitors can pay (statistically significant difference regarding the size of firms: $F = 5.055$; $p = 0.011$) and yet 55% assess their wages to be among the highest in the economy (though statistically insignificant).

However, from the analytical point of view the most intriguing finding is that higher percent of low-profit-per-worker firms claim to pay better wages than their 'less successful' competitors in the labour market do (58%), when compared with firms with higher profits (52%). They also relatively frequently (5 of them or 26%) pay workers higher than others in the economy (two of these firms have even negative profit). Although statistically insignificant it is still somewhat peculiar since they cannot be taken as the most productive firms: low profits per worker plus high wages cannot guarantee high value added per worker. On the other hand 5 of 8 firms with the highest profit per worker declare their wages are among the highest in the economy, which is expected. However, we cannot find any significant link between the two sets of data and cannot link wages with some specific features in terms of any other measure regarding intangible capital within our questionnaire. We may only conclude that the issue of wage levels is still pretty unclear within the Serbian economy when compared with firms' economic performance.¹¹⁴

The second issue regarding some basic economic indicators in this section deals with short term adjustments in employment. Our hypothesis is that short term adjustments should lead to definition of a proper core number of employed and yet should demonstrate flexibility in firm's organisation that could help in overcoming sudden shocks and/or acquiring sudden opportunities.

We wanted to particularly analyse what were reactions of the firms observed in turbulent period 2008-12. In our sample of 41 firms there are 23 (56%) that declare they had some short term adjustments in labour force during the period. In that number there were 9 large, 8 medium and 7 small firms in terms of number of employees. Moreover, this difference

¹¹⁴ It is possible that some of the firms do pay their workers higher than expected in order to keep and stimulate them. However, even this assumption will appear dubious when paired with some other data as we shall show further on.

based on the size of firms is statistically significant ($F = 2.389$; $p = 0.10$). Among the firms that do not report short term adjustments dominate (expectedly) small firms (9), followed by medium ones (6) and surprisingly, two larger firms (both FOF-s). On the other hand, FOF-s appear to be more flexible in general, since 7 of them (70%) affirm short term adjustments while only 52% DOF-s report similar alterations. The difference is not statistically significant but this can be due to a small FOF set).

However, as to the mode of short term adjustments in labour dominate pretty conventional methods – basically the most used way of change is additional working hours of the existing employees and/or hiring part time workers. Rarely one can find relationships with employment agencies, employment of students and similar. In case of economically undesired events shortened working hours are dominant practices.

The following two questions we have asked the firms deserve more attention as they are related to deeper insight in planning the real needs of labour and longer term adjustments. However, the firms' responses were pretty optimistic. Firstly, in majority cases they claim that have approached the targeted number of workers (or even have attained it already). This answer was given by 34 enterprises (83%) but interestingly, even 25 DOF-s (81%) are confident they are at or close to targeted number while 7 FOF-s (70%) are ready to assert this statement. In our view this higher percent within DOF-s should be understood as a higher degree of concern and caution among the FOF-s as well as an overestimated state of art among DOF-s. Such a conclusion is based on a number of other examples where FOF-s demonstrate usually better results in governance and management.

Secondly, the firms were asked to answer whether they do recognise a core group of employees that makes a nucleus of the firm and makes a firm's comparative advantage. The answers were again optimistic though with somewhat changed distribution of answers. In total 31 firms confirmed the statement (76%) but FOF-s appeared to be more familiar with the issue giving affirmative answer in 9 (90%) cases compared with DOF-s presenting 22 (71%) positive responses. Looking from the standpoint of economic results affirmative answer was given by 17 firms (81%) from the group with higher profit per worker and by 14 (70%) from the lower group.

Finally, when we tried to face the three answers on employment adjustment with those for wages calculating a compound factor for the former (0-3) and related it with the answers that claim considerably higher pay for labour than in the country we found an interesting result. In the group of firms with the value of the compound factor 0-1 (7 firms) there were no firms that claim wages that high. In the following and the biggest group with factor 2 (23 firms) there were 8 (32%) with exceeding wages reported. Finally, in the group with factor value 3 (11 firms) six of them (55%) have claimed top wages. One may conclude that firms with healthier planning and better strategies in their employment policies can afford better wages for their employees.

4.2 Decision making: owners, managers and workers

The most challenging part in the analysis – regarding internal relations – discusses the issue of decision making. The issue can be analysed in several perspectives such as: to what extent strategic decisions and management are recognised and separated in regard to operative decisions, what level of cohesion in decision making has been achieved in terms of

harmonious work between owners and managers and in particular with workers and other employees, what kind of loyalty exhibit workers towards their firms and are they ready to undertake some risks that a firm could meet etc. Finally, we shall try to find out how all these elements do affect satisfaction of employees and/or how much can add to rising of firms' social capital as factors of improving business performances.

The firms were firstly asked whether they systematically separate strategic from current operative decisions at various levels of decision making with an idea to investigate do they recognise specific features of strategic choices. In total, 24 firms (58.5%) confirmed such practices. However, it should be remarked that the majority of negative answers come from smaller firms (13 below 50 and 3 below 100 employees) which could be understandable to a certain extent. It should be noted that different responses to this question in regard to the firm's size is highly significant ($F = 18.496$; $p = 0.000$). There is a slightly higher percentage of firms that earn higher profit per worker and confirm separation between the two sorts of decisions (13 or 62%) when compared with the firms from the lower profit group (11 or 55%). A non-negligible difference appeared between FOF (8 or 80%) and DOF (16 or 52%) that indicates better management practices in foreign companies (though statistically insignificant probably again because of too small number of foreign firms in the sample).

Basically the similar results have been obtained within the set of firms' responses regarding harmony and coordination between owners and managers in strategic decision making over the past five years. In total, 25 firms (61%) declare that their managers and owners act harmoniously among which, somewhat surprisingly, 14 (70%) are in the lower while 11 (52%) in the higher group according to profit to employment ratio. Again it should be remarked that among the latter group there are 10 smaller companies and again we encounter a significant difference in managerial practices in regard to the size of the firms observed ($F = 8.445$; $p = 0.007$). Also, there was a difference when harmonious relations were reported by FOF-s 8 (80%) and by DOF-s with only 17 (55%) examples of the kind.

Finally, when asked whether strategic decisions are coordinated between owners, managers and workers there were 20 units confirming such a state but again with a sharp distinction between FOF and DOF. In FOF 8 firms (80%) positively responded to the question while in DOF only 12 (39%) did so, which despite the imbalance in size of the two sets appeared to be significant ($t = 2.147$; $p = 0.044$). Some difference in responses (though insignificant) was found between manufacturing (46%) and service firms (53%) and between exporters (46%) and non exporters (53%).

In general, we may conclude that foreign firms have established a better system of strategic decision making with fewer possibilities to turn into any kind of conflict among the key groups of agents and/or internal stakeholders.

As stated at the beginning the relations between managers and workers and general position as well as attitude of workers in a new surrounding of private firms was of specific interest. In essence we investigated three groups of questions: is there any form of workers' participation in decision making, are there trade unions units in firms and are workers ready and devoted to participate in risk bearing within their firms.

Table 4.2. Workers, participation and risk aversion, 2012 (number of firms, percentage)

	All firms (total: 41)	FOF (10)	DOF (31)	High P/L (21)	Low P/L (20)	ExF (26)	NExF (15)
<i>Participation in decision making</i>							
Right to be informed	26, 63%	9, 90%	17, 55%	11, 52%	15, 75%	17, 65%	9, 60%
Possibility to make proposals	19, 46%	6, 60%	13, 42%	8, 38%	11, 55%	16, 62%	3, 20%
Members of the board	7, 17%	2, 20%	5, 16%	2, 10%	5, 25%	3, 12%	4, 27%
<i>Trade unions (TU)</i>							
There are TU units	10, 24%	4, 40%	6, 19%	4, 19%	6, 30%	7, 27%	3, 20%
<i>Risk participation</i>							
Readiness to 'do something more'	29, 71%	8, 80%	21, 68%	16, 76%	13, 65%	18, 69%	11, 73%
Stay with the firm if offered better job	14, 34%	6, 60%	8, 26%	8, 38%	6, 30%	7, 27%	7, 47%
Willing to invest in the firm (financially)	7, 17%	4, 40%	3, 10%	4, 19%	3, 15%	3, 12%	4, 27%

As can be realised from the table presented 26 firms confirm they do inform workers properly. If we omit one firm under bankruptcy, it should be remarked that among the 14 firms which do not inform workers 13 are small and/or medium companies (1). On the other hand this should indicate that in all other firms whether small or big – workers are well informed. However, in explaining what means and kind of information are present we encounter very different answers, from 'publicly presented decisions' (with no previous consultations with workers) to regular meetings and discussions with them (4 examples) regarding new products, offered projects etc. as an usual way of workers' involvement in decision making. In contrast, an equal number of respondents (4) insist on pointlessness of these forms of information convincingly underlying that owners are the only ones in charge (not even managers).

As to some more developed practices that involve workers in decision making it is noticeable that less than a half of the firms in the sample (19) develop opportunities for their employees to give suggestions and/or make proposals. Also one may see that these practices are more developed among the firms from the lower profit per worker group. Actually, this could be explained by the fact that in the lower profit per worker group dominate larger firms, already recognised as more friendly with workers participation. It is interesting that both practices – better information and better opportunities to propose – are more developed in foreign firms than in domestically owned ones. FOFs appear only to be more reserved when workers membership in boards is considered though this is anyway just a sporadic practice.

The data on trade unions (TU) give a very specific picture. As in the case of collective bargaining and agreements it seems that existence of trade unions in Serbian firms appears more incidentally than regularly. There are 10 firms only with TU units while in just 3 of them act more than one TU organisation. Also, only four firms report that TU is concerned with the firms' economic success and performance.

Analysing what sort of firms report TU existence, at a first glance it seems that joint stock companies (5 that is, 100%) usually favour existence of trade unions while only 5 limited companies (5/36=14%) claim trade union presence. Seemingly, this can also be linked with the size of the firms since all of them are larger companies. However, when analysed more carefully one may remark that the difference observed has not much to do with legal status of the firms in question or their size. In fact, there is a more remarkable common feature within the companies with TU activities: they are all either 'old' companies that were in operation already in the former Yugoslavia or they were acquired by the firms with similar history and legacy. Thus, we may remark that 100% of these 'old' companies and/or their employees stick to some, say, traditional values inherited from the former institutional arrangement (whatever was the real role and position of the 'socialist' trade unions under communist led self-management system).

When asked to assess whether their workers are ready to participate in risks their firms could meet or whether they are risk averse 29 firms (71%) claim their workers are ready to do something 'more' for the firm. Among them 8 are the firms with TU-s (out of 10 with TU-s); 14 are those that report good workers' informing practices; 14 are those with open dialogues with workers, while 5 have workers in boards (of 7 having that arrangement). On the other hand, 10 are the firms stating that their workers are among the best paid in Serbia, while 18 are those that claim their workers are better paid than their competitors from the same industry.

However, coming to the explanations – what does that 'more' means it comes out that 10 firms point at additional working hours labourers are ready to work and 2 at their readiness to accept postponed wages or even their diminishing. Such answers, in the contest of unemployment could rather describe workers fears that might be laid off than their loyalty to the firm (we may quote another interesting answer – workers are ready to do *everything* they are ordered since they know that are well paid). Only two firms point at some more sophisticated practices stating that workers are interested in additional training and/or interested in new technology and processes or propose new products etc., while two more firms quote some other relevant examples. Additionally, it is interesting that in a control question on the same issue within another context, 3 positive answers changed into three negative but two negative were substituted for two positive keeping approximately similar percentages of positive answers in total.

One should also remark a systematically higher percentage of workers' readiness to participate in firm's risks among FOF in all categories when compared with DOF and in particular when their readiness to financially invest in the firm (statistically significant: $t = 1.770$; $p = 0.086$). This could be an indication of a higher level of labourers' trust in firm's success within FOF or at least in managerial abilities of their managers. It is also interesting that risk aversion among employees appear to be more evident in manufacturing companies than in services: summing up all three categories of possible risks the average value for manufacturing is 1 (out of 3) while in services it reaches 1.7 which represents a statistically

significant difference ($t = 2.00$; $p = 0.057$). Some difference is also evident in comparisons of ExF and NExF: the above table shows that employees in exporting firms are less loyal or more risk averse.

To conclude with we have tried to find out what firms claim their employees are more satisfied and loyal. Summing up positive answers for three questions – whether workers are ready to ‘do something more’, whether they will stay with firm if offered a better job somewhere else and do they are at least as satisfied as workers of other similar firms – we tried to establish a measure for employees satisfaction and loyalty. We obtained the following results. In the firms that do not experience workers participation in decision making and have no TU and accordingly, TU has no concern on firms’ performance (14 firms; positive answers 0 of 5) average values for satisfaction/loyalty is 1.5 (max = 3). In the firms where positive answers for participation and TU count 1 or 2 (14 firms) the satisfaction/loyalty measure reaches 1.9 while in the firms with participation/TU factor from 3 to 5 (12 firms) the average value for satisfaction/loyalty was 2.2.

A similar result was obtained in comparing managerial practices regarding coordination between managers and owners. If sum of three decision making indicators is 0 the satisfaction/loyalty measure is on average 1.6 (14 firms), but if the decision making indicators reach maximum value 3 (18 firms) the average satisfaction/loyalty reaches 2.1. Thus, we may conclude that an important factor of workers satisfaction and loyalty are sound owner-management-workers relations. In other words, open and trustful relations between owners, managers and workers and an active position of workers regarding their rights and participation appear to be a guarantee for employees’ loyalty and even for risk taking with obvious positive effects on upgrading social capital of a firm.

Finally, it is important to note that the level of employees’ satisfaction/loyalty is higher within foreign firms reaching 2.4 points when compared with domestic firms (1.6). Surprisingly in the context of inherited habits, the level of participation and TU activity is also higher within FOF where corresponding indicator is 2.1 while it is 1.5 among DOF which is in line with other results that connect this kind of relations with workers’ satisfaction/loyalty. Last but not least satisfaction/loyalty appears to be bigger in larger firms: it is at the level of 1.5 in small firms, 1.9 in the medium ones and 2.1 in larger companies (when readiness to financially invest was added to the sum for satisfaction/loyalty the same difference remain but is even greater 1.8; 1.9; 2.4, respectively).

4.3 Human capital

It was mentioned in the previous section that regarding some answers obtained from the survey workers do sometimes (and on their own) organise certain courses (predominantly in languages but also those for upgrading skills that are necessary in their work). In this section we shall consider how much do firms invest in human capital by organising various training practices. Basically, we shall explore what kind of training do firms organise, what is their scope and how the effects are measured and transferred. In table 4.3 some basic results are presented.

Table 4.3. Investments in human capital accumulation, 2012 (number of firms)

	All firms (41)	FOFs (10)	DOFs (31)	High P/L (21)	Low P/L (20)
Are there organised trainings	33	10	23	16	17
Involve more than 50% of workers	18	6	12	6	12
Measuring effects	16	4	12	5	11
On job training organised	30	8	22	17	16
Transfer of knowledge	33	8	26	11	7
Successors prepared	28	7	21	11	5

From the table presented one may conclude that the majority of firms from the sample (81%; while FOF even 100%) recognise the importance of investments in raising of human capital. Although some responses may be taken cautiously since seem to be too optimistic it is remarkable that 44% of firms have involved more than 50% of their employees in training activities while 39% claim to seriously measure effects attained. In regard to the latter issue the firms were asked whether they measure effects in some other way apart from surveys and they have reported various practices – mainly testing (5 firms), internal control of work and results (3), ISO procedures (1), quality control of products (1), though some firms did not precise what measurement they apply. It is also evident that firms with lower profits per worker are keen to more invest in training activities which could be assessed as a positive move in their efforts to increase profits.

Also, various forms of on job training are relatively widespread (73%; FOF 80%) and in particular internal transfer of knowledge between employees seem to be a familiar practice within the firms observed (81%). Around 68% of firms report proper preparations of workers who should succeed their colleagues when necessary. Although some self over-estimation is possible this could be taken as a positive sign of introducing new practices in human resource management. Moreover, in this field there are no substantial differences between domestic and foreign firms.

Comparing the satisfaction/loyalty factor (as explained above) with the scope of training practices it appears that fewer training forms has been applied in the firms with less satisfied/loyal employees (1-3 out of 6 training activities observed in the firms with an average satisfaction/loyalty factor 1.5) while more trainings have been found in firms with higher satisfaction (3-6 training forms with an average satisfaction factor 2). In order to finally conclude whether satisfaction and loyalty are induced by better training possibilities or other way round, we have compared participation and TU activities already seen as a factor that positively affects satisfaction and loyalty among workers. Expectedly, it appeared that in the firms with low score for participation and TU activity (0-1) 3.4 organised training forms have been conducted on average while in more participative firms (score 2-5) the number of training forms is one point higher (4.4). Hence, we conclude that more trustful relations with workers could ease training practices and raise their motivation for upgrading their skills.

5. Brand capital and external relationships

In this section we shall analyse preliminary results on brand capital and external relationships as parts of intangible capital in the companies from the sample. Relational capital includes firm's relations with its stakeholders, consumers, buyers, competitors, suppliers, government institutions, employees, etc. As we have already analysed internal relationships, in this part we will address relationships with external stakeholders.

5.1. Elements of brand capital

In current competitive environment, branding is recognised as one of the most important drivers of added value and an important issue for all stakeholders of a company. Branding has become a top management priority when it was recognised that brands are one of the most valuable intangible assets that firms could have (Keller and Lehmann, 2006). Brands are frequently seen as vital elements of intangible assets of all companies, regardless of industry, size, business strategy, country of origin. For companies brands represent means of legally protected unique features of a company, means of endowing products with unique associations, signal of quality level to customers, as well as source of competitive advantage and financial returns (Keller, 2003, p. 9).

Brand capital will be examined by analysing brand-related marketing activities, in four sections: (a) brand development activities, (b) brand value, (c) marketing innovations, (d) brand prospects.

In order to understand brand development, we tracked several aspects of brand management activities in our questionnaire:

- whether company develops its own brands of products/services,
- development of corporate brand,
- development of brand architecture.

Brand value section explains how companies build brand value, and it contains three questions:

- whether companies have legally protected their brands,
- how much they invest in brand development activities (investment as a share of sales), aiming to increase brand value,
- whether companies measure brand value.

The third section of brand capital analysis is dedicated to marketing innovation. In the questionnaire we include four variables for marketing innovation:

- the introduction of new media and/or techniques for promotion,
- important changes in design and/or packaging of products/services,
- new methods of product placement or marketing channels and
- new forms of pricing.

In the last section we consider the firm activities regarding future development of brands, based on three questions:

- strategy for future development of company brands,
- possibilities for future development of brands in new markets,
- possibilities for future leading market positions for company brands.

5.2. Brand capital: results

Our hypothesis is that there is correlation between brand development and brand value activities, as well as between brand development/brand value and marketing innovations. Also, we suppose that companies that report more developed brand activities and more brand value activities are better prepared for future marketing.

Results in section of brand development activities are shown in table 5.1.. In total sample, 71% of enterprises (29 firms) have their own brands of products/services, while 66% of companies developed corporate brand in addition to the separate brands of products/services. On the other hand, only 32% of companies have developed brand architecture (the way in which the brands within a company's portfolio are related to, and). The architecture should define how the company's brands are inter-related, support each other and how they are differentiated from one another. Low percentages in this section underline the great ignorance of brand development activities, as a way of market differentiation and of achieving competitive advantage.

Table 5.1. Brand development activities

	All firms	DOF	FOF	ExF	NExF
Existence of products brands	71%	65%	90%	73%	67%
Corporate brand development	66%	58%	90%	65%	67%
Brand architecture	32%	29%	40%	35%	27%

Some differences are evident among various groups of companies. The FOFs claim better results, in every segment of brand development activities, in comparison with DOFs. In our sample 90% of FOFs report development of its own products/services brands, as well as development of corporate brand, and 40% have brand architecture, while 65% of DOFs report development of its own products/services brands and 58% development corporate brand while only 29% confirm to have their brand architecture. Interestingly enough, there are differences among groups of companies that earn higher and lower profit per worker. Surprisingly, the group of companies with higher profit per worker shows lower results in terms of development of products/services brands (62% in comparison with 80% of companies in lower profit per worker group). Inferior results for higher profit per worker group could be an outcome of a higher share of service companies in this group, especially those that are distributors for international firms in Serbia. They usually operate behind the name and brand of the international company they represent and do not even use their corporate name in communication with market.

Relatively bad results for the first set of questions are in accordance with the results in the next set, regarding brand value (see table 5.2). Only 66% of firms report that they have legally protected company's brands, 58% of firms state that they have made some investments in marketing activities to increase brand value in the last five years, and only 17% of firms have applied some methodology of brand value measurement. We can also track previous indicators of the FOFs and DOFs since in these two groups main differences remain to be clearly visible. Thus, 90% of FOFs state that they have legally protected their brands compared with 58% of DOFs and 70% that have made some marketing investments to increase brand value versus 48% of DOFs. An average investment FOFs have made amounts at 3.54% of sales revenues while in DOFs it reaches only 2.22%; also 50% of FOFs report practices of brand value measurement in contrast to 6% of DOFs.

Table 5.2. Brand value activities

	All firms	DOF	FOF	ExF	NExF
Brand protection	66%	58%	90%	62%	73%
Investment in brands	54%	48%	70%	62%	40%
Investment in brands (% of sale, 2011)	2.68	2.22*	3.54	2.91	2.2
Brand value measurement	17%	6%	50%	19%	13%

*One company was excluded from the sample due to an unusual data value

In the sample 59% of firms have introduced some innovation in marketing communications, 61% in product design/packaging, 76% in marketing channels, and 83% in new forms of pricing. An interesting difference appears between manufacturing and service firms, as well as between firms with domestic and foreign ownership. Manufacturing firms report more innovation in promotion (statistically significant, $t = -2.338$, $p = 0.028$) and product design and packaging (statistically significant, $t = -1.849$, $p = 0.077$), while service firms innovate slightly more in pricing (80%:69%) and distribution (80%:73%), which is in accordance with specific characteristics of these industries. Finally, there is a systematic difference between exporting and non exporting firms and is always in favour of exporters.

Table 5.3. Marketing innovations

	All firms	DOF	FOF	Manufacturing	Service	ExF	NExF
Promotion	59%	55%	70%	73%	33%	65%	47%
Product/services design	61%	55%	80%	73%	40%	69%	47%
Distribution	76%	71%	90%	73%	80%	85%	60%
Price	83%	77%	60%	69%	80%	77%	67%

In the section concerning the future of brands, 59% of all companies reported that they have a strategy about the further brand development, 76% of companies see possibilities for expanding their brands to new markets and even 54% see a possibility for establishing the leading market position with their brands in future. In this group of questions one can again identify differences between manufacturing and service firms, FOF-s and DOF-s, as well as between exporters and non exporters: developed brand strategies can be more frequently found among FOF-s, manufactures and exporters and these firms are more confident in opportunities for their advancement in markets (table 5.4). Manufacturing firms see more possibilities of introducing brands to new markets (statistically significant $t = -2.355$, $p =$

0.031), which is an expected result since higher investments usually are necessary if services appears in new markets.

Table 5.4. Brand development

	All firms	DOF	FOF	Manufacturing	Service	ExF	NExF
Existence of brand strategy for further brand development	59%	55%	70%	62%	53%	62%	53%
Possibility of introducing brands to new markets	76%	74%	80%	88%	53%	81%	67%
Possibility for establishing brand leadership	54%	48%	70%	62%	40%	58%	47%

Lower results of DOFs in marketing and branding in comparison with FOFs can be explained by a higher share of small and medium companies among DOFs. Due to their size, small and medium enterprises do not have a potential to attract high qualified specialists and often do not find it even necessary. In fact, this is a result of high involvement of owners in decisions making and already mentioned absence of clear line between strategic and operative decisions at various levels of decision making, which is the main characteristic of small firms in the sample. On the other hand, FOFs are more attractive as employers for local specialists, and they bring up marketing practice and processes that they have already established in their domestic markets, which lead to better results in marketing and branding in Serbian market as well, especially in the case of firms that came from developed countries. Apart from this it is reasonable to suppose that the absence of positive marketing practices within domestic firms can be an outcome of insufficient level of knowledge in the field and inadequate engagement of educational institutions that should provide better educational programs for business and marketing.

Statistically significant differences appear between small, medium and large firms in many segments of brand capital, favouring large firms. They perform better in brand development activities (existence of products brands, $F = 3.821$; $p = 0.031$); corporate brand development, ($F = 8.953$; $p = 0.010$); brand architecture, ($F = 8.361$; $p = 0.010$) and brand value activities (brand protection, $F = 4.887$; $p = 0.013$); investment in brands ($F = 4.129$ $p = 0.024$); brand value measurement ($F = 23.472$ $p = 0.000$), as well as in all segments of marketing innovation, except in pricing (with statistically significant differences regarding innovation in promotion $F = 3.312$; $p = 0.048$). Regarding brands prospects, large firms perform better in all three segments (table 5.4), with statistically significant differences in identified possibilities for establishing brand leadership ($F = 2.849$; $p = 0.071$). This is in accordance to previous observations regarding small and medium firms and their lagging behind large firms in marketing knowledge and practices.

Regarding export orientation, it appears that export oriented companies report better results in all segments of brand capital that we have investigated. It seems that internationalisation has an important influence on brand capital and marketing innovations. Doing business in foreign markets, facing international competitors, cooperation with international buyers and distributors are important factors of international business strategy and have positive impact on marketing activities and marketing competences of companies. Internationalisation processes foster learning in organisations, and these effects are the

most visible in marketing and branding. Exporters innovate more, and more of them have developed brand strategies in comparison to non exporters. Consequently, they also invest more in brand development and in marketing activities and report better results regarding brands prospects. This is quite expected: it is impossible to be competitive in international markets without developed brand capital and developed marketing competences. On the other hand, this point at a necessity of continuous improvements of the discussed yet vital elements of intangible capital in order to increase number of firms that can effectively export, be competitive in foreign markets and increase the amount of export revenues in the entire economy. This can be taken also as a policy advice: incentives should be made for fostering export orientation but should simultaneously be followed by incentives in the field of quality business education, entrepreneurial training etc.

In order to examine relationships between different elements of brand capital we have conducted the following correlation analysis (results presented in table 5.5).

Table 5.5. Correlations coefficient table

			brand development	brand value	marketing innovations	future marketing
Spearman's rho	brand development	Corr. Coeff.	1.000	.747**	.393*	.630**
		Sig. (2-tailed)		.000	.011	.000
		N	41	41	41	41
	brand value	Corr. Coeff.	.747**	1.000	.524**	.612**
		Sig. (2-tailed)	.000		.000	.000
		N	41	41	41	41
	marketing innovations	Corr. Coeff.	.393*	.524**	1.000	.659**
		Sig. (2-tailed)	.011	.000		.000
		N	41	41	41	41
	future marketing	Corr. Coeff.	.630**	.612**	.659**	1.000
		Sig. (2-tailed)	.000	.000	.000	
		N	41	41	41	41

** . Significant at the 0.01 level (2-tailed). * . Significant at the 0.05 level (2-tailed).

Expectedly, we found positive correlation between brand development and all other categories of brand strategy (value, marketing innovations and future perspectives). These results also show that companies ranked higher on branding scale are also eager to implement more innovation within their marketing mix, while these companies are better prepared for future marketing activities.

5.3. Relational capital: external relationships

The analysis of relational capital includes three sections: (a) relationships with customers (buyers and consumers), (b) relationships with competitors, (c) relationships with suppliers.

Firm's relationships with business buyers and consumer we have analyze separately. Regarding business buyers, in total, 73% of firms state that employees from different functional areas meet regularly to exchange views and observations about customers; 81% of companies claim that they have regular meetings with business customers to determine

their needs, while 73% of firms state that business customers are engaged in process of developing new products and services. Service companies report lower involvement of business customers in development of new products/services (53%), in comparison with manufacturing firms (81%), but they paid more attention to internal meetings about their customers (80%) than manufacturing firms (65%). There is statistically significant difference among exporters and non exporting firms, regarding involvement of business customers in development of new products/services ($t = 2.080, p = 0.044$).¹¹⁵ Exporters to a greater extent involve their buyers in process of development of new products when compared with non exporting firms. It is known that an important factor of success in international business represents relationship with distributors, as key international buyers. They can help in overcoming the physic distance, which is the major barrier of internationalisation of firms and a key factor that explains variations in expansion patterns and firm performance. Involvement of buyers in development of new products represents the highest level of partnership marketing, and is a good indicator of quality of relationship.

Regarding final consumers and marketing competences in segment of business to consumer marketing we found a dubious gap between claims that companies had a detailed market analysis of behaviour of theirs consumers (85%), and statements that only 41% of firms had defined budget for market research. Evidently, this might be only a declarative consumer orientation without serious commitment to market research, which should be the first step in development of marketing programmes and sincere relationship building with consumers. The highest recognised level of commitment in marketing is customer relationship management – CRM. However, in the sample, only 22% of firms reported implementation of some elements of CRM (with higher share of service companies, 27% in comparison with 19% of manufacturing firms), primarily due to increase of loyalty programs in retailing sector. In implementation of CRM there are the great differences between the firms with domestic and those with foreign ownership, as well as between small, medium and large firms. FOFs implement CRM to a greater extent (40%) than DOFs do (16%). Large firms in this segment outperform small and medium firms ($F = 4.518; p = 0.018$), since 33% of medium firms implement CRM practice, 36% of large firms and none of small firms. One may remark that FOFs that FOFs more frequently incorporate marketing principles in their strategy when compared with DOFs.

We have analyzed companies' relationship with competitors from the perspective of defensive and/or offensive competitive orientation. More than 50% firms in the sample report defensive competitive orientation. They rather choose to follow market leaders, than to take aggressive business action in response to activities of major competitors. Better results in regard to offensive marketing strategy are reported by FOFs (60%, in comparison with 45% of DOFs), which can be an outcome of better performance in marketing, in general. However, the highest difference is found between exporters (62%) and non exporters (27%). Exporters have more aggressive marketing strategy (statistically significant difference: $t = 1.739, p = 0.091$)¹¹⁶, endeavouring to establish firm market position in foreign countries. A major number of exporters are those that have already established a position of leader in

¹¹⁵ Statistically significant differences appear between exporters that earn 20% or more of their revenues in foreign markets and the group of non exporters and those with foreign sales less than 20% of revenues.

¹¹⁶ Statistically significant differences appear between exporters that earn 20% or more of their revenues in foreign markets and the group of non exporters and those with foreign sales less than 20% of revenues.

domestic markets, and thus eager to rely on aggressive competitive positioning on foreign market.

Final section deals with suppliers, precisely the origin of suppliers. It appears that imported inputs have positive effects on productivity, since they allow and push firms to adapt to the advanced technology from abroad and benefit from foreign R&D. This suppliers' effect is crucially connected with the level of development of a country of their origin. Thus, in the sample 44% of companies report that more than 50% of suppliers are from foreign markets, while only 37% of companies state that majority of their suppliers comes from developed countries (which is substantially less than in Slovenian firms (73%), for example). However, origin of suppliers for higher profit per employee group is not significantly different from that of lower profit per worker group of firms. There are statistically significant differences between exporters and non exporting firms ($t = 1.789$; $p = 0.082$), since more than 45% of exporters have suppliers from developed countries, in comparison with 20% of non exporting firms.

6. Innovations and R&D

A good part of our survey deals with the issue of innovations, research and development investments and various sorts of competences in the field since traditionally this is an important element of firms' intangible capital. As it will be demonstrated below, despite of sometimes over-optimistic answers to the questionnaire we may identify some principal differences that appear among the set of firms observed and generally assess the state of art in this sector.

6.1. Innovations

At the beginning, the firms were asked to answer a question regarding their new products and to assess their quality in comparison with the similar activities in the firms they compete with. In total, 36 firms (89%) declare they have new products over the last five years and estimate to be at least as successful as their competitors. All foreign firms confirmed new products launch and are fully confident regarding their competitiveness. The confidence regarding competitiveness is confirmed also by all domestic firms that answered the question.

When asked whether they do assess to be more successful than their competitors, 26 firms in total (56.1%) confirmed the statement. It is interesting to note that among the firms that consider them more successful 11 comes from the lower and 12 from the higher profit per worker group. It is also evident that FOFs appeared to be more confident about their competitiveness (70%) than DOFs (52%). Moreover, when asked whether they consider them as leaders within the industry this gap was extremely widened: 7 FOFs (70%) consider them as leaders compared with only 10 (32%) of DOFs (statistically significant difference: $t = 1.539$; $p = 0.142$).¹¹⁷ Among the entire set of 17 firms that claimed their leading position in

¹¹⁷ When asked whether they consider them at least equally successful as competitors we have again a statistically significant result in favour of FOFs ($t = 2.460$; $p = 0.022$).

the industry they work in, 8 come from the lower and 9 from the higher profit group. It is particularly remarkable that only 2 firms of 17 are important exporters – one firm exports two thirds of its production (around 20% to former Yugoslav markets and 37% to the EU) and the other one 33% (22% to former YU and 11% to the EU markets). All other firms attributing themselves a leading position in the industry sell 80-100% of their production in domestic market. Finally, the distribution of leaders is almost even between manufacturing and service firms (42% and 40%, though manufacturing firms report higher activity in innovating products that is 96% to 73%).

In the Table 6.1 below firms' assessments are presented on what importance should be given to various forms of product upgrading and/or to new products.

Table 6.1. Upgrading and new products (38 responses)

Assess the importance of the following forms of new products in the firm	High	Medium	Low	Not in use
Repositioning of existing products	10	19	5	4
Additions to existing products	17	15	4	2
Upgrading existing product lines	11	15	7	4
New product lines	14	13	4	7
New products according to intl. standards	20	6	7	4

Data show that the majority of firms assess all forms of product improvements as to be high or medium. It is important to mark that among the firms that highly assess new products according to international standards (which is a category that was assessed as the most important one, 53% of firms) there are 15 manufacturing firms (from 26 in the sample; manufacturing firms systematically attribute higher importance to all forms of products innovation than firms in services do¹¹⁸). Comparing the data from the table with other available data we found that 12 firms come from the lower and 8 from the higher profit per worker group but among these 20 firms there are 9 that have considerably increased their profit per worker indicator over the period 2010-12. Though we do not know when their new products have emerged and have been offered in the markets this still gives an indication on effects new products could make and how could affect businesses. It is also interesting that exporting firms better assess the importance of new products in all of their forms when compared with firms that exclusively sell to domestic buyers: exporters assess the importance of new products from 1.9 to 2.3 while non-exporters just from 1.1 to 1.7. This could be understood as a mirror image of a considerably lower competition that home market oriented firms are faced with.

We tried to get some information about processing innovations asking firms have they undertaken in past five years considerable and/or substantial innovation in general and particularly improvements in production, in logistics, distribution and similar and in supporting departments like accounting etc. The answers obtained were definitely over-

¹¹⁸ Assessments in manufacturing range from 1.8 to 2.3 while in services from 1.5 to 1.7. However, it should be remarked that the difference mentioned could be connected with the fact that manufacturers are often exporters while services are predominantly oriented to home market with lesser competitive pressures.

optimistic: all firms reported some considerable general innovations while in other more specified questions reported improvements in at least 85% of cases up to 93% (with some difference between manufacturers and service sector regarding production and logistics improvements in favour of manufacturers).

6.2. Research and development

The structure of the sample analysed suggests that one should expect some variety in results obtained particularly when organisation of R&D is concerned. For that reason we have firstly investigated what could be the scale of investments in R&D among the firms observed since this could give an indication to what extent firms did recognise the importance of such a kind of spending. In total, 27 firms claim they have invested in 2011 at least 1% of their revenues in R&D. It is remarkable that manufacturing firms are more devoted to these endowments (80% of these firms report that scale of investments and only 40% in services) yet this difference is statistically significant: $t = -2.668$; $p = 0.013$). Among these firms there are 12 that invested more than 2% of the revenues (10 manufacturers and 2 in services) while 5 of them report even more than 3% (3 manufacturers and among them 2 big exporters that sell more than two thirds of their production in foreign markets and 2 in services).

It is important to underline that the firms which export at least 30% or more of their products abroad invest more in R&D: they invest on average 1.5% of their revenues while all others just 0.9%. However, we found another important characteristic regarding R&D investments: a big majority of firms that report some investments claim a change in these expenditures over a period 2008-10 but there is only one reporting a growing percentage in revenues. Implicitly we may conclude that during the crisis investments in R&D have been diminished.

It is also remarkable that all the manufacturers that report R&D investments come from the lower profit per workers group while service firms are all in the higher group. This could be understood as a consequence of the transition growth model that has favoured services oriented towards domestic markets and imports rather than exports (see: Cerovic and Nojkovic, 2011, 2011a). Such a position of manufacturing and no proper industrial policy might explain relatively low level of investments in general including R&D and substantial deterioration of manufacturing industries over transition.

On the other hand, it should be pointed out that among the firms that did not report any R&D investments (14) four foreign firms were found and one large domestic firm. All of them are parts of larger international systems or of a large domestic holding that usually organise R&D departments in other places. Among the remaining nine firms without investments of this sort 3 are micro enterprises with less than 5 employed. Also, within the entire group of 14 there are 10 firms that predominantly sell products of renowned producers, sometimes with minor finalisation. Hence, for all these firms it is not expected to have particular investments in R&D. However, this may be linked with a specifically poor outcome of the FDIs in transition since often they do not enhance expected spillovers particularly regarding knowledge and technology (see for example: Gunter, 2005; Gorodnichenkou *et al.* 2007).

As suggested above the nature of our sample could generate some specific differences among the firms. Thus for example, just 11 firms have special R&D departments. This is usually connected with the different size of the firms observed (it is not surprising that small firms have no departments of that kind) and their different positions regarding their principals (large foreign companies or a domestic holding). Among the 11 firms with R&D departments there are one with less than 100 employees (food producer), three between 100 and 200 and 7 companies with more than 800 workers; 10 are manufacturers and just one is in services (retailing). These firms also specify that their R&D departments systematically act in solving firms' problems and develop absorbing ability, while 8 of them see the department as an important agent in changes within the firm that establishes guidelines for technological development and in 7 cases the department is engaged in developing industrial design.

6.3. Competences

The firms were asked to assess their competences in technology and marketing in regard to their competitors but also to assess their complementary or matching competences in regard to competitors. The results obtained are presented in the tables 6.2, 6.3 and 6.4 below.

Table 6.2 Firm's technological competences *vis-a-vis* competitors (number of firms)

Assesments	substantially lower	lower	similar	better	substantially better
R&D knowledge highly developed*	4	6	10	7	7
We have high technological abilities in the firm or within strategic partnerships"	1	3	11	11	6
We correctly predict technological trends**	-	7	9	11	6

Responses: * 34; " 32; **33

In assessing their technological competences manufacturing firms appear to be more confident: they assess these competences to be on average somewhat better than of competitors with the assessments in range from 3.4 to 3.7. Firms in services are a bit more reserved particularly regarding their R&D knowledge (average assessment 2.6) but still are convinced that are better than their competitors in two remaining categories: 3.4 and 3.2. Foreign owned firms (FOFs) are decisively confident and assess on average to be substantially better than competitors with the assessments from 4 (predicting trends) to 4.3 (R&D knowledge). DOFs are more careful in assessing their competences ranging them from 2.9 (R&D) to 3.4 (technological abilities) and 3.5 (predicting trends; this does not seem to be quite reliable if compared with other responses). One may also notice that exporters assess their technological abilities noticeably higher than non-exporters do (3.8: 3.2).

Table 6.3. Firm's marketing competences *vis-a-vis* competitors (39 responses)

Assesments	substantially lower	lower	similar	better	substantially better
Acquiring information on consumers preferences and needs	2	2	19	9	7
Acquiring information on competitors	1	-	22	9	7
Long-term relations with buyers	-	1	12	13	13
Long-term relations with suppliers	-	-	11	14	13

It is remarkable that all the firms observed do highly assess their marketing skills with only few examples that confess their knowledge and practices are t a lower level in comparison with their competitors. DOF-s appear to be particularly self-confident giving assessments in range 3.5 to 4.1 and systematically higher than FOF-s do (from 3.1) except for relations with buyers where their assessments are equal. It is reasonable to suppose that all firms overestimate their skills and the domestic ones in particular. However, it is remarkable that exporters assess their marketing competences particularly high: from 3.6 (information on consumers' preferences) to 4.2 (long-term relations with suppliers) suggesting one more time that foreign competition press for advancement in business practices.

Table 6.4. Firm's complementary competences *vis-a-vis* competitors (39 responses)

Assesments	substantially lower	lower	similar	better	substantially better
Clearly defined tasks of units (dpts)	2	4	12	13	8
Good transfer of technological and marketing competencies between units	1	3	13	15	7
High level of R&D knowledge transfer with strategic partners*	7	2	11	13	5
Products development is efficient (in terms of costs)*	1	4	8	15	10

* 38 responses

In identifying complementary competences in regard to the competitors the firms seem to be somewhat more reserved than in assessing their marketing skills. However, they are confident that are particularly strong in products development (25 firms or two thirds of those that responded). FOFs find them particularly competitive in knowledge transfer (average assessment 3.9) and remarkably more competitive in R&D (3.6) than DOFs (3.1). On the other hand, in estimating the efficiency of introducing new products domestic firms seem to be more confident (3.8) than foreign ones (3.6). Exporters assess to have light advantage against competitors in all the four categories examined (3.3 to 3.9) and in all categories are in front of non-exporting firms (3 to 3.4)

Finally, the firms were asked to evaluate the importance of various sources of information that help them in acquiring knowledge regarding innovations, R&D and other components of their competitive advantage. The results are reported in table 6.5, below.

Table 6.5. Sources of information – importance level (40 responses)

Assesments		high	medium	low	Not in use
Internal	Within the firm	25	12	2	1
Market	Equipment suppliers	13	22	2	3
	Other suppliers	16	17	3	3
	Buyers	17	15	1	6
	Competitors or other firms from the region	13	16	8	2
	Consultants, R&D private firms etc.	5	13	9	13
Institutional	Universities, higher education institutions	3	10	12	15
	Government or public research institutions*	-	8	13	18
Other	Conferences, fairs, exhibitions	14	15	3	8
	Journals or commercial publications	7	16	5	12
	Associations, chambers etc.	4	15	10	11

*39 responses

From the table above it is evident that a good number of firms do not use (or use in a very small capacity) institutional sources of information (including their own associations and/or chambers of commerce or similar) and in particular government and/or public institutions. This is specifically evident when smaller firms are in question. However, this also points at an insufficient support of the institutions in question in improving business practices. This is an important finding that urges for more active policy in the field, especially regarding smaller and medium enterprises. Surprisingly, foreign firms frequently do not use – apart from public institutions – university sources or even other scientific sources, which could be an indication of a lower level of technology applied in FDI established/acquired local enterprises and lower level of investments in R&D within local companies.

On the other hand, it is interesting that all the firms which do not make use of consultants or other private R&D firms are domestic ones and predominantly small. This could be an indication of a typical local entrepreneurial habit – owners of smaller firms recognize predominantly their own ideas and do not feel they could acquire some additional knowledge from professional consultants and advisers. In contrast to this finding, it is evident that exporting firms assess these sources of information – including universities and journals – to be almost twice more important than non-exporters do (1.4; 1.2; 1.7 against 0.9; 0.6; 0.9).

6.4. IT capital

In this section we shall add a few remarks regarding IT capital that is, the development of IT sector, investments in the IT and its understanding regarding business efficiency and competitiveness. We firstly asked firms whether they possess an adopted strategic plan regarding IT development, is it implemented and does it is updated regularly. Also we explored what part of the revenues is allotted to the IT investments. The answers are presented in the table 6.6.

Table 6.6. Development of IT capital

	All firms	ExF	NExF	DOF	FOF	Service	Manufacturing	P/L low	P/L high
IT strategic plan									
<i>Adopted</i>	59%	54%	67%	48%	90%	53%	62%	65%	52%
<i>Implemented</i>	37%	31%	47%	32%	50%	33%	38%	40%	33%
<i>Updated each 2 years (at least)</i>	27%	27%	27%	23%	40%	20%	31%	20%	33%
Investment in IT (2011)									
<i>> 1% of revenue</i>	49%	62%	27%	55%	30%	33%	58%	40%	12%
<i>> 2% of revenue</i>	15%	15%	13%	15%	0%	13%	15%	25%	1%
<i>> 3% of revenue</i>	10%	12%	7%	3%	30%	13%	8%	5%	3%

As it can be easily seen a good number of firms (59%) claim they have a strategic plan on IT development. However, only 37% confirm an implementation of the plan while just 27% of enterprises do update the plan (at least) once in a two year period. As in some previous examples a remarkably higher percentage of FOF-s exhibits these activities (90%, 50% and 40% respectively) when compared with DOF-s (48%, 32%, 23%). Having in mind that among 74% of firms that report investments in IT of at least 1% of the revenues (or more) we find a higher percentage of DOF-s this means that many of them have no clear plan regarding an efficient use of these investments and further development of IT capital (poor implementation and update of strategic plans). The conclusion is particularly strengthened when firms respond to the questions aimed at exploration of their understanding of the IT importance. Although 68% of DOF-s agree that the role of IT is not just a support for usual businesses (FOF: 100%) and 61% claim that IT changes the mode of doing business (FOF: 100%), only 45% recognise that could attain certain competitive advantage by means of IT (FOF: 70%). Basically, these results confirm an already formed picture on understanding and recognition of intangible capital among domestic firms: very often they have a rudimentary idea on the importance of certain components of intangibles but are not competent enough to fully benefit from their use. On the other hand, despite better employment of IT in FOF-s the results indicate a similar state as in regard to R&D: there are not always remarkable investments in IT nor full engagement in the IT capital development, which reduces potential spillover effects across the local economy.

7. Conclusions

Presented data and the analyses conducted although just preliminary, lead us to a conclusion that the importance of investments in intangible capital is slowly becoming recognised in Serbian economy. However, despite some better results in several specific practices – deeper insight shows that many aspects of intangible capital that could be invested remain still at a rudimentary level.

This general conclusion to a certain extent may be ameliorated and be more positive in regard to some specific groups of companies observed. Frequently we found examples of advanced practices within foreign owned firms and among firms that are present in foreign markets.

As to the foreign companies that do business in Serbian market it is evident that they go further than a typical local firm in intangible capital investing. Nevertheless, in some aspects of intangible investments, predominantly in R&D, foreign owned firms have not some particular experience. We conclude that such a situation is caused by a lower level of technology and perspective progress of these firms when established in Serbian economy. A negative side of such state of art is that we cannot expect any substantial spillover effects concerning intangible investments that might influence practices of domestic firms.

In regard to the firms that export their products or at least have some other relationships with foreign markets we have remarked a deeper involvement concerning intangible investments. This can particularly be seen when marketing practices are explored. We conclude that this was influenced by higher degree of competition in foreign markets but also represents a kind of spontaneous learning and a spillover effect of practices met in foreign markets. On the other hand, exporters come usually from manufacturing sectors that are at the lower level of economic results when compared with services. Our hypothesis is that this predominantly signifies an undesired outcome of a liberal transition project that neglects any kind of industrial policy in designing development and growth models of transition countries.

A specific concluding note should be made in regard to internal relations. Firstly, our analysis has shown that even despite declared separation of strategic and operational decisions in many companies this distinctiveness is pretty blurred and that decision making process could be better structured. It seems that internal relations suffer of too literarily understood social relations change during transition characterised by attributing to owners an excessive role and power in managing companies.

Secondly, the problem is particularly evident in regard to workers' position within the firms observed. Understanding of the importance of workers involvement in various processes – from good information to their proposals and some decision making – that affect firms' performance, appears to be pretty rude. Moreover, there is an evident lack of traditional workers rights regarding trade unions, and collective bargaining that sporadically appear and predominantly where these activities have been inherited. These problems are especially tough in smaller firms.

On the other hand, our analyses have shown that the degree of satisfaction and loyalty to the firm depends on well-ordered internal relations along the entire agency chain – owners, managers, workers. Accordingly but surprisingly considering local self-management legacy, we found a systematically higher percentage of workers' readiness to participate in firm's risks among FOFs in all categories when compared with DOFs and in particular regarding their readiness to financially invest in the firm. Basic explanation should be found in an extremely poor local institutional arrangement of workers' rights and high unemployment when domestic firms are in question and in better established practices imported from home countries within the foreign firms.

Finally, we have found a specific difference in understanding of various forms of intangible capital within smaller firms that exhibit both ignorance on the matter and an exceeding self-confidence with the abilities of their owners. We find this attitude is in consequence of low level of knowledge, poor institutional (bad regulation) and economic environment (high unemployment and lack of competitiveness). Together with a very low degree of recognition

of possible support that could be acquired from public consultants, economic associations and educational sector among small entrepreneurs force us to conclude that some important reforms should be done in these institutions.

The basic conclusions listed above bring about some policy advice. We suggest a more active policies that will support export led growth, enhance manufacturing production and make the country attractive for higher tech foreign investments. According to our findings the companies that will emerge and/or develop under such policies will eventually lead to better understanding and broader undertaking of intangible investments. Also, we suggest more attention to be paid to general economic education and business in particular including a deeper study on human resource management, upgrading internal relations and in marketing strategies, as well as various forms of entrepreneurial training. Finally, we suggest industry associations, employers associations, chambers of commerce and trade unions to be better institutionally positioned and designed in a new manner that will corresponding to the ongoing changes and global economic environment.

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HOW TO PROMOTE SUSTAINABLE HUMAN DEVELOPMENT IN POST-SOCIALIST COUNTRIES?

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ABSTRACT

Development used to be considered to be equal with economic growth and welfare was equal to financial well-being. These approaches have been exploded, and now more and more interpretations of development and well-being take into consideration qualitative effects as well. Experts tend to believe that development means not only economic growth, but it also incorporates social factors.

The paper focuses on the effect of the main socio-economic indicators on human development. After describing what human development means and how it can be measured, it examines how monetary poverty, income inequality, labour market and education level influence human development. Monetary poverty is measured with poverty headcount index and relative poverty gap and income inequality is measured with Gini coefficient. As for labour market conditions, regional cohesion and long-term unemployment rates are taken into consideration, while the indicator of education is the rate of early school-leavers. To measure human development, Human Development Index is used. The hypothesis states that poverty reduction, the decrease of income inequalities, the decrease of long-term unemployment rate and of regional cohesion and the fall in the rate of early school-leavers promote human development.

The paper also focuses on the effect of intra-generational income redistribution on human development. I hypothesize that there is a significant positive relationship between the rate of social and welfare expenses and human development. The hypothesis implies that social and welfare expenses aiming to reduce income inequalities do not moderate human development, but support it.

The area of the research includes the countries classified to the same income category by the World Bank. Upper-middle income Eastern European countries consist of eight countries (Croatia, Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland and Slovakia) that all changed their political and economic system from planned economy to market economy at around 1990. Thus the analysis examines the time period since 1990. I use multiple regression and correlation analysis to test the hypotheses.

The results of the analysis can highlight how human development has been affected by the socio-economic changes in the last years. It can reveal how the global economic crisis affected human development. Moreover, it will be possible to identify the areas where improvement is necessary in order to ensure sustainable human development.

Key words: post-socialist countries, human development, unemployment, inequality, poverty, redistribution

JEL code: O15

Introduction

Development used to be considered to be equal with economic growth and welfare was equal to financial well-being. Lately, however, this approach has been exploded, and now more and more interpretations of development and well-being take into consideration qualitative effects as well. Experts tend to believe that development means not only economic growth, but it also incorporates social factors.

The paper focuses on the effect of the main socio-economic indicators on human development. After describing what human development means and how it can be measured, it examines how monetary poverty, income inequality, labour market and education level influence human development. Monetary poverty is measured with poverty headcount index and relative poverty gap and income inequality is measured with Gini coefficient. As for labour market conditions, regional cohesion and long-term unemployment rates are taken into consideration, while the indicator of education is the rate of early school-leavers. To measure human development, Human Development Index is used.

The paper also focuses on the effect of intra-generational income redistribution on human development. It examines whether social and welfare expenses aiming to reduce income inequalities moderate or support human development.

Well-being and human development

The ultimate goal of human life is well-being. That is why research works about happiness has become important in sociology, psychology, and in economics. Research results show that subjective well-being, which can express happiness, is not associated with material well-being above a certain income level (G. Fekete – Siposné Nándori 2013; Takács 2009). There are several explanations for this phenomenon, called welfare paradox:

- Problems with leisure time: Regardless of high income level, individuals may not be able to spend their leisure time in a meaningful way.
- Status competition: In spite of the fact that individuals make efforts to improve their relative living standard, the improvement of the living standards of each individual is not possible as the total amount of income is fixed. The struggle for the improvement of living standard results in a stressful life, which can be harmful for subjective well-being.
- Treadmill effect: Far-reaching changes can modify subjective well-being only temporarily. They do not have any effect on it in the long run.
- Choice paradox: The improvement of material well-being is usually associated with an increase in the available options, often resulting in the phenomenon of cognitive dissonance, which can decrease subjective well-being.
- “Time-saving” inventions: Inventions designed to help the individuals saving time (like washing machine, dishwasher or car) do not create more leisure time for their users. They only reach better results over the same time than earlier solutions

(trough, washing with hands or coach with horses) (G. Fekete – Siposné Nándori 2013; Takács 2009).

In order to be able to measure well-being and not only material wealth, different indices have been elaborated. The Human Development Index (HDI) is the most widely used measure of them. It makes the comparison of human development in different countries possible by taking into account other factors in addition to economic growth. The HDI is made up of three components:

- average life expectancy as a measure of long and healthy life;
- mean years of schooling and expected years of schooling as measures of education level;
- GNI per capita in USD as a measure of living standard (Zambrano 2011).

The values of the three dimensions range from zero to one, so a transformation of the original values is necessary by taking into account the maximum and minimum values of the given variable. The HDI is then calculated as the average of the three transformed values. Before 2010, the HDI used to be calculated as their arithmetic mean, since then, however, their geometric mean has been used.

$$HDI = \sqrt[3]{I_{education} \cdot I_{education} \cdot I_{income}} \quad (1)$$

(Fóti 2003, Husz 2001, Husz 2002, Zambrano 2011)

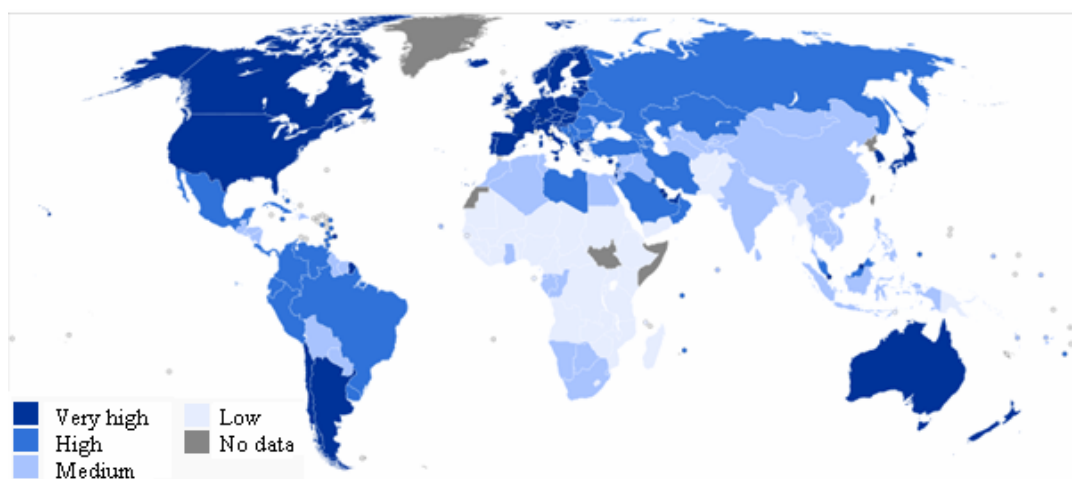
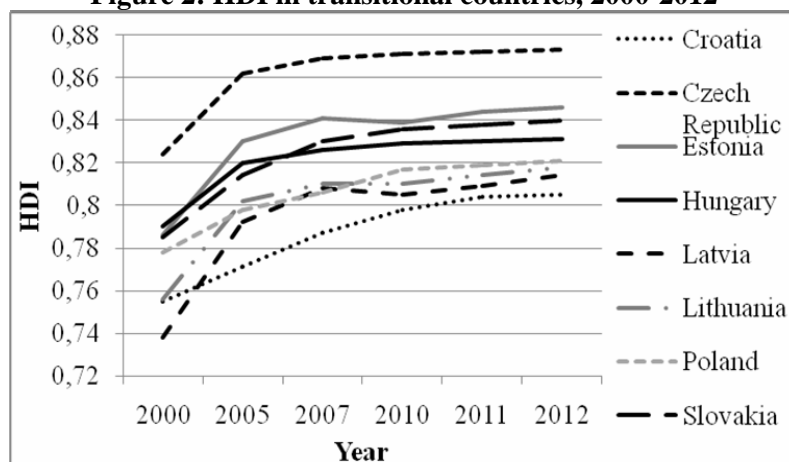


Figure 1: HDI values in the world, 2011
Source: G. Fekete – Siposné Nándori 2013

Nowadays, HDI values are very high in North America, Western and Central Europe, Australia and South America. In most of the African countries, however, this value is extremely low (Figure 1). In transitional European countries (Figure 2), HDI has been increased since 2000. The HDI of the Czech Republic outstands from other countries' values.

Figure 2: HDI in transitional countries, 2000-2012

Source: own compilation based on Human Development Report 2013

Methodology

The area of the research includes the countries classified to the same income category by the World Bank. Upper-middle income Eastern European countries consist of eight countries (Croatia, Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland and Slovakia) that all changed their political and economic system from planned economy to market economy at around 1990. The analysis examines the time period since 1990.

The effect of the socio-economic indicators on human development is examined with multiple regression and correlation. The following socio-economic indicators are included in the analysis as explanatory variables:

- Poverty rate (x_1): the ratio of the population living below the poverty line.
- Poverty threshold (x_2): the value of the 60% median national equalized income.
- Poverty gap (x_3): the average distance of the poor individuals' income and the poverty threshold.
- Regional cohesion (x_4): the coefficient of variation of the employment rates at NUTS2 level regions expressing labour market regional disparities. As Latvia, Lithuania and Estonia are made up of only one NUTS2 region each, regional cohesion cannot be calculated in this way. In order to include regional cohesion in Baltic states as well, the study calculates employment rates at the NUTS3 level for these countries.
- Long term unemployment rate (x_5): total long-term unemployed (unemployed for at least a year) population expressed as a proportion of the total active population as an indicator of labour market;
- Rate of early school leavers (x_6): as an indicator of knowledge level;
- Gini coefficient (x_7): as an indicator of income inequalities

The dependent variable is HDI (signed by Y).

Before examining which socio-economic indicators have a significant effect on human development, testing the relationship between the independent variables is necessary. If these variables are highly correlated, the multiple regression model may not give valid

results about the predictors because of multicollinearity (I have to be careful of this problems as some of the explanatory variables refer to similar phenomenon, therefore there is a change they are highly correlated). In practice, the presence of multicollinearity can be considered to be dangerous if in the correlation matrix of the independent variables, there are any values higher (in absolute values) than the coefficient of multiple correlation. In my case, each value in the correlation matrix is lower than the coefficient of multiple correlation (0.943) (Table 1).

Multicollinearity, however, can be present in more than two predictors as well. The linear relation among more than two predictors can be detected with the variance inflation factor (VIF). A VIF of 5 (or 10) and above indicates a multicollinearity problem (Kutner – Nachtsheim – Neter 2004). Based on VIF values (refer to Table 2), multicollinearity problem arises in the case of poverty rate and the Gini coefficient. Therefore further analysis can only be carried out with the exclusion of these variables.

Table 1 Correlation matrix of the independent variables

	x ₁	x ₂	x ₃	x ₄	x ₅	x ₆	x ₇
x ₁	1	-0.447	0.739	-0.107	0.040	0.279	0.737
x ₂	-0.447	1	-0.573	-0.002	-0.359	-0.392	-0.520
x ₃	0.739	-0.573	1	0.029	0.072	0.128	0.722
x ₄	-0.107	-0.002	0.029	1	0.338	-0.051	-0.279
x ₅	0.040	-0.359	0.072	0.338	1	-0.473	-0.017
x ₆	0.279	-0.392	0.128	-0.051	-0.473	1	0.329
x ₇	0.737	-0.520	0.722	-0.279	-0.017	0.329	1

Source: own computation

Table 2 Variance inflation factors of the predictors

<i>Predictors</i>	<i>R²</i>	<i>VIF</i>
Poverty threshold	0.783	4.61
Relative poverty gap	0.672	3.05
Poverty rate	0.945	18.18
Regional cohesion	0.374	1.60
Rate of early school leavers	0.697	3.30
Long term unemployment rate	0.666	2.99
Gini coefficient	0.948	19.23

Source: own computation

The hypothesis concerned the effects of socio-economic indicators states that poverty reduction, the decrease of income inequalities, the decrease of long-term unemployment rate and of regional cohesion and the fall in the rate of early school-leavers promote human development.

When the effect of intra-generational income redistribution on human development is examined, explanatory variables are selected based on Cashin (1995).

Cashin (1995) states that the production function has the following form for each economic actor:

$$y(t) = A \cdot k(t) \cdot \left[\frac{G(t)}{K(t)} \right]^\alpha \cdot \left[\frac{T(t)}{K(t)} \right]^\beta \quad (1)$$

where A is the parameter expressing technology, k(t) is the per person private sector capital, G(t)/K(t) is the ratio of the aggregate public capital stock, T(t)/K(t) is the ratio of aggregate public transfer payments, α is the output elasticity of the G(t)/K(t) ratio and β is the output elasticity of the T(t)/K(t) ratio. For the elements of the formula, $K(t) = Nk(t)$ is true, where N is the total number of the economic actors (Cachin 1995).

The included explanatory variables and economic growth is related in the following way:

$$GRWKR_{it} = \beta_1 \ln(IGOV_{it}) + \beta_2 \ln(SOCSEC_{it}) + \beta_3 \ln(CURREV_{it}) + \beta_4 \ln(INIT_{i,t-T}) + \varepsilon_{it} \quad (2)$$

where GRWKR is the growth rate of per capita GDP, IGOV is the change in the stock of public capital as a share of GDP (%), SOCSEC is the expenditure of social security and welfare as a share of GDP (%), CURREV is the rate of current tax revenue as a share of GDP, INIT is the natural logarithm of the GDP rate of growth, $\varepsilon_{it} = \alpha_i + \nu_{it}$ ($i = 1, \dots, N$ signs the countries and $t = 1, \dots, T$ stands for years) and β_i is the coefficient of regression. Based on the theoretical model, SOCSEC and IGOV are positively, while CURREV is negatively related to economic growth, assuming that other variables in the model are constant. Cachin (1995) also includes EDUC, the gross enrolment of children aged 12 to 17 years at secondary school as the share of the population of children in the country's school age group in his analysis.

For my analysis, I use a modified version of Cachin's (1995) model. Instead of the growth rate of per capita GDP, I use the growth rate of HDI as dependent variable (signed with Y). Furthermore, CURREV is excluded from the model when calculating the effect of redistribution on human development.

I hypothesize that there is a significant positive relationship between the rate of social and welfare expenses (SOCSEC) and human development (Y). The hypothesis implies that social and welfare expenses aiming to reduce income inequalities do not moderate human development, but support it.

Data for the calculations are derived from the public database of Eurostat, World Bank, International Monetary Fund, from International Financial Statistics and Government Finance Statistics (published by the International Monetary Fund) and from the Human Development Reports of the United Nations. In multiple regression analysis, backward method is used to find the optimal regression. Because of the limited available statistical data, the analysis to examine the effect of different socio-economic indicators on human

development is carried out for the period from 2000 to present. Based on the available data, the analysis to examine the effect of intra-generational income redistribution on human development can be carried out for the period 1994-2008.

Effect of socio-economic indicators

Based on the regression analysis, the effect of four predictors is proved to be significant (Table 3): poverty threshold, relative poverty gap, regional cohesion and rate of early school leavers.

Table 3 The effect of socio-economic indicators on human development
(t-values are in brackets)

<i>Predictor</i>	<i>Step 1</i>	<i>Step 2</i>
Constant	-0.274 (-2.270)	-0.358 (-4.270)
Relative poverty gap	0.040 (1.778)	0.046 (2.131)
Poverty threshold	0.069 (2.778)	0.087 (5.101)
Regional cohesion	-0.032 (-2.285)	-0.031 (-2.204)
Long term unemployment rate	-0.009 (-0.957)	-
Rate of early school leavers	-0.034 (-2.245)	-0.023 (-2.333)
F	12.508	15.507
F significance	0.000	0.000
R ²	0.839	0.827

Source: own computation

Poverty threshold – which is the 60 percent of the median equalized income in this case – can be regarded as a measure of economic growth as well, so its strong correlation with human development is not surprising. A 10 percent increase in the rate of early school leavers decreases human development by 0.2 percent. This supports the fact that the role of human capital keeps increasing in development (Besenyei 2007). The growth of regional cohesion decreases development. Human development is thus affected by monetary poverty (poverty line and relative poverty gap), knowledge level (measured by the rate of early school leavers) and labour market processes (regional cohesion) (Siposné Nándori 2011).

Effect of intra-generation income redistribution

The optimal regression analysis is carried out in two steps: with and without the inclusion of the EDUC variable. As for the significant independent variables, the two models have the same results.

The effect of income redistribution is significant in both cases. A 10 percent increase in the expenditure on social security and welfare as a share of GDP will raise human development by 0.32 percent (Siposné Nándori 2012).

**Table 4 Growth regressions for upper middle income Eastern Europe, 1990-2007
(t-values are in brackets)**

Predictor	Included predictors	
	INIT, IGOV, SOCSEC	INIT, EDUC, IGOV, SOCSEC
Constant	0.063 (4.025)	0.063 (4.025)
IGOV	-0.008 (-1.750)	-0.008 (-1.750)
INIT	0.003 (2.524)	0.003 (2.524)
SOCSEC	0.032 (3.321)	0.032 (3.321)
EDUC	...	-

... The given variable is not included

- The effect of the given variable is not significant on the dependent variable.

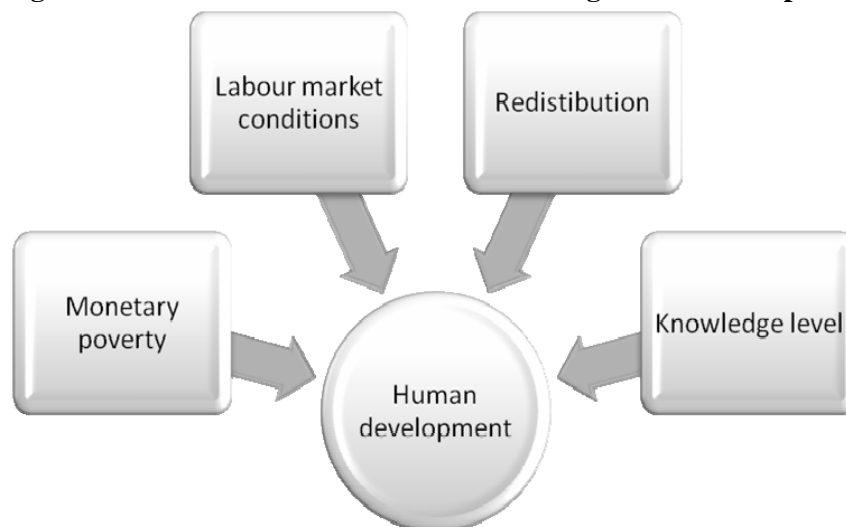
Source: own compilation

Conclusion

Human development in post-socialist countries is significantly affected by many socio-economic indicators. Besides monetary poverty, labour market conditions, intra-generational income redistribution and average knowledge level of the individuals play an important role in influencing human development (Figure 3).

In the recent global economic crisis it is crucially important to highlight that redistribution does not slow down human development. On the contrary, it promotes it. If governments of these countries try to promote economic growth, which is one of the most important aims in the recent global crisis, they have to be aware of the fact that redistribution is not against this aim. In the realization of redistribution, however, it is important to focus on poverty reduction instead of the decrease of income inequalities – like applying higher tax rates for higher income levels.

Figure 3: Socio-economic indicators influencing human development



Source: own compilation

In other words, the aim is to ensure that each member of the society can reach a minimal living standard and not to reduce the differences between the wealthiest and the poorest parts of the society. This latter would slow down human development partly directly partly indirectly through the decrease of income inequalities

In the future, the study can be extended to examine the relationship between poverty and economic growth at country level to reveal any potential differences among post-socialist countries.

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INVESTMENT POLICIES OF THE WESTERN BALKANS AS A FACTOR OF ECONOMIC DEVELOPMENT IN THE POST-CRISIS PERIOD

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ABSTRACT

For the transition countries of the Western Balkans, in conditions of insufficient domestic savings and narrowing opportunities for further borrowing from international financial institutions, the need for dynamic inflow of foreign direct investment becoming one of the key preconditions for their future economic development. The economic crisis has sharpened the competition in the international capital market and the situation is that a number of countries are competing in the global market. Under such conditions, only those countries that have attractive investment policies can pretend to serious capital inflows of foreign direct investment. Foreign direct investments are very important for countries of the Western Balkans as they enable rapid development of many fields, especially trade that brings tangible and intangible resources that also mobilize domestic factors. In this paper, the authors will attempt to estimate investment policies in the Western Balkans and the effects they have on their future economic development. It highlights those policies that have the most impact in attracting foreign investment, as well as the weaknesses of some policies applied by the economy. In the paper will be used correlation model between foreign direct investment and the measure of economic growth, using relevant foreign direct investment database. Based on the used research methodology and analysis of relevant investment policies of the Western Balkan countries, the paper will show that the Western Balkans countries need to create favorable business environment, regulate the problems of law enforcement, transparency, corruption and improve infrastructure in order to more effectively attract foreign direct investment.

Key words: investment policies, Western Balkans, foreign direct investments, economic development, post-crisis period.

JEL codes: F02, F20, F43

1. INTRODUCTION

Foreign direct investment (FDI) is recognized as a key modality of economic development of underdeveloped countries. Positive effects of FDI on export, economic growth and creating of new jobs, as well as the fact that, besides transfer of capital, these inflows also lead to transfer of intangible resources, such as technology and know-how, give FDI advantages over other sources of growth. This particularly applies to the Western Balkan countries for which, in the circumstances of economic crisis, opportunities to rely on their own finance sources or borrowing from international financial institutions are considerably limited.

Situation is similar in other transitional countries. Hence there is a keen competition for attracting FDI in the global market and legal regulations are quite liberal in all countries

aspiring to be hosts of FDI inflows. When speaking of legal regulations, labour price, incentives for attracting FDI and the like, they are becoming more or less the same in most transitional economies. Therefore, in the future period the vital factors for attracting FDI will be macroeconomic stability and functioning of the legal system and institutions. Advantages of transitional countries for attracting FDI in relation to the countries which have already joined the EU are lower labour costs and government measures for boosting foreign investment. These measures typically include fiscal incentives, financial subsidies and building necessary infrastructure.

Whether foreign investors will invest in one country or not, depends on the level of its macroeconomic and political stability, its institutional development, market orientation and openness for foreign trade. Therefore, for Western Balkan countries to become an attractive destination for foreign investment, the preconditions are credible monetary and fiscal policies, creating favorable business environment with competitive local market and anti-monopoly regulations, transparent legal system, implementation of laws, protection of proprietary rights, reducing corruption, improving infrastructure and continuing efforts towards the European integrations.

2. LITERATURE REVIEW

Effects of FDI on gross domestic product (GDP) and imports are frequently analyzed. Much research has been published on this topic, so Yan (2011) showed on the example of Nepal that the relationship between FDI and GDP cannot be described as direct linear or log-linear relationship, but that analysis of impact must be based on the secondary analyses which separately cannot produce genuine insight into this relationship. However, the summarized results can provide appropriate picture of the interdependence of these variables.

Furthermore, in his paper Gligorić (2013) confirmed the high positive correlation between FDI levels *per capita* and the levels of foreign trade in CEE countries in the period from 1995 to 2003. In addition, results of the empirical analysis indicate that FDI inflows represent a possibility for developing countries to improve their exports structure. It is mentioned that certain CEE countries which were in the first phases of transition led by domestic demand and were manufacturing clothes and furniture recorded later a notable FDI inflow and the largest growth in exports of components and parts of higher value added for further production.

Shawa and Shen (2013) examine the impact of FDI and GDP on the export in Tanzania, in the period from 1980 to 2012. By applying the classical VAR model, they came to the conclusion that there is significant causal link between FDI and exports, whereas the causality between FDI and GDP is not found. This result shows that by attracting FDI it is possible to influence increase in exports, whereby it is mentioned that Tanzania is a developing country, which should be taken into consideration when interpreting these results.

Liu, Burrige and Sinclair (2002) examined on the example of China the relations between FDI, GDP and trade. They used multivariable VECM (*vector error correction model*) tests of causality. It proved that there are strong two-way causal links between FDI, GDP and exports, whereas the feedback causality from exports was much weaker.

Sandalcilar and Altiner (2012) examine the relationship between FDI and GDP in ECO region through panel analysis. They applied the unit root, co-integration and causality tests in case

of panel analysis and found, as a result, that the effects of FDI inflows on the economic growth cannot be ignored in the countries which got independence in the 1990s.

Mercan and Yergin (2013) conducted an empirical analysis of the effects of FDI, exports and economic growth on the example of Turkey in the period from 1991:Q4 to 2013:Q1. Their research showed that there is a notable positive impact of FDI and exports on GDP, while only FDI separately influence GDP much less than exports.

In the above examples, it can be seen that the variables were observed separately or within the panel. However, the results obtained are different. Thus, results of some papers showed that the variables had considerable effects on each other, whereas the results of some other researches did not show significant impact. If positive causality between these variables is established, it means that it is possible to influence the economic growth of a country or a region by improving investment policies.

3. FDI AS A FACTOR OF ECONOMIC DEVELOPMENT IN WESTERN BALKAN COUNTRIES

For small, open economies, without adequate sources of domestic savings, the importance of attracting FDI becomes one of key preconditions for future economic growth. This is particularly important for transitional countries of the Western Balkans which are aspiring to become members of the EU. Accession process itself brings additional costs of catching up, because these countries started the transition process relatively late, facing greater difficulties than successful transitional economies. Knowledge and technology transfer that occurs through investment processes is equally important as capital transfer.

Low rate of domestic (private) savings is indicated as a reason for low investment rates in these countries as they all record high current account deficits. Therefore, their need for attracting foreign investment is obvious as they have no chance for growth without investment. Another reason lies in the expectations that investors will increase average productivity of the economic activity, which will in turn boost new investment opportunities. Even in the countries which do not have the same levels of current account deficits, those with higher share of FDI will record higher investment rates.

Based on the conducted research, it can be concluded that there is a strong correlation between the pace of economic growth and FDI inflows. Mutual interdependence of the pace of economic growth and FDI inflows is reflected so that direct inflow of capital either stimulates economic growth and transformation or responds to the opportunities resulting from the economic growth and progress of transformation. Economic growth can come as a consequence of foreign investment through additional investment of funds or transfer of technology, managerial and organizational skills, as well as through better access to export markets. On the other hand, foreign investors respond positively to the consolidated market economy regulations and continuation of economic growth.

Effects of FDI can also result in increase in employment and exports. There are several empirical researches which prove the high positive correlation between the level of FDI *per capita* and the level of foreign exchange. In the observed region, as in all other parts worldwide, FDI inflows and foreign exchange are complementary. Furthermore, numerous researches show that inflows of foreign investment represent an opportunity for the developing countries to improve their exports structure.

The overall effects of FDI on the local economy and its potential for economic growth can vary, depending on the capability of local companies and economic policy measures of the FDI recipient country. If foreign investors invest in the markets with technologically and financially weak local companies and with possibilities for differentiation of products and achieving effects of the economies of scale, there is a very high likelihood that companies with foreign capital may create a monopoly. This may lead to creating dual economic structure where foreign-owned companies compete with small local firms, which considerably weakens the resilience of domestic economy to the market cycles and changes in foreign-owned companies.

If the country's economic authorities conduct the competition policy based on liberalization of external flows, efficient anti-monopoly legislation and reducing market entry barriers and if they take a strategic approach towards FDI which implies their sectoral targeting and limitation of their entry into certain sectors, then it may be expected that presence of foreign capital in the local market will have positive effects on local firms. Increased competitiveness of local firms means that technological gap between these companies and companies with foreign capital is closing, which may lead to reduction in demand for products of foreign-owned companies, thus increasing the motivations of these companies for technology transfer. Transfer of advanced technology offers a possibility for appearance of technological externalities. (Nedeljković, 2003, page 95).

Many research papers came to conclusion that FDI had a significant contribution to the economic growth of CEE transitional economies, much greater than in developed and developing countries. If we take a look at the graph on Figure 1 (right), it can be seen that much more foreign investment went to transitional countries in comparison to the Western Balkan countries. It results from certain features of transitional economies which are primarily manifested in an opportunity for increasing productivity at the beginning of transition (due to initial inefficiency of usage of resources) and in the fact that this region had fairly developed human capital, whereas managing the existing physical capital was initially poor. Through combined action, these two factors allowed foreign investors to achieve fast growth in productivity by implementing modern management, new production and new capital (Kovačević, 2004, pages 436-437). Figure 1 (left) shows how the trend of foreign investment inflows is decreasing due to the consequences of the global financial crisis. This is yet evidence that Western Balkan countries must constantly strive to improve their investment policies, because any external shock may largely disturb the positive trend of FDI inflow.

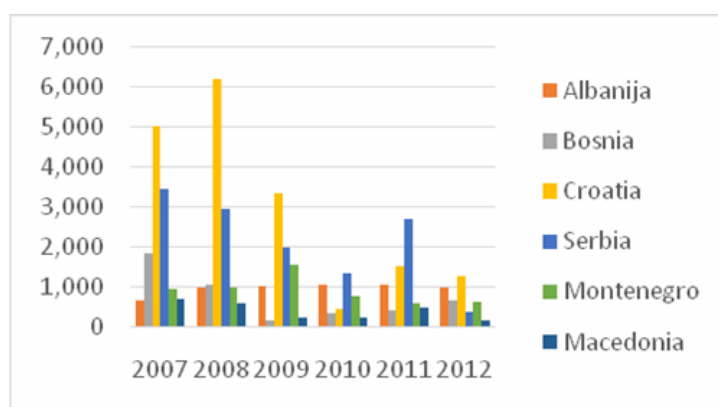
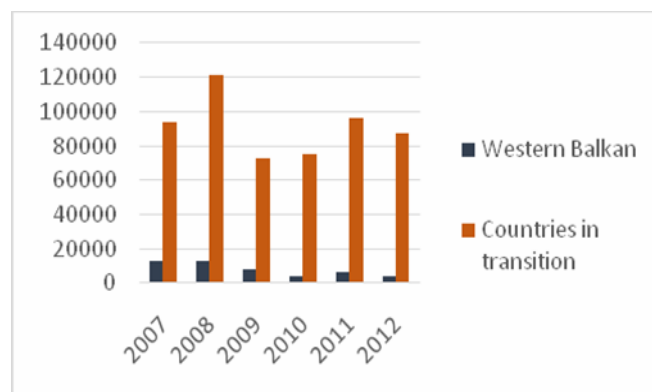


Figure 1. FDI inflow in the Western Balkan countries, in the period from 2007 to 2012



Source. The World Bank database 2013

According to last World Bank data projections (Vincelette, 2014), countries of Western Balkan have slow road to recovery. For future development these countries need to be driven by exports, need to have positive near-term outlook and need to provide macroeconomic stability and structural reforms. These elements together are key to sustaining growth of these countries. Recession in Western Balkans finally ended in 2013 on the back of the Euro Area recovery. Economies have recovered thanks to pick up in external demand, combined goods exports grew over 16 percent in 2013. Current account balances is narrowed. Exports strengthened and imports fell, contributing to trade rebalancing. External debt is remained high. Also, domestic demand was still very weak. Concerning labour market, outcomes are remained poor. Albeit falling, unemployment is still stubbornly high especially among vulnerable groups. However, for improvement of productivity and competitiveness for growth, these countries need to require structural reforms across the board – improve investment climate and labor market.

4. THE METHODOLOGY DESCRIPTION AND ACHIEVED RESULTS

Subject of the research in this paper is analysis of mutual correlation between FDI, GDP and exports in Western Balkan countries. The authors included the following six countries into Western Balkan countries: Serbia, Croatia, Montenegro, Bosnia, Macedonia and Albania. The observed time frame covers the period from 2002 to 2012. Values of these variables represent the summed up values for the above-mentioned countries, on annual level.

Examining the causal links was conducted by means of the basic econometric tools. The authors used the vector auto regression system (VAR) to explain the dynamic links among the observed three variables, through the following three steps.

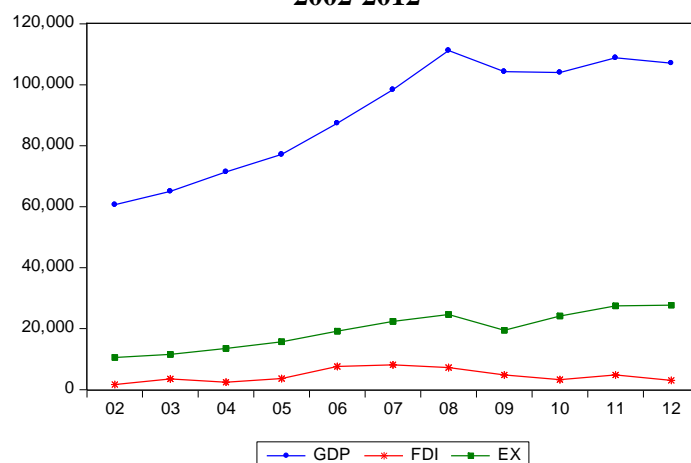
The first step included examining stationarity of the time series. In other words, the authors checked whether each of the series separately has a unit root. The trend or stationarity shows that the series, observed in the long term, fluctuates around the line of deterministic trend or around its mean value, while non-stationarity means that the series tends to fluctuate far from the initial value with indefinite variance. Testing of stationarity is conducted by Dickey-Fuller test. Adequate null hypothesis claims that the series has a unit root.

If the above-mentioned test shows that series are of the same level of integration, long-term relationship of these series is checked. By testing the co-integration, it is established whether the linear combination of series with the same integration level is in the long run stationary. In such case the series are considered to be co-integrated. For those purposes, the authors used the Johansen Co-Integration Test.

As a final test, the authors applied the Granger Causality Test. This test provided information whether two or more variables mutually affect each other, whereby the test result shows whether such causality is unilateral or multilateral. When appropriate number of steps is chosen, the Granger Causality Test gives answer to the question whether by means of the previous values of one variable is possible to describe the other variable and vice versa or, respectively, whether the coefficients with previous values of the relevant variable are statistically significant. Null hypothesis of this test is that there is no Granger causality.

The first graph shows dynamics of movements of the three observed variables: GDP, FDI and exports for Western Balkan countries.

Graph 1: Dynamics of GDP, FDI and export in the Western Balkan countries, in the period 2002-2012



Source. UNCTAD database.

A large number of macroeconomic time series have unit root, that is, represent non-stationary series. It is for this reason that the authors used as the first test the Unit Root Test. At the same time, the order of integration of the observed series will be checked, which will be used later by the authors when checking the co-integration of the series. The result obtained through ADF test is given in the Table below.

Table 1. Stationarity (unit root) test (ADF)

Var	t-statistics			Critical value		
	At level	1st differences	2nd differences	1%	5%	10%
GDP	1.891242	-1.652937*	-3.601767***	-2.847250	-1.988198	-1.600140
FDI	-0.457749	-2.522498**	-3.135757***			
EX	1.531089	-2.502736**	-3.363157***			

Note: *, **, *** denote rejection of unit root at the 10%, 5%, 1% levels of sign. respectively.

Source. The results of author's research

Based on the results, the authors were able to conclude that none of the series is stationary at the level, while at the test significance threshold of 10% all series are stationary on the first differences. At the significance threshold of 1%, the hypothesis of presence of the unit root in other differences is rejected. Considering that for other series the hypothesis of unit root presence in the first differences can be rejected, the authors proceeded with the Johansen-Juselius Co-Integration Test.

Table 2. Johansen co-integration test

Series: GDP, FDI				
Hypothesized No. of CE(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob.
None	0.529183	9.767058	15.49471	0.2991
At most 1	0.282473	2.987508	3.841466	0.0839
Hypothesized No. of CE(s)	Eigenvalue	Max-Eigen Statistic	0.05 Critical Value	Prob.
None	0.529183	6.779550	14.26460	0.5515
At most 1	0.282473	2.987508	3.841466	0.0839

Note: Trace and Max-eigenvalue test indicates no cointegration at the 0.05 level

Source. The results of author's research

The Co-Integration Test applied to the series of GDP and FDI showed, as a result, that there is no co-integration, that is, at the significance threshold of 5% both Trace and Max-Eigenvalue statistics reject presence of co-integration equation. Observing the FDI and EX series also shows that there is no co-integration.

Table 3. Johansen co-integration test

Series: FDI, EX				
Hypothesized No. of CE(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob.
None	0.385115	4.632836	15.49471	0.8465
At most 1	0.028039	0.255953	3.841466	0.6129
Hypothesized No. of CE(s)	Eigenvalue	Max-Eigen Statistic	0.05 Critical Value	Prob.
None	0.385115	4.376883	14.26460	0.8176
At most 1	0.028039	0.255953	3.841466	0.6129

Note: Trace and Max-eigenvalue test indicates no cointegration at the 0.05 level

Source. The results of author's research

Table 3 contains results obtained for testing co-integration of GDP and EX variables. This case also shows that at the threshold of 5% the hypothesis of non-existence of the co-integration equation in either of the statistics cannot be rejected.

Table 4. Johansen co-integration test

Series: GDP, EX				
Hypothesized No. of CE(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob.
None	0.401948	5.831610	15.49471	0.7153
At most 1	0.125304	1.204907	3.841466	0.2723
Hypothesized No. of CE(s)	Eigenvalue	Max-Eigen Statistic	0.05 Critical Value	Prob.
None	0.401948	4.626703	14.26460	0.7880
At most 1	0.125304	1.204907	3.841466	0.2723

Note: Trace and Max-eigenvalue test indicates no cointegration at the 0.05 level

Source. The results of author's research

While the co-integration test shows long-term equilibrium relationship, the Granger Causality Test identifies short-term equilibrium relationship. Considering that by Johansen Co-Integration Test the co-integration series for the analysis of Granger causality was rejected, the authors also used the unrestricted VAR model. An optimum step defined by the information criterion is equal to 1. Results of the Granger Causality Test are given in the Table below. Probability in Table 5 represents probabilities of rejecting the mentioned hypothesis.

Table 5. Granger causality test

Hypothesis	Prob.
FDI does not Granger cause GDP	0.0255
GDP does not Granger cause FDI	0.8426
FDI does not Granger cause EX	0.1299
EX does not Granger cause FDI	0.6776
GDP does not Granger cause EX	0.0145
EX does not Granger cause GDP	0.0530

Source. The results of author's research

The Granger Causality Test leads to a conclusion that there is a significant positive impact of FDI on GDP as well as the impact of GDP on exports. Effects of FDI on GDP prove the theoretical assumptions, which mean that it is possible through FDI inflow to influence a GDP growth. The authors have also observed that probability of rejecting the hypothesis that exports does not affect GDP is equal to 0.0530 (at the significance threshold of 10%), which proves the strong correlation between exports and GDP and vice versa.

5. INVESTMENT POLICIES OF WESTERN BALKAN COUNTRIES

Taking into consideration the above-proven positive effects of FDI on economic growth, the authors find that it is important to identify certain factors which cause that some countries

are more successful than others in attracting FDI and/or have better investment policies in comparison to other countries. These factors include the market size, its dynamics, openness and structure, costs of labour, energy and raw materials, as well as macroeconomic, institutional and political stability, foreign trade liberalization and membership in trade organizations, EU integration, subsidies for attracting FDI and quality of infrastructure. This paper will underline the advantages and disadvantages of the investment policies applied by the countries of the Western Balkans, as well as any unresolved questions in the investment environment.

Western Balkan economies largely use the incentives for attracting FDI. For instance, in Croatia, Macedonia, Montenegro and Serbia these incentives are non-discriminatory and made publicly available. Furthermore, many economies have signed a large number of international investment agreements. The main purpose of those agreements is to strengthen the credibility of these countries and to create a more favorable setting for attracting investors.

With regard to promotion and investment incentives, all economies have agencies for promotion of investment with the fixed annual budget and political support. However, capacities of some of these agencies need to be strengthened. This also means that it is necessary to establish a mechanism for monitoring and assessment of effectiveness of investment promotion agencies. The most developed system of the relationship of these agencies with clients was seen in Macedonia and Serbia.

Despite ongoing efforts to improve investment climate and business environment, Western Balkan countries still face certain constraints. Thus, for instance, Albania, Croatia, Montenegro and Serbia do not have the national requirement for board of directors and for temporary employment of management in foreign companies, while in Bosnia, Croatia, Macedonia and Montenegro there is concern about complicated administrative procedures for approval of temporary workers. In Croatia and Montenegro, the procedures for obtaining work visas and permits can be too long and include the obligation to meet with the relevant representatives of the authorities.

One of the major problems still faced by foreign companies is solving the question of ownership over industrial and residential land. There are also certain restrictions concerning purchase of agricultural land, as well as for purchase of real estate for non-EU member states. Ownership over the land is more limited in Albania where non-residents and non-resident legal entities may acquire state-owned non-agricultural land, provided, however, that the value of investment is three times higher than the value of the land. In Bosnia non-resident legal entities may not own certain resources, such as natural resources, although concessions are occasionally granted. In Croatia, foreign investors may not acquire agricultural and protected areas. In addition, there are rules that prohibit construction and commercial use in the coastal zone 70m off the coastline. In Macedonia, foreign residents may not acquire agricultural land although they may conclude long-term lease agreements under reciprocity principles and under the condition that the Ministry of Justice, in cooperation with the Ministry of Agriculture and Ministry of Finance, approves such lease. In Montenegro, there are also restrictions concerning the ownership acquisition of agricultural land and bordering zones, as well as forests and cultural heritage. In Serbia non-resident legal entities may not purchase agricultural land. Furthermore, there are restrictions for purchase of real estate, especially for citizens from non-EU member countries. For example,

in Croatia, acquisition of real estate by investors coming from non-EU member countries is allowed only upon approval of the Ministry of Justice and on the reciprocity basis. In Macedonia, citizens from the countries which are not EU and OECD members may own buildings, flats and business premises only upon reciprocity basis, according to the Law on Property and Other Real Rights.

Another big problem in these countries is registration of land, cadaster and restitution. Numerous reforms have been implemented in order to simplify the procedure of property registration. There are still, however, unresolved questions related to property rights in the region. Ownership over the land remains unclear in many economies. In Albania, ownership rights often overlap and the process of restitution is hindered due to illegal construction and corruption. In Macedonia, great efforts have been made to improve the land cadasters, but there are still inconsistencies.

In addition to the above, concerning the impact of certain factors on investment climate in Western Balkan countries, foreign investors gave the lowest mark to the mechanism for handling disputes between investors and state authorities, then information availability and availability of documentation, technical obstacles and shortcomings, certification, accreditation and harmonization, administrative hindrances for trade, human capital, access to financial resources, tax policy, as well as electric power and physical infrastructure.

Although all Western Balkan economies conducted reforms with a view to attract as much FDI as possible, weaknesses in the general business climate are still hindering investment flows.

6. CONCLUSION

Western Balkan economies have made considerable progress over the past years in developing open, transparent and predictable investment policies. Many economies signed a series of international investment agreements in order to ensure predictability and safety for investors. All economies have established investment promotion agencies with fixed annual budget and political support. Foreign investors actively participated in the process of privatization of companies in these countries; however, due to the onset of the economic crisis, most of these processes are stagnating or lagging behind. In the past few years, Western Balkan economies have achieved great progress in capacity building for implementation of tax policy, regular forecasts of aggregate tax revenues and supervision of public revenues and expenditures.

Although all Western Balkan economies carried out reforms in order to attract FDI, there are still weaknesses in the general business climate that are hindering investment flows. The obstacles for creating the competitive business environment in this region are corruption, insecurity and unpredictability of the legal and regulatory framework. In addition, a great problem lies in non-transparency and absence of necessary employment skills in these countries. Most companies find that available infrastructure in the region lacks competitive advantage. Furthermore, in terms of infrastructure quality, there are enormous differences in doing business in the major cities as compared to smaller towns outside the capitals.

Only those policies which are sustainable and which have long-lasting effects on the economy of a certain country contributed to the growth in FDI, whereas one-off incentives increased inflow of foreign investment only in the short run. To conclude, architects of investment policies in these countries should work on improving infrastructure, legislation, transparency, reducing bureaucracy and fighting corruption. It has been proved that the existing inflow of FDI in the observed countries was not sufficient to boost economy, solve economic problems and increase the living standard. For Western Balkan economies it is necessary to create more favorable business environment in order to ensure better positioning of these countries on the map of foreign investors.

By founding investment promotion agencies, all Western Balkan countries have institutionalized their aspirations towards attracting foreign investment. All the observed countries, except Croatia, have decided to attract foreign investment through tax incentives. Various measures and reforms have been undertaken in these economies in order to make business environment more attractive for foreign investors. The laws governing this area and intended for facilitating the procedures for investors, as well as protection of their rights have been adopted. On the other hand, the laws and regulations were not efficiently implemented. Western Balkan countries are still characterized by weak infrastructure, inefficient implementation of law, non-transparency and presence of corruption, which proved to be a considerable disadvantage of the region in the attempts to attract the limited investment resources and which will undeniably affect the sustainable economic development of these countries even after the global economic crisis.

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SME, Quantitative Measurements Session

SOME QUANTITATIVE ASSESSMENTS ON THE ROLE OF CREATIVE INDUSTRIES IN EAST AND SOUTH EASTERN EUROPE- THE KEY TOWARD SUSTAINABLE KNOWLEDGE ECONOMIES

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(Prized student paper of the 3rd ASECU-Youth International Conference, July 2013, Kotor Montenegro)

ABSTRACT

Nowadays, the roles of creative industries are increasingly important for the knowledge-based economy as it produce knowledge, cultural goods with very high export value. Obviously, those countries in East and South Eastern Europe should explore the potentials of creativity as a new, major driver of competitiveness in the new economic era. In fact, studies regarding the emerging creative industries in this region have been developing since the beginning of the 2000s. The result of the increasing awareness on the importance of the Creative Industries for the development of their economies has grasped so much attention from policy makers and key players to build a healthy and substantial Creative Economy. In conclusion, the impact of the creative industries on the base of the Knowledge Economy is so clear, thus, the quantitative assessment on the role of creative industries is a key foundation for policy outcome toward the sustainable Knowledge Economy. Therefore, the research paper aims to use the quantitative method- statistics with software SPSS to produce the essential assessment for the development of Knowledge Economy in East and South Eastern Europe.

Key words: creative industries, the substantial Knowledge Economy, Creative Economy, the quantitative method.

1. Introduction

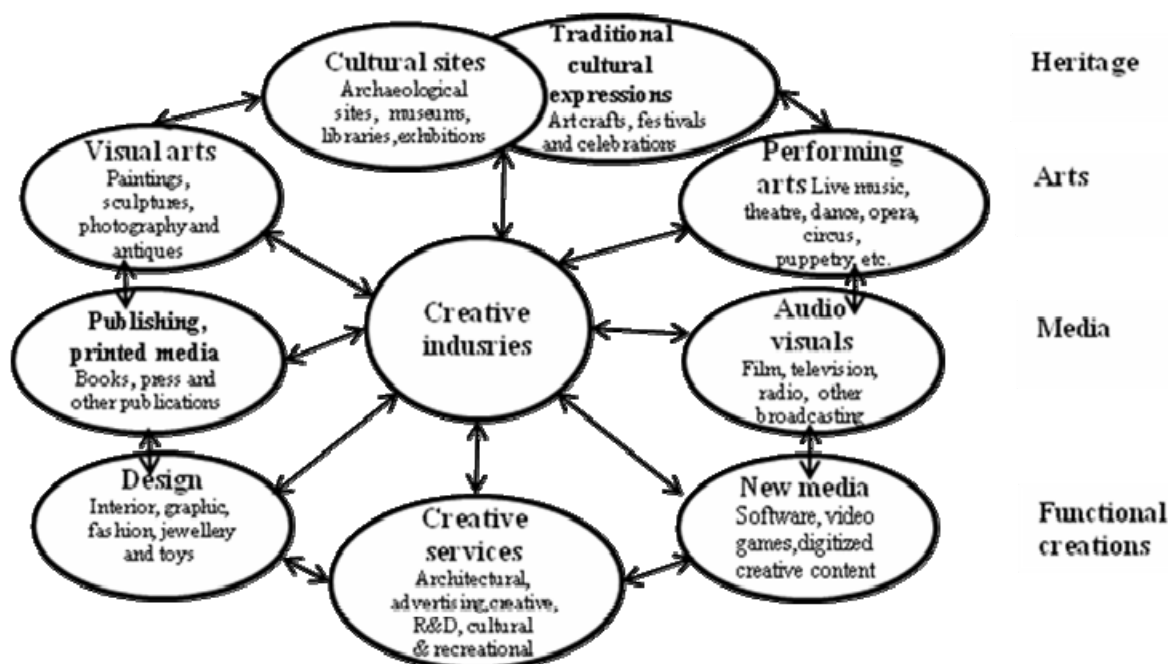
The role of creativity and of creative people in the knowledge economy is gaining increasing attention. Moreover, data gathered by various agencies in the countries from East and South Eastern Europa (EE and SEE) suggests that sectors which produce symbolic and provide employment to a growing number of people (European Commission, 2009). Most often these sectors called “creative industries”. My research is based on measuring contribution of creative industries to capture growing role of creativity in driving economic and social development, especially, the knowledge economy for the Eastern and South Eastern Europe countries.

The papers provide “a picture” about what these countries have made in the process of building the creative industries in 2001-2011, in addition, quantifiable contribution to the national economies. This includes how much the creative industries contribute to Gross Domestic Product (GDP); Productivity and Profitability; value of export by sector creative industries.

According to UNCTAD’s definition, the creative industries:

- are the cycles of creation, production and distribution of goods and services that use creativity and intellectual capital as primary inputs;
- constitute a set of knowledge-based activities, focused on but not limited to arts, potentially generation revenues from trade and intellectual property rights;
- comprise tangible products and intangible intellectual or artistic services with creative content, economic value and market objectives;
- stand at the crossroads of the artisan, services and industrial sectors and
- constitute a new dynamic sector in world trade.

Fig.1 Classification of creative industries in Eastern and South- Eastern European countries from UNCTAD definition



Source: UNCTAD

2. Methodology and Data

The paper proposes an approach for the measurement EE and SEE creative potential for determining its capacity to attract and develop creative human capital. We define contribution of the creative industries to national countries by indexes: value added to Gross

Domestic Product; Productivity and Profitability by Creative industries; total export value of creative goods – added to GDP:

- Value added to Gross Domestic Product (% of GDP) is the net output of creative industries after adding up all outputs and subtracting intermediated inputs. It is calculated without making deductions for depreciation of fabricated assets or depletion and degradation of natural resources.
- Productivity of creative industries is defined by the ratio which between values added and employment costs. It is considered as an average measure of the efficiency of production of the creative industries.
- Profitability of creative industries is defined as operating margin, also known as operation income margin, operating profit margin and return on sales- is the ratio of operating income divided by net sales, in percent. That is the way to look at the net profits of the business in the creative industries.

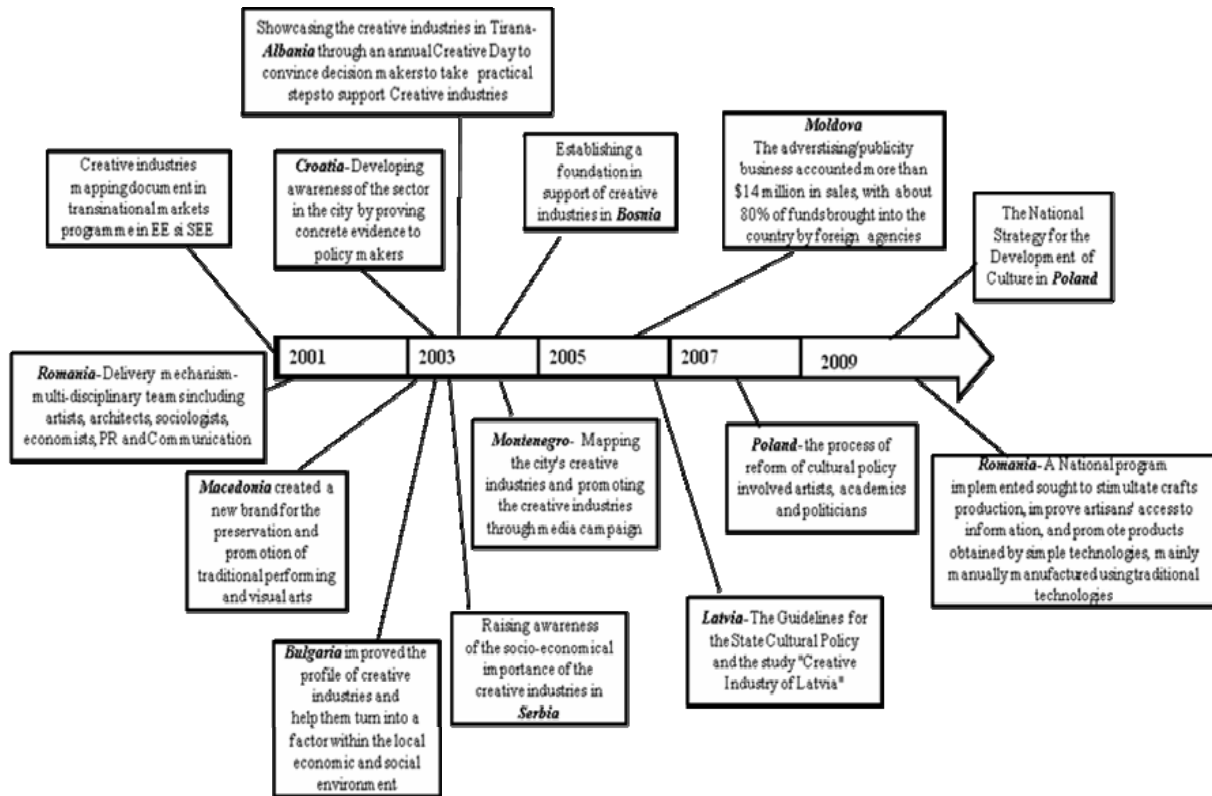
As the final steps in the analysis, looking at the relationship between how a country scores on the ECI and its recent performance or trend. To do so, developing the Euro- Creativity Matrix (apply with software SPSS). The Euro-Creativity Matrix is essentially a two-by-two chart that compares the ECI score to the Euro- Creativity Trend Index. It enables us to position the EE and SEE nations in European context and also position them in the future. The classification of the countries analyzed in four different categories: *Leaders*, which are countries with developed creative economies and with high growth rates in creative potential; *Up and Coming*, which are countries with lower European Creativity Index scores, but with higher growth rates; *Losing ground*, which are countries with relatively high European Creativity Index scores, but cannot sustain the growth of their creative capabilities; and *Laggards*, which are countries with low scores for their European Creativity Index and with low rates of creative growth.

The resulting indexes establish a quantitative base of policy makers in their efforts to prove the value of the creativity industries in EE and SEE countries.

3. Key event in the evolution of the creative industries in the countries from East and South Eastern Europe

In most EE and SEE countries, the task of developing creative industries policies has been assigned to the division of the national administration that is responsible for the protection and development of culture. The potential discovered and the increasing need to find new economic alternatives, found fertile ground in their brand new government structures for whole new policy developments. Obviously, the governments have begun to measure the size and scope of the creative industries as an important index of economic health. Studies regarding the emerging creative industries in EE and SEE countries have been developing since the beginning of the 2001s’.

Fig. 2- Key event in the evolution of the creative industries in the countries from East and South Eastern Europe 2001- 2009



Source: based on Peter Sanfey and Simone Zeh (2012), "Making sense of competitiveness indicators in South-Eastern Europe, European Bank for Reconstruction and Development

Additionally, mapping creative industries documents were developed and have been carried out in EE and SEE countries, as a result, increasing awareness on the importance of the creative industries for the development of their economics, has reached policy and key players; first step in the building of a healthy creative economy. On the other hand, yet in fact, subsequent to the mapping endeavor have brought no considerable progress, and the creative industries sector's position in the national economy is still largely undefined. Besides, the creative industries concept is very cautiously received in transitional countries. Moreover, conflation of market and consumer oriented creative industries with traditionally elitist cultural policy can create a rather conflicting mix. Therefore, it is difficult to generalize about these states of the creative industries in economies in transition.

From the reasons above, it is necessary to determine particular indexes with aim to find and resolve the problem from EE and SEE countries in process of developing the creative industries.

4. Contribution of creative industries (CI) to economy of EE and SEE countries

4.1. Value added to national GDP

Tab. 1- Value added of creative industries to national GDP in EE and SEE countries, 2003

	Value add to national GDP (%)
Bulgaria	1.2
Cyprus	0.8
Czech Republic	2.3
Greece	1.0
Hungary	1.2
Poland	1.2
Romania	1.4
Slovakia	2.0
Slovenia	2.2

Source: Economy of Culture in Europe, prepared by KEA European Affair, Turun Kauppakorkeakoulu Turku School of Economics for the European Commission, Directorate-General Education and Culture, 2006.

In terms of the respective national economies, the value added to their GDP by the creative industries is highest in Czech Republic, Slovenia, Slovakia in EE and SEE countries which all above 2.0%. Meanwhile, value added in Cyprus and Greece is lowest which under 1.0%. In comparison to other industries sectors, the creative industries contribute significantly in economies, this is particular true for the economy as Czech Republic, Slovenia, Slovakia or Romania. There are few other sectors which contribute more than 2.0 % to the national GDP.

4.2. Contribution of creative industries to other industry sectors

The effect of creative industries on other sectors has differences among those countries. In fact, Greece, CI does not effect on others. However, CI in Czech Republic's economy, has a strong influence on Food, beverages and tobacco with the high point – 2.8% and also in Poland with a highest contribution 4.7 %, besides, in Slovenia, on Chemical, man-made fabrics with 3.4%. Therefore, creative industries also have the substantial contribution to other sectors in economies of EE and SEE countries.

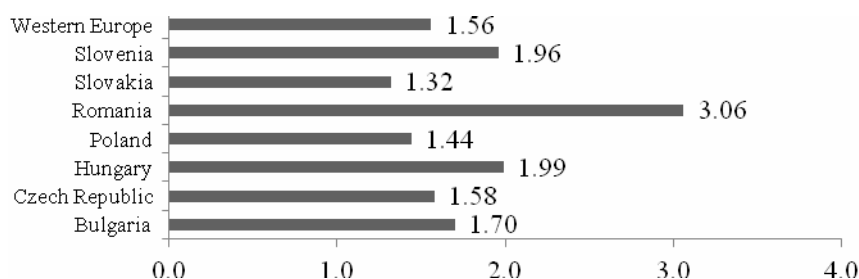
Tab. 2- Contribution of creative industries to other industry sector in SEE and EE countries 2003

	Food, beverages & tobacco	Textiles	Chemicals & man-made fabrics	Rubber & plastic	Machinery & equipment	Real estate	Computer	Cultural & creative sector
Bulgaria	2.2	2.0	1.1	0.4	1.3	0.4	0.3	1.2
Cyprus	2.7	0.4	0.5	0.3	0.2	0.0	0.6	0.8
Czech Republic	2.8	1.0	1.3	1.5	2.3	1.4	1.2	2.3
Greece	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.0
Hungary	2.9	0.0	1.9	0.9	1.2	1.8	0.8	1.2
Poland	4.7	0.8	1.4	0.9	1.2	1.3	0.6	1.2
Romania	1.9	2.1	0.8	0.5	1.0	0.5	0.5	1.4
Slovakia	1.5	0.7	0.6	0.9	1.5	0.5	0.6	2.0
Slovenia	2.0	1.3	3.4	1.4	2.2	0.4	0.8	2.2

Source: Economy of Culture in Europe, prepared by KEA European Affair, Turun Kauppakoulu Turku School of Economics for the European Commission, Directorate-General Education and Culture, 2006.

4.3. Productivity and Profitability

4.3.1 Productivity

Fig.2- Productivity of creative industries in EE and SEE countries, 2003

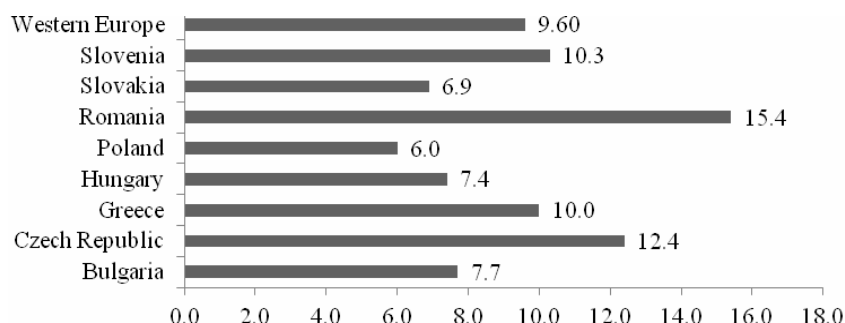
Source: Economy of Culture in Europe, the European Commission, Directorate-General Education and Culture, 2006.

From the figure above, although the value of creative industries to national GDP in Romania and Hungary and is low but these countries have high productivity, even Romania has productivity index- 3.06% which is highest in European countries in which include western countries that have creative industry development. Moreover, others in EE and SEE also have high productivity index. This demonstrates that EE and SEE, especially, Romania have potential creative industries. If these countries have the policies in developing creative industries, definitely, CI will be one of the most important in EE and SEE countries.

4.3.2. Profitability

Profitability is proportional to Productivity, thus, Romania also have highest operating margin that is not only in EE and SEE countries but also in European countries. As we can see that IC brings a high net revenue for business owners in EE and SEE countries.

Fig. 3- Profitability of creative industries in EE and SEE countries, 2003 (%)



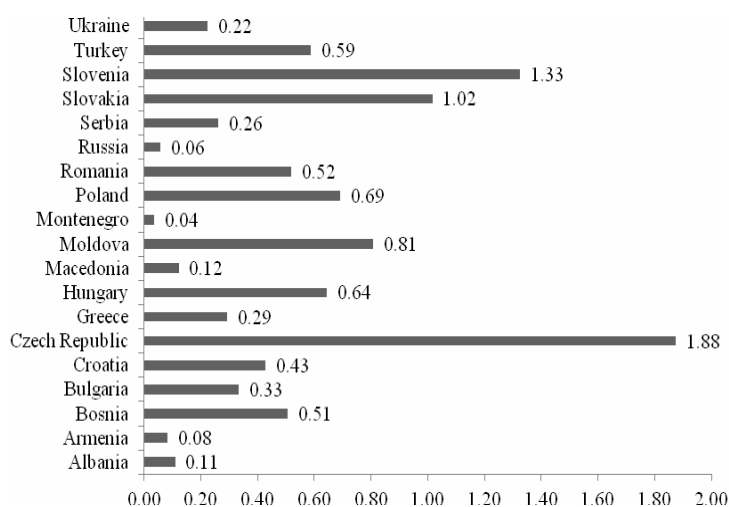
Source: Economy of Culture in Europe, the European Commission, Directorate-General Education and Culture, 2006.

4.4. Export of creative industries

In recent years, creative industries have been among the most dynamic sectors in global trading systems. The average growth rates of creative services are increasing faster than those of other more conventional services. Obviously, we can see that from figure.4 below, export of creative industries contribute significant to their GDP, the highest is 1.88% GDP in Czech Republic, Slovenia with 1.33%.

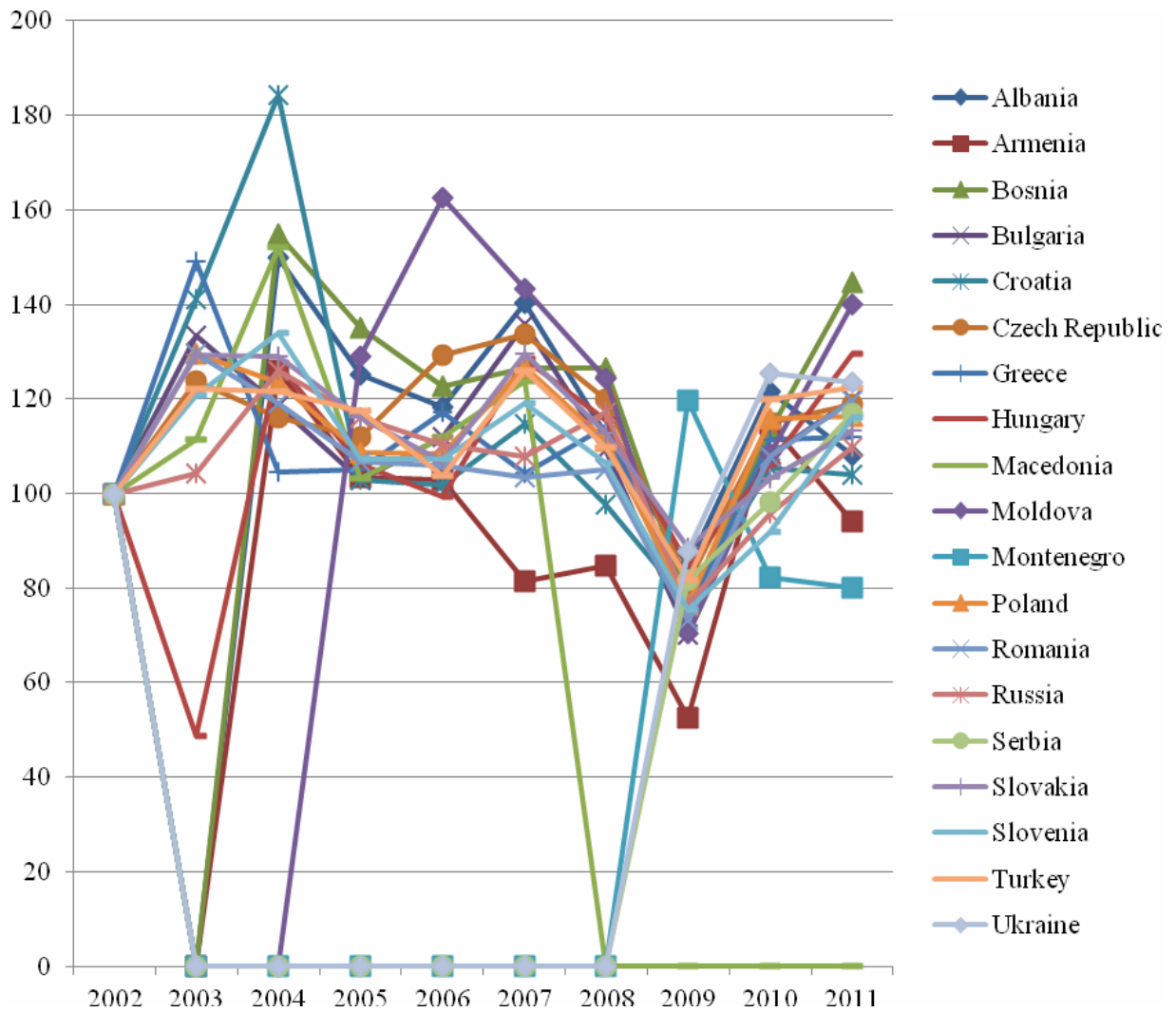
Considering with the period from 2002 to 2011, creative industries is also sensitive to the crisis period, in which, in those countries , values of creative industries in export dropped down, especially in lowest point in 2009. However, Montenegro starts measuring value of creative industries in export with low growth rate. On the other hand, in 2011, showing signs of growing again with the highest growth rate is 20% in Bosnia, Moldova and Hungary, on the contrast, Greece, Montenegro, Albania, Armenia continue declining but this is with low rate.

Fig. 4- Contribution export of creative industries to GDP (% of GDP) in EE and SEE countries, 2011.



Source: calculate based on UNCTAD available at:
<http://unctadstat.unctad.org/TableViewer/tableView.aspx?ReportId=14773>

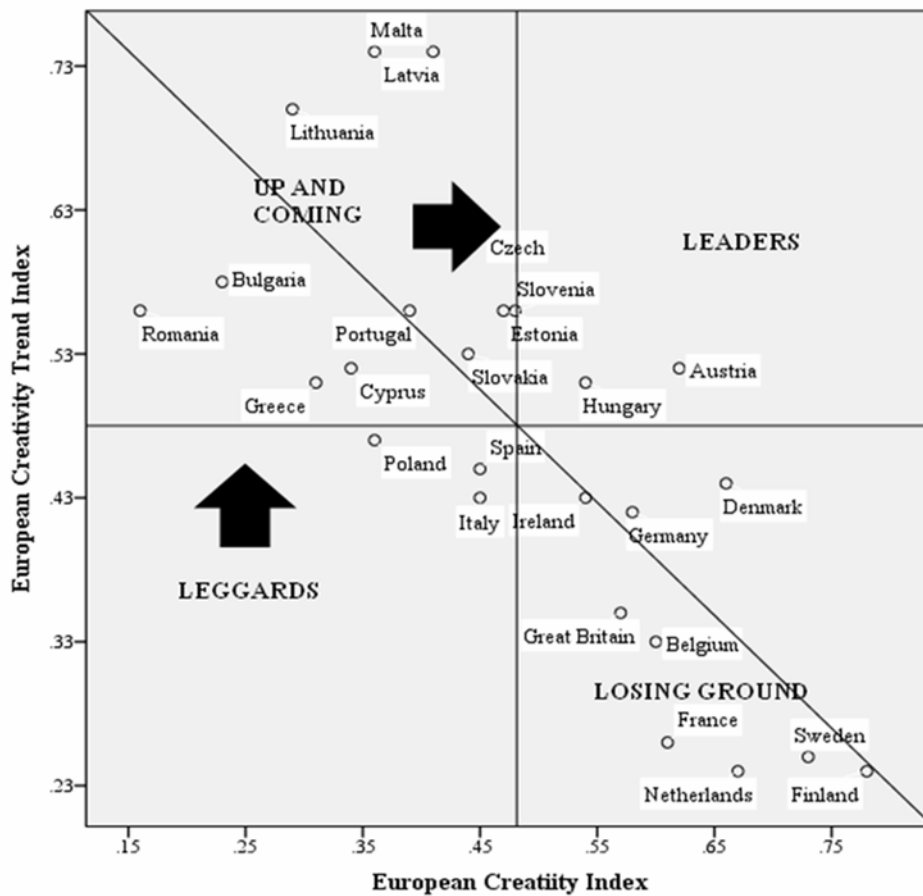
Fig. 5- Growth rate of export in EE and SEE countries by creative industries 2002-2011



Source: calculate based on UNCTAD available at:
<http://unctadstat.unctad.org/TableViewer/tableView.aspx?ReportId=14773>

5. The countries' movement in the short-run trends on the way of building creative industries

Fig. 6-The Euro- Creativity Matrix- database on 2006



Source: calculate based on “Creativity and Prosperity: The Global Creativity Index”

In the next years, EE and SEE’s position are:

- Leaders are Hungary. Their competitive position overall is as good, are proving successful and are likely continue to do well.
- Up and Comers- most EE and SEE countries in this case- have lower ECI scores but relatively high rates of creative growth. Their position is improving.
- Poland is in Lagguards, have low ECI and low rates of creative growth. Poland will find it hard to compete in the European context and also global context. It means that the nation appear to be in a difficult position.

Most nations from Western Europe are in Losing Ground- they have relatively high ECI scores but are falling to sustain growth in their creative capabilities. They are falling behind in competitive terms.

EE and SEE have a huge potential in the future in process of developing the creative industries based on advantage competitiveness with countries in Western Europe.

6. Conclusion

By promoting creative industries as major development in the region, the countries in EE and SEE have value significant of CI in economies. Especially, Romania have a potential development of CI meanwhile. Hungary, Czech Republic, Slovenia, Slovakia have high value of CI in all indexes considered. If these countries have the right policies in developing creative industries, definitely, CI will be one of the most important in EE and SEE countries. From analyzing indexes, CI have their origins in individual creativity, skills and talent and which have potential for wealth and job creation through the generation and exploitation of intellectual property. In addition, to realize this latent advantage that stems for their underlying attitudes and values, these nation will have to liberalize their policies to increase value of export in this sector. More than that, it is important to note that these countries are just beginning to develop the most rudimentary strategies to actually attract and retain talent, bolster their underlying creative capabilities and develop their people climates. Much more research is needed on the nature, extent and efficacy of these emerging efforts. Therefore, there is no doubt that at the EU level, creative industries will drive EE and SEE nations on an accelerated growth map.

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OUTSOURCING OF ACCOUNTING SERVICES AS A MECHANISM TO ENCOURAGE THE DEVELOPMENT OF SMALL AND MEDIUM-SIZED ENTERPRISES IN THE MODERN ECONOMY

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ABSTRACT

The aim of the study is to identify the role of accounting outsourcing as a mechanism for supporting the activities of small and medium-sized enterprises (as exemplified by the Polish customer, market and the attempts of its deregulation), which gives access to expertise without having to hire full-time accountants. Thus, even small entities can use complex solutions, so far available only for the richest entities with complex accounting departments and – through the acquisition of services provided by the market – to build their competitive position.

The increasing importance of services in the world economy is an economic regularity, a requirement of civilization growth in the contemporary world, particularly important in the still developing countries of Southern and Eastern Europe. Therefore, it must be emphasized that the growing role of services in national economies results directly from the development of these economies.

The present rapid transformation of the services sector results from the so-called servicizing. It has a significant impact on the growth modern services in the economy, and is the effect of the international exchange – a response to the potential of external demand. It also allows the mitigation of the recent economic crisis. Usually taking the form of outsourcing, this – although known for decades – has recently become the dominant trend in the new methods of doing business.

The essential feature of outsourcing is the ability to commission specific tasks or functions to independent, specialist companies on a permanent basis. This allows operators to change and add flexibility to its own organizational structure and aims at achieving designated economic effects in the core area of business. A popular direction of using services is outsourcing accounting services. Along with its increased accessibility (via modern data transmission systems) and popularity (wide literature on the topic), accounting outsourcing has become the *modus operandi* deployed by operators regardless of their size and profile. Entrusting accounting services to providers not only increases the speed and correctness of decisions, but also affects the efficiency of a company's own resources. With this approach, the best results are achieved using the expertise of many professionals in many fields of accounting who know the specific issues in detail.

The recent experience of the economy shows that the wrong implementation of the principles and rules of accounting and only seemingly reliable information derived from it have led to the collapse of many entities, causing the global financial crisis. This roused the need to re-verify solutions to avoid similar threats in the future. In the light of recent events, *ex post* financial statements and forecasting of future activities is becoming increasingly complex and generates the need of wider description and analysis. Only properly qualified experts can achieve this. However, due to the fact that services provided by professionals are very expensive, particularly small and medium businesses rarely can afford to employ them full time and are thus making decisions based on the purchase of appropriate services.

Keywords: accounting, outsourcing, services, financial reporting,

JEL Classification – M

Introduction

With the advent of the twenty-first century, a generally growing trend of the increasing interdependence of national economies has been noted. It results from the increasing international trade, and at the same time – the growing financial flows. This phenomenon is a derivative of globalization of the world economy within, which the concepts of liberalization, integration and interdependence¹¹⁹ are emphasized in particular, as they have a significant impact on the transnational labor market, the products and services, as well as the transnational financial market. They are promoted by the open access to knowledge and cutting-edge technologies for all market participants. Simultaneously, expectations regarding ways to describe economic reality are becoming more demanding, which is reflected in the financial statements presented by business entities, prepared based on rules of accounting.

For the reliability of information coming from the market, the correct quantification of the manifestations of economic life is of undoubted importance. With accounting, it has been possible to quantify the transition from *in the number and rank* to *value*.¹²⁰ Quantification leads to an effective management of carefully calculated assets¹²¹ and their representation in reliable reports. Thus, it is expected from accounting to present the actual image of business entities. It should be noted, however, that it is not the rules of accounting themselves, but the people with relevant knowledge, competence and ethics that are essential to ensure proper achievement of accounting tasks.

The aim of the study is to identify the role of outsourcing accounting services as a mechanism for supporting the activities of enterprises, which gives access to specialist knowledge and experience offered by service providers without having to hire full-time accountants.

1. Outsourcing in the contemporary economy

The effect of direction adopted by the economy is the constantly increasing share of the services sector in the income of individual countries. As noted by D. Minoli, the result of the commodification of transactions are the parameters related to the frequency of their making and the specificity of assets used.¹²² It is widely claimed that the use of services provided by specialized entities can not only significantly reduce costs for businesses and help them

¹¹⁹ G. Kołodko, *Wędrujący świat*, Prószyński i Sk-a, Warszawa 2008, p. 98.

¹²⁰ B. Micherda, M. Szulc, *Współczesne uwarunkowania kwantyfikacji w rachunkowości*, "Zeszyty Naukowe PTE", No. 12, Krakow 2012, p. 253 – 254.

¹²¹ T.A. Lee, *Financial Reporting & Corporate Governance*, John Wiley& Sons, Inc., England 2006, p. 60.

¹²² D. Minoli, *Analyzing Outsourcing. Reengineering Information and Communication Systems*, McGraw- Hill, New York 2003, p. 28 – 29.

focus on their core activities, but also to raise quality.¹²³ This also affects changes in the structure of employment, production and consumption.

The development of the services sector is an important indicator for measuring the manifestations of globalization and it frequently is the essence of competitive advantage. This is especially important in the wake of the constant – as indicated – increase in employment in this sector. It should also be emphasized that the roles both of Poland and Romania in the international arena in the business services industry have continued to grow, as individual cities are becoming the world leaders.

Therefore, it follows that today's rapid transformations of the services sector are the result of the so-called servicizing. It has a significant impact on the growth of the role of new services in the economy, which is a derivative of their international exchange arising as a response to the potential of external demand. It is also the result of the ICT revolution which enables the transport of services abroad and subjecting them to international trade, affecting the development of the sector¹²⁴ by increasing the capacity of commercial services.¹²⁵ It also allows for the mitigation of the recent economic crisis.

Provision of services is the most common form of the so-called outsourcing, which – although known for decades – has recently become the dominant trend in doing business.

According to the definition adopted by the Basel Committee on Banking Supervision outsourcing is a regulated firm's use of a third party (either an affiliated entity within the same group or an external entity) to perform activities on a continuing basis.¹²⁶ Outsourcing is, therefore, a tool that serves the use of foreign specialized resources offered by outsourcing partners for the implementation of offshored tasks and objectives of the company. Thus, the use of the idea of core competencies affects the entity's own strengths, while the less implemented functions are outsourced to outside entities specializing in their areas.¹²⁷

The demand reported by market participants has affected the rise of several models of outsourcing, which enables entities to either fully or selectively outsource their functions.

Among the basic forms of outsourcing, the following should be mentioned:

¹²³K. Świetla, "Usługi rachunkowo- księgowo w świetle obowiązujących regulacji oraz oczekiwań ich odbiorców" [in:] *Stabilność System finansowego warunkiem rozwoju gospodarczego*, Vol. II, S. Owsiak, Ed. Bielsko – Biała 2012, p. 194-205.

¹²⁴A. Szymaniak, K. Pniewski, *Globalizacja usług. Outsourcing, offshoring i shared services center*, Wydawnictwa Akademickie i Profesjonalne, Warszawa 2008, p. 7.

¹²⁵A. Masłowski, *Nowe formy usług opartych na wiedzy*, Handel Wewnętrzny 2005, p. 19.

¹²⁶ *Outsourcing In Financial Services*, The Joint Forum, Basel Committee on Banking Supervision, Bank For International Settlements, February 2005, p. 4.

¹²⁷ J. B. Quinn, *Strategic Outsourcing: Leveraging Knowledge Capabilities*, "Sloan Management Review" 1999, p. 12.

Table 1. Chosen types of outsourcing

Form	Rules of operation
Participation in benefits	founding an entity – a supplier creates a joint venture together with the customer or expands an existing entity in order to provide services,
Co-sourcing	a strict form of cooperation between the customer and the contractor, consisting in the fact that outsourcing activities are performed by the customer's employees under the direction of the contractor,
Netsourcing	concerns the exercise of internet services – as part of the service, an entity uses a different entity's server and uses applications contained therein,
Inter-sourcing	associated with the establishment, by several customers, of a new entity whose main task is to collect information and data using specialized knowledge,
Insourcing	improvement of a specific activity of an entity, by creating a specialized business unit and the provision of services to its own subsidiaries and other companies,
Outsourcing functions	transferring a selected cell in an entity's own demand chain to another entity, usually regarding simple ancillary services (e.g. cleaning, snow removal).

Source: K. Świetla, K. Derylak, Outsourcing usług księgowych we współczesnej gospodarce na przykładzie Polski, in print.

An essential feature of outsourcing is the ability to commission specific tasks or functions on a permanent basis to independent, specialist companies. The increasing versatility of logistic units and the use of the latest technologies are a key premise of the development of the services market.¹²⁸ This allows business entities who use it to change and improve the flexibility of their own organizational structures and aims at achieving a designated economic effect in the core area of the business.

With the dissemination of modern technology, relocation of services and data transmission is moved mainly in three ways: to national, unrelated entities providing specialized services that support mostly the small and medium-sized businesses; to subsidiaries created for this particular purpose, located abroad; and to unrelated foreign entities.¹²⁹ Such activities encourage new forms of cooperation, chiefly characterized by:

- quickly and frequently concluded strategic alliances and associations, independent of national borders and the range of markets or sectors of the economy, forming networks,
- networks consisting of increasingly smaller entities focusing basic skills conducive to gaining a competitive advantage under certain circumstances (the organization arises as a result of the externalization of processes that can be performed better and cheaper by an external entity).¹³⁰

¹²⁸ P. A. Trunick, *Outsourcing: "A Single Source for Many Talents"*, *Transportation & Distribution*, July 2005, p. 20.

¹²⁹ Mclvor R., *Global Services Outsourcing*, Cambridge, UK 2010, p. 149.

¹³⁰ W. M. Grudzewski, I. Hejduk, "Kierunki rozwoju zarządzania a globalizacja", *Ekonomika i Organizacja Przedsiębiorstw*, January 2002, p.7.

2. Outsourcing in the economies of Romania and Poland

The growth of the importance of services in the world economy is an economic regularity and a condition for the progress of civilization in the modern world, particularly important in the still developing countries of Southern and Eastern Europe.

Nowadays, Central, Eastern and South Europe is well-established as a world-class destination for Shared Services Centers and Business Process Offshoring investment. With Poland as the strongest location in the region, other countries such as Romania, Czech Republic and the Baltics are important investment destinations. These countries have become important locations for business services on a global scale in recent years. Today, there are approximately 1,000 service centers with foreign capital in the region, especially from the countries in Western Europe and the USA. A positive evaluation of the market promotes the growth of employment in this sector, which is estimated at about 300,000. These estimates, however, are quickly becoming outdated, because, due to the relatively low cost of creating jobs in the industry, employment continues to grow.

It should be emphasized that in the context of business process outsourcing, the knowledge and skills of, among others, Polish specialists are becoming more widely used.¹³¹ Although globally Poland is not yet able to match up to the global giants such as India and China, which have far greater labor markets, it has a large economic potential¹³² which, according to statistical data analysis¹³³ allows one to assign the dominant role in Central and Eastern Europe to Poland, as well as prognose an optimistic outlook for the future. Particular importance is placed on Krakow, listed at number 10 among locations from around the world in the Tholons report,¹³⁴ with Warsaw on the 36th position.

The situation is similar in Romania, where the business services sector currently employs ca. 30,000, placing this country on the 4th position in the region of Central and Eastern Europe in terms of employment.¹³⁵ Romania is also seen as one of the most attractive emerging investment markets in Europe (Bucharest plays an especially important role, being recognized as the 44th location in the aforementioned Tholons list). Also, the International Monetary Fund forecasts indicate the high expectations to the country's GDP growth in the coming years. In particular, the excellent prospects of Romania in the field of development in the already indicated area of business services are stressed.¹³⁶ It should also be noted that business service investors see Romania, just like Bulgaria, as slightly cheaper than Poland. The more expensive countries include the Czech Republic, Slovakia and Hungary.

¹³¹According to the ABSL 2013 report, Krakow is characterized by the highest employment in foreign service centers that employ just over 25,000, representing 23% of all BSC employees in Poland. Modern Business Services Sector in Poland, the Business Services Sector In Poland, ABSL 2013. *Nowoczesnych Usług Biznesowych w Polsce, Business Services Sector In Poland*, ABSL 2013.

¹³² *Bilans Kompetencji Branż BPO i ITO w Krakowie*, Centrum Ewaluacji i Analiz Polityk Publicznych, Jagiellonian University 2012.

¹³³ *Sektor Nowoczesnych Usług Biznesowych w Polsce, Business Services Sector In Poland*, ABSL 2013.

¹³⁴ *2013 Top 100 Outsourcing Destinations, Rankings and Report Overview*, www.tholons.com

¹³⁵ <http://www.adhugger.net/2013/10/08/absl-romania-strategic-partnership-to-sustain-business-services-sectors-long-term-development/>

¹³⁶ <http://www.outsourcingportal.pl/pl/outsourcing/wiadomosci/rusza-absl-w-rumunii.html#sthash.VPdaNOJO.dpuf>

Because, over time, the competence and experience of service providers increase, this has led the present Polish services sector to move towards more and more advanced projects based on knowledge and innovation. At the same time, the global investment market of the services sector in Romania is starting to play a complementary role for Poland, complementing the Polish offer. It should also be stressed that Romania, which joined the world competition later than Poland, is following the Polish experience and is currently at the stage where companies in Poland were about 3 years ago. However, the question of overcoming this distance is within a horizon shorter than the specified time, as the activities carried out in this respect by the Romanian providers are very effective, especially in the field of accounting. This is because, according to T.R. Weinrich, C.G. Avery and H.R. Anderson, accounting is global (universal system), international (methodology and standards) and is used in the context of corporate practices which are active in at least two countries¹³⁷ though the author believes that GDP is also not irrelevant, as are flows of services within one country. This approach allows for the separation of the operator and the activities from the location of its accounting processes.

At the same time, as is clear from the experience of the economy in recent years, poor implementation of the rules of accounting, and only seemingly reliable information derived from it, have led to the collapse of many entities – both large as their smaller cooperators (the domino effect) – causing the global financial crisis. This resulted in the need to re-verify solutions to avoid similar threats in the future.

In the light of recent events, both ex post financial statements and the forecasting of future activities are becoming more and more complex and generating the need of their wider recognition and analysis. Only properly qualified experts can stand up to such tasks. However, due to the fact that services provided by professionals are very expensive, businesses – particularly small and medium ones – most often cannot afford to employ them on-time and thus decide to purchase appropriate services.

3. Outsourcing accounting for small and medium-sized enterprises

Knowledge and experience of outsourcers have a direct bearing on the functioning of economic entities. The use of outsourcing by large companies and the accessibility of the Internet, the increasingly lower costs and greater safety are contributing to the ability to access external services for smaller traders. They follow the example of large companies and, despite the narrower scale of their operations; they successfully implement the already proven solutions.

It is being widely recognized that, especially in the field of accounting services, they are purchased not only by large corporations but have also become available to small and medium-sized entities. Their goal is the same as in the case of large corporations – namely, the reproduction of capital. As K. Fabiańska K. and J. Rokita declare, the market economy connects the proper functioning of the organization to the necessity of its development¹³⁸

¹³⁷ T.R. Weinrich, C.G. Avery, H.R. Anderson, *International Accounting, Varying Definitions*, New York 1971, p. 65.

¹³⁸ K. Fabiańska, J. Rokita, *Planowanie rozwoju przedsiębiorstwa*, AE, Katowice 1984, p. 65.

that is promoted by the concept of divestment.¹³⁹ At the same time, even small entities can use complex solutions so far only available to the richest organizations with complex accounting departments, and build their competitive positions through the purchase of services provided by the market.

Due to the constant evolution of solutions to reflect the economic situation of the phenomena occurring, outsourcing has become a popular direction of using accounting services. In principle, it aims to improve the implementation of a delegated process, allowing for savings by reducing the employment while increasing the quality of the accounting processes for their greater efficiency.¹⁴⁰ It also allows the management to focus on the core business and reduce operational risks arising from managing a separate process.¹⁴¹

With the increased accessibility (use of modern data transmission systems) and the popularization of outsourcing (numerous publications approximating the issue), accounting outsourcing has become the modus operandi deployed by market operators regardless of their size and business profile. Factors determining the decision to outsource accounting functions include the size and complexity of transactions (including the complexity of the circulation of documents), along with the range of the financial reporting prepared and presented.

This is important especially in the case of complicated functions that may occur in the accounting of a particular company, its structure, scope of the circulation of documents, disclosure requirements, etc. The proper implementation of the organization's plans in this area may take place increasingly often, through the use of knowledge and competence of senior professionals, who could not be hired full-time due to the high cost¹⁴² and the need for modern equipment and software. As a result, a purchase of professional services improves the quality of information derived from accounting.¹⁴³ It can be said that outsourcing is being treated as a strategic objective of the organization.¹⁴⁴

To summarize, the outsourcing of accounting favors:

- refining the procedures for the circulation of documents,
- implementation of financial and accounting records, facilitating the speed of data processing,
- cost savings (e.g. reduction in employment staff, need to purchase expensive hardware and software),

¹³⁹The process of releasing the entity subordinate components in order to focus on potentially profitable lines of action, see: F. A. Lovejoy, *Divestment for Profit*, Financial Executives Research Foundation, New York 1971 p.3, M. L. Taylor, *Divesting Business Units*, Lexington Books, Toronto 1988, p. 65, H. Lewandowska, *Outsourcing, Model zarządzania w podmiotach sektora ochrony zdrowia, Difin, Warszawa 2003*, p.39 – 41.

¹⁴⁰G. Blokdijs, *Outsourcing 100 Success Secrets – 100 Most Asked Questions: The Missing IT, Business Process, Call Center, HR – Outsourcing to India, China and more Guide*, USA 2008, p. 12-13 and onwards.

¹⁴¹P. Gembicki, *Zastosowanie outsourcingu w sektorze usług finansowych*, Wydawnictwo My Book, Szczecin 2006, p. 19.

¹⁴²N. Ramachandran, R. Kumar Kakani, *Financial Accounting for Management*, The Mc-Graw Hill Companies, New Delhi 2007, p. 426.

¹⁴³K. K. Świetla, K. Derylak, *Outsourcing usług księgowych we współczesnej gospodarce na przykładzie Polski*, in print.

¹⁴⁴B. Vagadia, *Strategic Outsourcing, The Alchemy of Business Transformation in a Globally Converged World*, Springer, UK 2012, p. 45 – 47.

- redesigning accounting processes – in order to improve them,
- streamlining the process of registration and circulation of accounting documents,
- increasing the quality of information obtained from the system.

Thus, entrusting accounting service to providers will not only affect the speed and accuracy of decisions, but also save resources. This is because ensuring the desired quality and credibility of information from accounting requires from professionals involved in it to improve their competences and increase the level of professionalism, and therefore remain in continuous training, which is time consuming and expensive. At the same time, it is worth noting that the best results are achieved by entities that use the knowledge of many specialists (tax advisors, financial analysts, credit counselors, etc.) in the fields of accounting, who are familiar with the most specific details.

The basis of properly implemented outsourcing is determining the objectives of cooperation by all concerned parties, as these will be the springboard to expected benefits.¹⁴⁵ The key decision to acquire the relevant services is to analyze whether:¹⁴⁶

$$\sum \Delta P_{im} - \sum \Delta K_{im} > 0$$

$\sum \Delta P_{im}$ - the sum of the changes in revenue in “i” areas of the enterprise as a result of outsourcing.

$\sum \Delta K_{im}$ - the sum of the changes in costs in “i” areas of the enterprise as a result of outsourcing.

If the value is greater than 0, the decision to separate a specific area of operations (accounting service process) should prove to be beneficial for the entity. A slightly broader approach is proposed by R.L. Click and T.N. Duening, who present a three-criterion matrix developed for the purpose of making decisions concerning separating a process or a part thereof. The solution is adopted based on the identification of costs and the achievable performance with the determination of critical points.¹⁴⁷ Identification of the area to be separated within a specific part of the matrix provides the answer to the relevance of the decision.

In addition to the obvious advantages and opportunities offered by outsourcing to small and medium-sized entities there are also some concerns regarding outsourcing function.

Reduction of risk in the implementation and execution of contracts is possible if both parties show due diligence, knowledge and expertise in this field. At the same time, it should be clearly emphasized that, contrary to the fears expressed by skeptics, outsourcing does not mean the loss of control over the process outsourced to contractors; because most of them provide the customers an opportunity of continuous surveillance of the tasks entrusted to them, or closely cooperates with them in this field. Thanks to this, quality is maintained and even improved, mostly in comparison with the situation in which the accounting service would be implemented within their structures.

¹⁴⁵ C. Gay, J. Essinger, *Outsourcing strategiczny. Koncepcja, modele i wdrażanie*, Oficyna Ekonomiczna, Krakow 2002, p. 50.

¹⁴⁶ P. Millgram P., Roberts J., *Economics, Organization and Management*, Prentice Hall, Englewood Cliffs 1994.

¹⁴⁷ R. L. Click, T. N. Duening, *Business Process Outsourcing. The Competitive Advantage*, John Wiley & Sons, New Jersey 2005, p. 67.

This also applies to the rules of confidentiality that are the basis of trust and proper cooperation between the parties. An obstacle to the use of outsourcing may be not so much the fear of disclosure of business secrets. Entities providing accounting services are required to maintain strict confidentiality and diligently keep their customers' data confidential. Otherwise, they would lose their current and potential customers, and thus risk bankruptcy.

Therefore, it can be said that through the spread of outsourcing, both the providers and recipients benefit, and the result is growth for the economy of the country (or countries) where they operate.

Conclusion

The above considerations raise the conclusion that the increasing role of services in national economies is partly a direct result of the development of these economies and – at the same time – education, experience and competence of specialists.

Satisfaction from activity is a derivative of financial results obtained, expected by the owners (management) as well as investors. Due to their increasing demands regarding the quality of financial reporting, it is increasingly becoming a necessity to support the core business with accounting services because of the complex solutions that require specialized knowledge, practice, and ethical behavior.

Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC¹⁴⁸ intended to simplify the requirements regarding reporting and at the same time lower the costs of accounting, should facilitate the accounting activity of small and mid-sized entities. This does not mean, however, that small and medium-sized entities shall forgo the services provided by specialists. However, there is a potential chance that the cost of the purchased services will be slightly lower and the money saved will be invested in the core business and the development of these services.

¹⁴⁸ L 182/19, 29.06.2013

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SMES AND INNOVATION: LESSON FROM COOPERATIVE RELATIONSHIPS BETWEEN SMES AND LARGE FIRMS IN IRELAND AND ASIA – JAPAN AND OTHER ASIAN COUNTRIES

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ABSTRACT

The paper discusses: (1) there exist a variety of SMEs in terms of nature, (2) SMEs are classified depending on activity in relation to innovation, (3) kanagata making enterprise in Japan is taken as an example of relationships with large enterprise, in comparison with tool-making enterprises in Ireland, in terms of cooperation and innovation, (4) the community based performance of SMEs is shown in Japan, Thailand, and Indonesia in terms of solidarity, cooperation, and innovation. It would be claimed that innovation in SMEs could be distinctive from the case of large enterprises and it is basic for SMEs to cooperate each other to be innovative.

The paper argues: (1) there is a difference between Ireland and Asian countries in terms of cooperation among SMEs; the case studies show there exist few cooperations between SMEs or with principle firms in Ireland, (2) community-based innovative activity is picking up in the case of Japan and, apart from scale and scope, Thailand and Indonesia have witnessed the rise of community-based economic performance with innovation. While the nature of innovation between Japan and other South Asian countries is distinctive in terms of a variety of degree, and SMEs is overwhelmingly micro-sized in Thailand and Indonesia, it may be considered that there is a common feature in these countries. (3) It could be that their cultural core values are essentially community derived, but they are also the out come of a bottoms-up approach to community actualities to the top-down state policy, which is based on the recognition of community power. This can be observed in Japan, Thailand and Indonesia.

The paper claims the importance of cooperation for innovation both internally and externally. Cooperative activities are based on the cultural values of social structure, which can be observed in Japan as keiretsu relationships, 'community culture (*Watthanatham chumchon*)' in Thailand, and 'mutual spontaneous assistance (*Gotong royong*)' in Indonesia. However, the case studies of Irish toolmaking industry have possibly shown that principles such as keiretsu values can be learnt, even if partly so.

Key words: SMEs, innovation, cooperative relationships, Ireland, Japan and other Asian countries

JEL codes: Economic sociology

Either in Ireland or in Japan, more than 99 per cent are SMEs out of a total number of enterprises. Other Asian countries, this situation does not change. Thailand, Vietnam, and Indonesia are overwhelmingly micro enterprises in number. SMEs are fundamental for both national and local economy in terms of job creation and local prosperity. SMEs need to be innovative for survival, development and prosperity. This is especially true and urgent in the case of Japan. Many SMEs are struggling and fighting to survive two major hardships, one is the hollowing out of their clients – large

companies, and the other consumers' declining demand for domestic products because of much cheaper other Asian countries' imported products. Against such a trend, Japanese SMEs are challenging to divert it by innovation. Other Asian countries, Vietnam, Thailand and Indonesia, are at the different phase from Japan in terms of innovative performance. Recent studies (Mizuno, 1996; Sakata, 2012) show that rural industries in these countries are independent and showing the gathering of momentum. The paper will take a brief view of these rural industries about their innovative activities.

Innovation of SMEs is distinctive from large firms and depending on the country. This paper discusses: (1) there exists a variety of SMEs in nature, (2) SMEs are classified depending on activity in relation to innovation, (3) kanagata making (toolmaking) enterprises in Japan is taken as an example of relationships with large enterprise, in comparison with toolmaking enterprise in Ireland, in terms of cooperation and innovation, (4) the community-based performance of SMEs is shown in Japan, Thailand and Indonesia in terms of solidarity, cooperation and innovation. The paper argues: (1) there is a difference between Ireland and Asian countries in terms of cooperation among SMEs; the case studies show there exists few cooperation between SMEs or with principle firms in Ireland, (2) community-based innovative activity is picking up in the case of Japan and, apart from scale and scope, Thailand and Indonesia have witnessed the rise of community-based economic performance with innovation. While the nature of innovation between Japan and other these Asian countries is distinctive in terms of technological and organisational degree, and SMEs in these other Asian countries are overwhelmingly micro-sized, it may be observed that there is common feature in these countries, that the cultural core values as the principles of social structure are the base of innovative performance, and they are the source of the top-down state policy, which is based on the bottoms-up approach of community actualities and on the recognition of community power. This is observed in Japan, Thailand and Indonesia. The paper claims the importance of cooperation for innovation both internally and externally. They are observed as keiretsu relationships in Japan, 'community culture (*Watthanatham chumchon*) in Thailand, and 'mutual spontaneous assistance (*Gotong royong*)' in Indonesia. While the case studies of Irish toolmaking industry show a gap between Ireland and Asian countries in terms of cooperative performance, they have possibly shown that principles such as keiretsu values can be learnt, even if partly so.

The paper begins with literature review on innovation, which is followed by SMEs classification in relation to innovation. Then the actuality of SMEs in Japan is discussed. Third, it is argued that keiretsu relationships, networking and cooperation are the basis for SMEs' innovative activities, and the core values, trust and dependence, as the principles of social structure underlie all these relationships. Fourth, Irish toolmaking industry is explored in terms of innovative activities and cooperation contrast with its Japanese counterpart. Fifth, SMEs in Vietnam, Thailand and Indonesia are briefly viewed from the aspect of innovation and cooperation.

1. Literature review

Whitley (2000, 1991) argues that the characteristics of SMEs are different and thus their innovation strategies as well among countries or regions in different environments. He argues above all the importance of institutional settings, which affect business systems and vary depending on the region or country. The concept of innovation has been defined in different ways. Schumpeter (1934 (2008)) states that innovation is not just technology development but the social process of destruction of *gewohnten bahnen* (beaten tracks). He defines innovation as the setting up of a new production function, which covers the case of a new commodity as well as those of a new form of organisation or merger, or the opening up of new markets (1939). He created the entrepreneur as purely economic existence and

carrier of innovation. The entrepreneur appears in the period of economic stagnation and carries out 'creative destruction' for breakthrough to dynamic economy with his followers. Schumpeter (1939) locates the entrepreneur as mediator between economic and social process. This entrepreneur is abstract persona conditioned by history and institutions, not as primary factor of change but as carrier of changing mechanism. This theory looks at 'creative destruction' or 'innovation' and 'innovator' from the viewpoint of historical scale and scope (Ohno, 1970). In the White Paper on Small and Medium Enterprises in Japan (Ministry of Economy, Trade and Industry; Japan Small Business Research Institute), innovation is understood as product and process innovation in narrow meanings, i.e. remarkable improvement or small inventions in process or product which lead the enterprise to new market and increased profit. A lot of SMEs are doing low risk but continuous innovation. Importantly, such a small scale innovation is continuously carried out by SMEs in Japan. Among them an enterprise with 10 employees has the 420 years' history (Suzuki, 2012). Schumpeter (1939) distinguishes innovation from invention, which produces of itself ... no economically relevant effect at all. In recent Japan, it is observed (Shibayama, 2011) that particular phenomenon of fresh relationships between enterprises or personnel has been shaped up in local industry. This phenomenon shows the birth of free and autonomous entrepreneurs in local Japan and it also shows new trend of innovation which is trying to add goods new meanings and values, i.e. innovation (Shibayama, 2011). Shibayama (2011) sees such a phenomenon as preliminary to the main historical event of 'creative destruction', involving cultural and sociological change. On the other hand, empirical studies (Suzuki, 2011, 2012) point out that innovation of SMEs in old industrial district in Tokyo is affected by the district's particular industrial atmosphere. These SMEs have evolved creative SMEs, diverted innovation product and developed into two types of SMEs manufacturers, 'problem solution product' and 'highly sensitive and functional product'. Marshall (1919, 1920) stated that social trust is important for institutional settings to work smoothly to maintain the 'industrial atmosphere' in 'industrial district'.

Otherwise it should be noted that many SMEs are struggling to survive two major hardships, one is the hollowing out of their clients – large companies and the other consumers' declining demand for domestic products because of much cheaper other Asian countries' imported products. Against such a trend, Japanese SMEs are challenging to divert it by innovation (Ministry of Economy, Trade and Industry; Japan Small Business Research Institute). Networking among them is one major way toward this direction. It is assumed that fruitful networking requires trust at the base. Marshall (1919, 1920) remarks that social trust is important for institutional settings to work smoothly to maintain the 'industrial atmosphere' in 'industrial district (Marshall)'.

There is simply two ways of interpreting innovation as seen. One represented by Schumpeter sees 'innovation' from a historical point of view involving cultural and sociological change. Shibayama (2011) argues that new trend of networking among SMEs in local industry is a forerunner of historical new phase of 'creative destruction' in Japan. However, while highlighting such new trend of networking, he may neglect keiretsu relationships as traditional network which accounts for around 50 per cent on average of suppliers and is evolving (White Paper on Small and Medium Enterprises in Japan). Other view focuses on innovation as continuous and daily work's extension from the viewpoint of SMEs' actualities (White Paper on Small and Medium Enterprises in Japan; Suzuki, 2012). This paper will take a view that, while a bird's eye view, highlighting a new trend of

networking as could-be preliminary to dynamic economy, it is important to locate the innovation phenomenon in terms of economic history and sociology, this paper will look into the actualities of innovative activities in relation to networking and argue the central importance of core cultural values in social structure for innovation in Ireland and Asian countries.

2. Various SMEs

There are various aspects about how SMEs are related with innovation strategies, as follows.

- SMEs' early network establishment of relationships enhance innovation capacity (Jørgensen and Ulhøi, 2010).
- There is positive relationship between organizational size and innovation, particularly in manufacturing and profit making organizations (Damanpour, 1992).
- SMEs are similar to large firms concerning to the way that innovation strategy and formal structure are the key drivers of their performance, but do not utilize innovation culture in a strategic and structured manner (Terziovski, 2010).

Jørgensen and Ulhøi (2010) argue this aspect with regard to young SMEs, which focus on innovation, to develop and foster network relationships early on in their evolutionary life cycle in order to support learning, knowledge sharing and innovation. Damanpour (1992) demonstrated the distinguishable influence of organisational types on the size-innovation relationship and concluded that the large firms are more innovative than SMEs in the manufacturing sector. Terziovski (2010), likewise, argued manufacturing SMEs are likely to improve their performance as they increasingly mirror large manufacturing firms with respect to strategy and formal structure. Further he concluded that SMEs do not appear to use innovation culture in a strategic and structural manner.

3. SMEs in Japan

- Variety of SMEs

The paper examines three types of SMEs in terms of organizational structure and capabilities in Japan. The paper used *White Paper on Small and Medium Enterprises in Japan* (Ministry of Economy, Trade and Industry) as the basic materials. SMEs in Japan are the pivot of supporting manufacturing industry. This is the case, particularly in the machinery manufacturing industry. In comparison with Large Enterprises (LEs), they are different in many ways. They account for 99.7 per cent of all firms and about 70 per cent of all employees (2011 White Paper on Small and Medium Enterprises in Japan). In manufacturing industry, they account for about 50 per cent of added value. Not only in their size but also SMEs are different from Large Enterprises (LEs) in their approach to innovation. SMEs are further divided depending on whether they are suppliers or independent enterprises.

- Three salient features in the innovation by SMEs

According to the White Paper (2009 White Paper on Small and Medium Enterprises in Japan), there are three salient features in the innovation by SMEs reflecting the compact size: 1. Managing Director (MD) himself/herself tackles innovation, taking a leadership from

planning measures to contriving ideas or originality in the working place. 2. Outside of continuous R & D activities, there is a great role of creativity and ideas which flashed in the working place and/or in daily life, and which turned into innovative products and improving production processes. 3. SMEs are instrumental for innovation in niche markets. In addition, flexibility and quickness in decision-making by MD may be taken into consideration as advantage for innovation. Generally speaking they are not willing to take risks

- Three categories of SMEs

In fact, SMEs in Japan may be divided into three categories: suppliers, independent enterprises or entrepreneur, and 'between' (White Paper on Small and Medium Enterprises in Japan). With regard to 'between' they are or were suppliers and trying to be successful at independent entrepreneur by innovation. Their approach to innovation is different depending on their nature.

Suppliers are officially, over 60 per cent, in the *keiretsu* relationships¹⁴⁹ in every manufacturing sector: 100 per cent in electronic parts, devices and electronic circuits, 75 per cent in transport machinery and equipment, 72.2 per cent in general machinery (2010 White Paper on Small and Medium Enterprises in Japan). Under subcontracting conditions, they take orders from their clients and fulfill requirement for products and/or processings. SMEs in the *keiretsu* relationship share the plans and prospects of their principal firms (60 per cent), and their MDs involve in mutual exchange with their counterparts of LEs (54 per cent). Basically, because of such relationship, they do not have to do marketing activities. They do concentrate on and develop technical know-how and skills for the required products and/or processings. These expertise are fundamental. While the rate of R & D activities among these SMEs was basically low compared with independent entrepreneur, SMEs in the manufacturing sector are confronted with increased competition from cheaper manufactured products from such countries as China and India, and are consequently struggling to develop competitive products, process improvement and services through innovation. SMEs have a high rate of activities aiming to innovate through non-continuous research and development or methods other than research and development (2009 White Paper on Small and Medium Enterprise in +Japan).

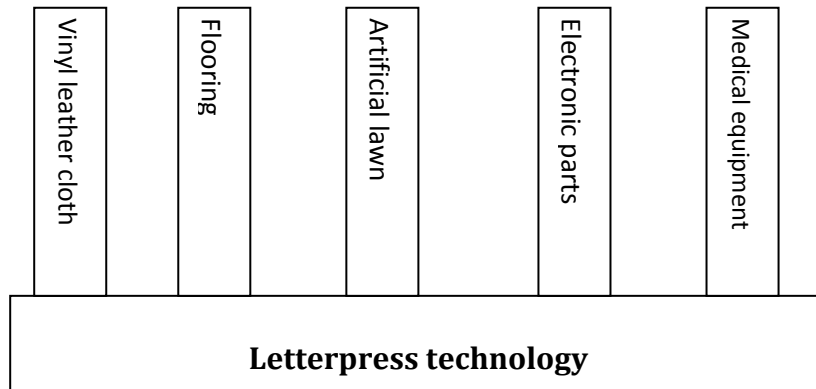
In large scale enterprises with more than 250 employees, more than 80 per cent of them are tackling innovation through continuous R & D on the one hand, and in small-scale enterprises with 10 to 49 employees, a half of them through continuous R & D and the rest of them through non-continuous or no R & D, on the other.

Independent or entrepreneur SMEs are instrumental in innovation in the niche market, not through R & D activities but ideas or creativity which flashed in daily life. Suppliers, who are trying to be independent, need to be innovative in products and/or process. As suppliers they have fundamental technical know-how and expertise. They exploit their expertise to develop new products and/or process innovation (numerous examples are shown in the White Paper on Small and Medium Enterprises every year). These phenomena are interesting. They display the essential importance of fundamental technology and skills.

¹⁴⁹ Keiretsu is the vertical relationship system between suppliers and users and lasts for generations since the 1950s. The relationships are based on the principles of social structure – trust and dependence – in Japan (Oikawa, 2011).

More precisely, they show tremendous potential of such assets for innovation of new products. Figure 1 shows one example.

**Fig. 1 Approach to effective technological development:
An approach based on a root technology**



Source: Minato (1982: 10)

4. Networking

As a general trend, the *keiretsu* relationships are expanding by networking. This is recognised as 'meshing' for survival and development (Japan Small Business Research Institute, 2006).

It is noted that 57.1 per cent of small and medium-sized enterprises are still under the traditional *keiretsu* relationships, *i.e.*, they belong exclusively to their long-term customers. This pattern is increasing (Japan Small Business Research Institute, 2006). Otherwise they exchange information, ideas or knowledge with other enterprises by joining the local industrial association (56.4 per cent) or a kind of heterogeneous business exchange association and studying circles (64.1 per cent). More positively, they pay a visit to other companies on a daily basis and get merits such as, that they are able to judge precisely their customer's level of technology or skills (73.0 per cent), or that it is straightforward for them to modify or to propose technical matters with their customers (65.1 per cent) (2010 White Paper on Small and Medium Enterprises in Japan).

- *Kanagata* (die and mould) makers and users relationship are an exemplar. In fact this relationship has contributed a great deal to product and process innovation. The relationships are characterised as follows:

- (1). The die and mould blueprints and processing data containing the know-how of the manufacture should be considered intellectual property. But it is presumed that there has been no consideration in terms of intellectual property and also that no contract existed between suppliers and customers.

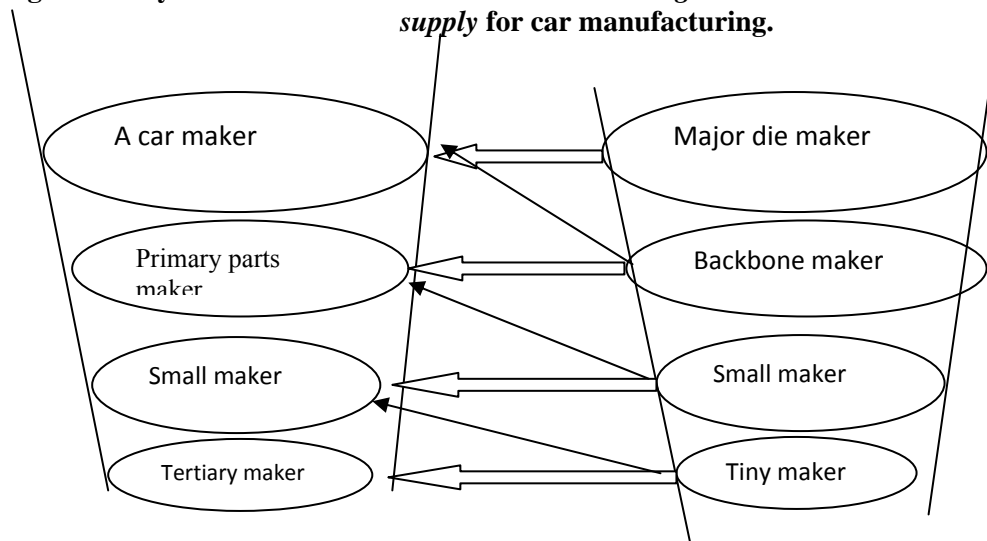
- (2) The above relationship has been institutionalised as a social norm.

- (3) *Kanagata* industry is characterised by its highly specialised and subdivided structure of subcontracting system based on cooperative values

Kanagata makers are systematically organised based on the social structure of highly developed division of labour (Taguchi, 2001).

Kanagata makers consist of three layers, the major, the backbone and the small which correspond to different equipment, technology, and market. The market for each layer parallels the social structure of the mass-produced machinery industry as shown in fig. 2.

Fig. 2 The layered market structure of users and *kanagata* makers in the case of *stumping dies* supply for car manufacturing.



The white arrow shows the major transactions, which are not fixed and the thin black arrow transactions take place. Source: Taguchi (2001: 57)

Based on such highly specific skills and technological expertise, they could attain innovation or improvement using imagination and/or inference (Asai, 1996; Koike, 1999).

5. Principles of the *keiretsu* relationships

Granovetter (1992, 1994, 2005) argues the importance to recognise how economic action is constrained and shaped by the structures of social relations in which all real economic actors are embedded. Granovetter (1994) also suggested the existence of the principles in the cooperative relations and indicated that these principles are identifiable by such factors as region, political party, ethnicity, kinship or religion. In the case of *keiretsu* it is identified that they may be 'trust and dependence'¹⁵⁰. These principles are the foundation of the *keiretsu* relationships and have a basic effect on maintaining cooperative relationships for innovative performance, by sharing skills or tools or exchanging information about new technology or niche market.

¹⁵⁰ This is based on my article (2011) 'Economic organization and Social solidarity: *Keiretsu* as a Local/Global Concept' in *Firm-Level Internationalization, Regionalism and Globalization*, Elaine Hutson, Rudolf Sinkovics and Jenny Berrill (Eds.).

6.-SMEs in Ireland – Toolmaking industry

The Irish economy is particularly characterised by the overwhelming presence of foreign multinational companies. While they have positive effects for both the high-and low-tech sectors (e.g. Görg and Strobl, 2002), for instance, they have shown volatility in terms of presence continuity in Ireland. Further, although foreign multinationals are more engaged in manufacturing, producing three times more than Irish-owned companies in terms of sales, their employment levels-257,000 in 2010-are less than in Irish-owned companies-854,000 in 2010-according to CSO. This explains a major tenet of industrial policies that the Irish government has tried to promote consistently for the indigenous manufacturing industry. As a matter of fact the substantial presence of Irish indigenous companies is vital in terms of employment, ubiquity and consistency for the Irish economy.

The competitiveness of indigenous industry is important as a source of economic growth and employment. The engineering sector is one of the traditional sectors comes predominantly from Irish-owned firms, while the output of modern sectors comes very largely from foreign-owned firms (O'Malley, 1998: 44). Irish SMEs are widely dispersed throughout Ireland and providing substantial employment and basic products in Ireland (WDC, 2004).

- Cooperataion and grouping

The importance of cooperating and grouping to help financial and organisational problems is highlighted and emphasised as follows (Kennedy, 1990).

'The importance of cooperation and grouping to expansion with other toolmaking companies as joint marketing, joint trading, shared equipment and so forth rather than technical knowledge must be considered, but little evidence of this. The Irish toolmakers seldom consider trading among themselves. Working within a group might make better sense. Participating firms might become subsidiaries, or they might supply to a central toolroom, and these companies would have shares in a joint marketing operation (Kennedy, 1990: 41)'.

The reality is that 'Irish managers think that everyone outside the factory gate is a deadly rival out to take rather than give business (Kennedy, 1990: 42)'. Such a situation appears to have been changing, depending on the company. The case studies of five toolmakers in Ireland show some evidence relating to cooperation. Two companies can be considered a good model as toolmaker in Ireland in terms of the State agencies' strategic policy. Both companies illustrated a clear understanding of the fundamental importance of continuous adaptation in terms of both advanced technology and training. Both companies realised the importance of training to acquire skills for new machine tools. They have also been exploring new markets, through new innovative products and by challenging new difficult materials for component products. Both have invested more in improving technology than the other companies surveyed. The fact that most employees have been working with the company since its establishment (20 years) should have made it possible for greater cooperation on the shop floor. When they encountered a difficult problem, 90 per cent of such problems were resolved jointly. The other was established in 1998, at a later stage of technological change in Ireland. However, it is assumed that the relationship between workers and between the company and their suppliers and customers, is similar to that as found in the

former. The fact that the distribution of profit and reward is transparent to the employees may have encouraged them in working and led to non-absenteeism.

It is thought that both MDs' experiences as employees of the Japanese multinationals have made a profound impact on their management styles, as they referred to it. They have learned the importance of nurturing a continuous and close relationship of intra – and inter companies in order to maintain their customers and to get informal knowledge and/or information about possible markets or technologies.

- Issues 1. – Grouping, cooperation and cluster: the government strategic policy

The common ideas behind are reduction of expenses for equipment investment, sharing and exchanging knowledge and information for skills and trading with intra-and inter companies. For these strategies a degree of social relations is central. In reality, 'a big cultural change for a lot of companies' in the case of Ireland (Thoms McDermott, the AMT Ireland Manufacturing Technologies Centre's manager, quoted in Nolan, 1993: 30)

The 'fostering clusters' which was stressed as one of the central recommendations for industrial policy based on the idea of a cluster drawn from Porter's theory (1990), does not appear to have been put into practice nor adapted as recent empirical studies show. In fact, MD of the toolmaker I interviewed in 2009, said that they had no contact with other manufacturers in the cluster.

- Issues 2. – The concept of core technology and industrial policy

According to Dept of Industry and Commerce (1990) the 'key technologies' is used to mean that on which industrial development depends. It is described as 'enabling technologies' such as nano technology, biotechnology, microelectronics, optoelectronics, advanced manufacturing technologies. The skills and technology of toolmaking are defined as low to medium technology in Ireland, and there seems to be no concept to approach the dynamics from low to high technology because of the absence of a concept of core technology. In Ireland it seems that they have chosen to deal not with a technological accumulation structure, but with new specific high technologies, which are located at the centre of mapping in terms of different technologies for manufacturing industries. This is a new perspective adopted in the so-called the 'new economy'. As a result, the toolmaking is located on the periphery. It could be said that there are two viewpoints on mapping industrial technologies, one is structural and the other spatial.

7- Rural industry in South East Asia – Vietnam, Thailand and Indonesia;

The landscape of SMEs in South East Asia is very different from in Japan. SMEs in South East Asia are greatly highlighted as supporting industry for multinationals. This section, however, is concerned with rural industry, which consists overwhelmingly of micro enterprises. It is worth noting that they have shown a remarkable development or they could show the potential for further development, to be the leading or a viable rural industry in Vietnam and Indonesia (Fujita, 2006; Sakata, 2008, 2012; Mizuno, 1996; Sato, 2011).

In the case of Japan, it is rural traditional industry that maintains traditional craftwork and vitalises rural economy as rural based industry (Seki, 1985). In contrast with modern

manufacturing industry, which while expanding to local areas, has not always played a role to make the areas prosperous. Such modern manufacturing industry has created only a dearth employment and not much benefit to rural industry. They have just formed a region as dispersed branch factory, isolated from rural society.

- Rural industry in Vietnam

In Vietnam entrepreneurship is quite active; from the 1960s until 2000~2005 there was 75.2 per cent increase of enterprise (Kurose, 2011). There is a view that Vietnam is developing led by rural industry (Fujita, 2006). In fact, it is one of important characteristics that the rural population rate remains 70 per cent of the total in 2010, and the real number is increasing while Vietnam is entering into the real industrialising phase (Sakata, 2012). The question is what are the means rural residents are making a living. In Vietnam small enterprises are overwhelming in number. Enterprises less than 10 employee account for 51.7 per cent of the total number and less than 50 for 85.7 per cent. Almost all of them are of non-state sector. Vietnam has two sectors, state sector and non-state. So far as industrial production is concerned, non-state production showed sharp increase. In line with it the number of micro enterprise (less than 2 employees) increased more than small enterprises (less than 50 employees) (Sakata, 2008). It is noted that rural industry is leading a remarkable development not only after *doi moi* (socialist-oriented market economy started in 1986 in Vietnam) but also after joining WTO. As a matter of fact, rural Vietnam is increasing in construction and service sector, which accounts for less than 40 per cent out of micro enterprises in rural Vietnam (Sakata, 2012). On the other hand, industrialisation of craft villages is quite remarkable, suggesting the considerable importance with regard to economy. Craft village is a typical example of rural industrialisation. Craft village has developed and formed clusters in which micro enterprises produce craftwork in community based clusters. Most prosperous craft village is *Bat Trang* in suburb of Hanoi. Such villages are based on domestic handicraft industry. This kind of village is 1077 to 2000 in total number in 2006. Inside the village division of labour has meticulously and systematically well organised. As a result there exists no competition or conflict among producers or retailers (author underlined)(Sakata, 2012).

- Thailand - *watthanatham chumchon* (community culture)

The national culture in Thailand consists of a wide variety of numerous community cultures, which vary depending on the district (tambon). Originally *watthanatham chumchon* is based on local agricultural groups in terms of traditional mutual cooperation and friendships. It is claimed that rural people and their mutual trusted relationships and culture are understood to be 'community'. For example, there was a change to accommodate to economic problems caused by market economy in the rural area. Around the 1980s rural people had created new type of economic organisation such as 'savings cooperative' and 'rice bank'. These organisations are funded and managed by the people themselves (Shigetomi, 2009). This thought, *watthanatham chumchon*, has spread wide in Thai society and had considerable impact on politics in Thailand at present (Shigetomi, 2009).

watthanatham chumchon has four components. 1. Rural people has their own viewpoint and culture; 2. At the base of such culture there is the principle of mutual aid; 3. Culture and economy cannot be parted; 4. Community is traditional rural socio-economic system, which provides happiness, identity, and potential to develop negotiating power for the people. It is

noteworthy to mention OTOP (one village one product) policy, which started in 2001 and is known it has been successful. In 2004 the gross sales was equivalent to one per cent of GDP (three quarters for domestic use and the rest for export) (Takei, 2007). This policy came originally from Japan and is spreading other Asian countries.

- Rural industry in Indonesia — *Gotong royong* (mutual assistance)

Distinctive from the case of rural industry in Vietnam or Thailand, Indonesia has no definite leading industry for development and looks that leading developing industry is dispersing (Sato, 2011). The section sheds light on one of them, community-based weaving industry surveyed in two different regions in West Java respectively (Mizuno, 1996; Hashimoto, 2008). These examples show that product and process innovation has been successfully carried out in rural industry based on the cultural core values *Gotong royong* (mutual assistance).

Majalaya region [Mizuno, 1996] :

The Majalaya region has a long history as weavers. This region showed the will power of independence of the weavers when their textile industry faced the crisis, which was caused by the breakup of its weaving factories. They turned products whose markets had not yet been completely monopolised by large corporations or power-loom operators. In order to these products they cut production costs and resulted in a new division of labour, as a large number of locally based traders took innovative measures to open up new marketing networks. What happened was the formation of a weaving production area/community centring around the village that was freed from dependence on either factories or wholesalers in other regions. Further there is one added point. In spite of the fact that the pay is better working for others as wage labour, the choice of lower paying independence can be attributed to in part to the weavers' character, which prefers self-employed work to working for someone else. Another point is that independent businesses, despite the low income offered for weavers, produce about the same amount of income as rice farming among middle-strata owner operators in the village.

Takusimalaya prefecture [Hashimoto, 2008]:

It has only around 10 years old history. The West Java silk industry has suffered the sharp rise of imported cocoon after Asian economic crisis and many domestic market-oriented enterprises in silk industry were closed down. Silk industry in Takusimalaya prefecture is maintaining the production. It is an integrated production system based. Such a rural industry above is meticulously and systematically organised by the cooperative and resulted into low cost production system. It is claimed that rural industry creates employment for unskilled labour by forming social division of labour of production

The historical background of *gotong royong* in origin is opaque. However, it is since the independence day of Republic of Indonesia in 1st of June 1945 that *gotong royong* is publicly and officially declared as the embodiment of the principles of the national foundation. There are the three cultural operator in contemporary Indonesia, *koperasi* (cooperatives), *musyawarah* (consensus), and underlying all the others, *gotong royong* (mutual and reciprocal assistance, as in the traditional Javanese village (Bowen, 1986). The term *gotong royong* itself implies spontaneous and mutual aid altogether among people (Gumisawa, 2004).

Gotong Royong in the strict sense can be rendered as collective social activities. But the deepest meaning of *gotong royong* can be explained as a philosophy of life that takes the collective life as the most important. The philosophy of *gotong royong* is now a part of Indonesian culture because *gotong royong* is not the property of a particular ethnic group (Sinar Harapan, June 22, 1984: 6; cf. Bowen, 1986:546)

8. Conclusion

Theories of Schumpeter above all seem great to understand significance of innovation in historical and sociological context. Then, case studies of SMEs in Asian countries and Ireland will provide the concrete, detailed knowledge for SMEs how innovation should be carried out. The difference of the core cultural values between Ireland and Asian countries may affect the difference of innovation between these countries. The basis of these difference could lie in individualism and community-based culture, trust is in the very centre, respectively.

What is missing in the ideas of Schumpeter or Marshall could be the acknowledgement of basic importance how the core values or the principles of social structure affect the industrial atmosphere and cooperative relationships for innovation in SMEs. At least this is the case in Japan and other these Asian countries. In Ireland there may exist not such principles of social structure in Japan— trust and dependence – or cooperative spirit and trust as cultural core values in Vietnam, Thailand and Indonesia, but individualism which is the base of social relations in Ireland, same as other Western countries. From this viewpoint innovation of SMEs in product or in process may vary depending on culture.

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SUPPORT OF THE INTERNATIONAL DEVELOPMENT OF THE SMALL AND MEDIUM ENTERPRISES IN BULGARIA

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ABSTRACT

The importance of the Small and Medium Enterprises (SMEs) for the Bulgarian economy is growing steadily. The small entrepreneurship is a necessary element of the market economy, allowing solving important socio-economic tasks. This is confirmed by the experience of developed countries, where small business is an important factor in the development of national economies. It constitutes the main generator of the innovation process in the industry, the dynamic response of the change in the structure of consumption. SMEs intensify structural changes in industries overcome monopoly in the economy affect the structure of prices, etc. No small business economy cannot function effectively or to develop. Moreover, there is a clear correlation between the efficiency of the economy, the level of social welfare and the level of development of small business.

For Bulgarian SMEs, markets outside the country are becoming more attractive because of the low and stagnant domestic market. They focus their efforts abroad, but a number of their characteristics (size and limited resources, insufficient staff expertise and organizational structures for fully independent functioning abroad), require that they receive support from the state.

The aim of this paper is to present the efforts of the Bulgarian government to support SMEs in internationalization.

Realizing the potential of internationalization is associated with the development of appropriate government policies, creating incentives and facilities (manufacturing, banking, tax and export) for Bulgarian SMEs. By promoting the development of SMEs is possible to attract foreign investment and increase the amount of exports.

Important role in the implementation of support for SMEs play The Bulgarian Small and Medium Enterprises Promotion Agency (BSMEPA). It was established in 2004 with the Ministry of Economy and Energy of Republic of Bulgaria. BSMEPA is a Government institution and its main functions are focused on the implementation of the Bulgarian Government's policy for SMEs.). In this respect the Agency provides to Bulgarian SMEs information and consulting services, organizes training courses and implements promotion activities in supporting the increase of SMEs competitiveness and strengthening their international positions. One of the basic arms of BSMEPA is to promotion of the internationalization of the Bulgarian SMEs.

Key words: Small and Medium Enterprises, international development, government support, The Bulgarian Small and Medium Enterprises Promotion Agency

JEL code: F23

The importance of the Small and Medium Enterprises (SMEs) for the Bulgarian economy is growing steadily. The small entrepreneurship is a necessary element of the market economy, allowing solving important socio-economic tasks. This is confirmed by the experience of developed countries, where small business is an important factor in the development of national economies. It constitutes the main generator of the innovation process in the industry, the dynamic response of the change in the structure of consumption. SMEs intensify structural changes in industries overcome monopoly in the economy affect the structure of prices, etc. No small business economy cannot function effectively or to develop. Moreover, there is a clear correlation between the efficiency of the economy, the level of social welfare and the level of development of small business.

For Bulgarian SMEs, markets outside the country are becoming more attractive because of the low and stagnant domestic market. They focus their efforts abroad, but a number of their characteristics (size and limited resources, insufficient staff expertise and organizational structures for fully independent functioning abroad), require that they receive support from the state.

The aim of this paper is to present the efforts of the Bulgarian government to support SMEs in internationalization.

Bulgarian SMEs *are still suffering from the consequences of the crisis*, to different degrees depending on their sector of activity. As of November 2012, 45 % of people who lost their job came from the private sector, where three quarters of job losses were concentrated in SMEs. Looking at the different sectors, construction and real estate have been hit hard by the burst of the speculative bubble, while there are worrying trends in the wholesale and retail trade sector, where the majority of Bulgarian SMEs are concentrated. Bulgaria made some general progress in improving the business environment in such areas as entrepreneurship, public procurement and skills & innovation, where some broad initiatives were taken, such as overhauling the procedures for the award of public contracts and addressing the innovation gap of the SME sector. However, the main policy challenges for the country have remained broadly unchanged. In spite of this progress, Bulgarian SMEs are still suffering from limited internationalization and access to finance, which hamper the prospects for growth and recovery from the economic crisis. SMEs would benefit from improvements in tax administration, the streamlining of insolvency procedures and contract enforcement, and full implementation of the Point of Single Contact and e-government solutions¹⁵¹.

Table 1 shows the parallel between the state of the SME sector in the European Union (EU) and Bulgaria.

¹⁵¹ See: http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/countries-sheets/2013/bulgaria_en.pdf.

Table 1. Parallel between the state of the SME sector in the European Union (EU) and Bulgaria¹⁵²

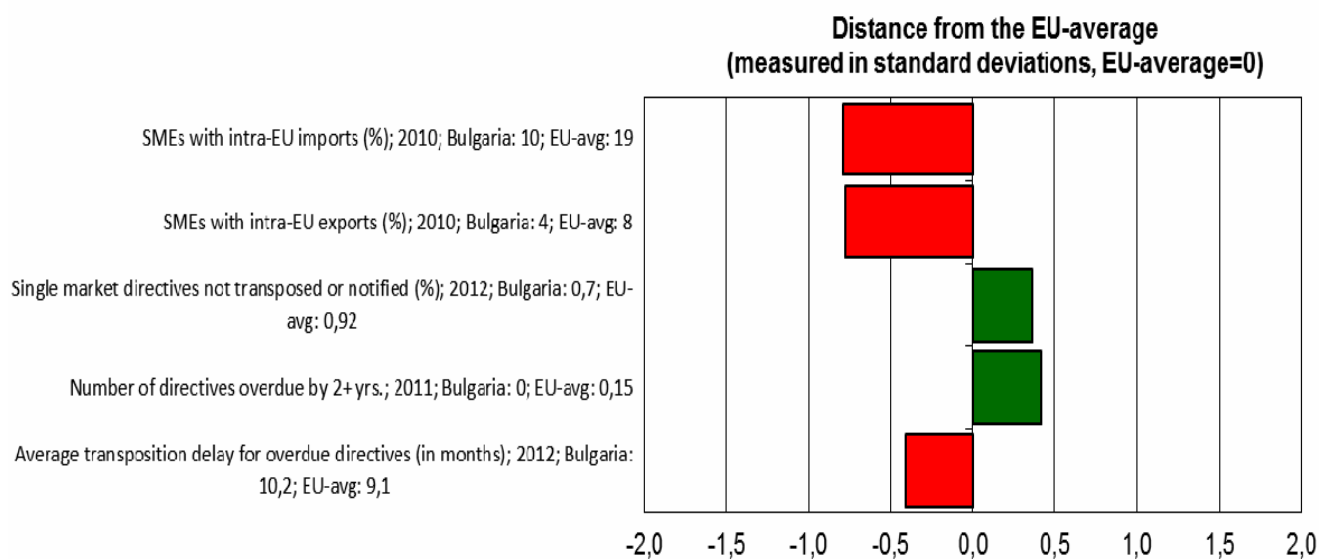
	Number of enterprises			Number of employees			Value added		
	Bulgaria		EU27	Bulgaria		EU27	Bulgaria		EU27
	Number	Share	Share	Number	Share	Share	Billion €	Share	Share
Micro	252,137	90.0%	92.1%	532,880	28.9%	28.7%	3	16.9%	21.1%
Small	22,871	8.2%	6.6%	447,581	24.3%	20.4%	3	20.8%	18.3%
Medium-sized	4,325	1.5%	1.1%	412,065	22.3%	17.3%	4	24.9%	18.3%
SMEs	279,332	99.8%	99.8%	1,392,527	75.5%	66.5%	10	62.6%	57.6%
Large	676	0.2%	0.2%	451,752	24.5%	33.5%	6	37.4%	42.4%
Total	280,008	100.0%	100.0%	1,844,279	100.0%	100.0%	16	100.0%	100.0%

The table show, that The Bulgarian SME sector is more or less similar to the European average in terms of the breakdown among business size-classes. However, **the contribution of SMEs in creating value added and especially in providing jobs exceeds the EU average.** In fact, the share of SMEs, compared to Large Enterprises (LEs), in value added and employment in almost all sectors is higher than the EU average. But one consequence of the large number of individuals employed by SMEs is that labour productivity is below the EU average, because of the lower capacity to benefit from economies of scale, especially in low-value sectors.

Bulgarian SMEs do not generally tend to internationalize and Bulgarian LEs that do are more likely to target non-EU neighbouring countries such as the western Balkans and Turkey rather than the EU. This is because *Bulgarian companies have a better knowledge of these markets and face less competition there from multinationals.* In general, however, Bulgarian SMEs, especially start-ups, *mainly rely on the dynamics of their domestic market.* Because of this dependency, **Bulgarian SMEs receive no additional opportunities from either European or foreign demand, due to the currently unsatisfactory economic climate.**

Bulgarian SMEs do not use all the possibilities available to them by Single market (see fig. 1).

¹⁵² These are estimates for 2012 produced by London Economics, based on 2008-12 figures from the Structural Business Statistics Database (Eurostat). The data cover the 'business economy', which includes industry, construction, trade, and services, but not enterprises in agriculture, forestry and fisheries and the largely non-market service sectors such as education and health. (source: http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/countries-sheets/2013/bulgaria_en.pdf).



Note: Data bars pointing right show stronger than EU-average performance and data bars pointing left show weaker performance.

Fig. 1. Parallel between the SMEs in EU and Bulgaria for use the possibilities available by Single market¹⁵³

Overall, Bulgaria's performance in this policy area is slightly below the EU average. However, groups of indicators point in different directions. On the one hand, *Bulgarian SMEs seem to be reluctant to exploit the potential of the single market*, either via imports (almost half the EU average) or exports (half the EU average). On the other hand, *Bulgaria performs well in terms of transposition of single market directives, with no directive overdue for more than two years, even if the average period by which transposition is overdue is slightly longer than the previous year.*

On the policy front, during the first half of 2013, Bulgarian legislation was amended to bring it into line with the Services Directive. Still in 2013, the Bulgarian Institute for Standardisation announced that it would develop a certification system that would help Bulgarian SMEs to ensure and prove that they comply with the requirements of standards, in order to improve their competitiveness within the single market.

In the area of internationalization parallel between the SMEs in EU and Bulgaria show, that *Bulgaria's performances is consistently and significantly below the EU average in this policy area (see fig. 2)*

¹⁵³ Source: http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/countries-sheets/2013/bulgaria_en.pdf.

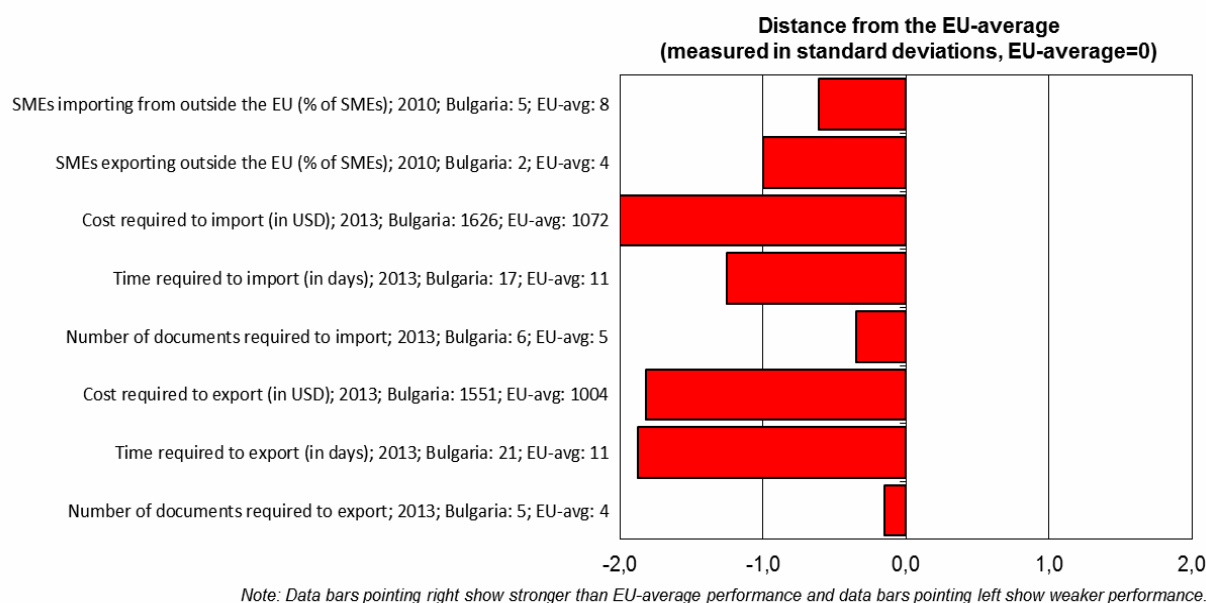


Fig. 1. Parallel between the SMEs in EU and Bulgaria in the area of internationalization¹⁵⁴

The more negative indicators concern the time and costs involved in exporting to and importing from outside the EU, in spite of the limited number of documents required. Against this background, the percentage of Bulgarian SMEs importing from (5%) or exporting to (2 %) outside the EU is not so significantly below the EU average, but there is clearly room for improvement here as there is within the single market. *On the policy front, additional efforts should be made to further reduce the time and costs involved in exporting and importing.*

Overall, up to 2012, Bulgaria exported twice as much to the EU as it did to non-EU countries, while imports decreased slightly within the single market. This was driven by a drop in imports from EU countries of about 15 %, while imports from non-EU countries increased by 10 %. In contrast, Bulgarian exports showed a more stable pattern from 2008 to 2012. Between 2008 and 2012, exports to the EU increased by just 10%, while exports to non-EU countries increased by 45%. However, about two thirds of the export volume to countries outside the EU is accounted for by LEs. On the other hand, the export volume of SMEs to EU countries grew by 20% between 2008 and 2012. In the current context, **growing exports and stable imports are welcome as they help to reach a more sustainable trade balance.**

Realizing the potential of internationalization is associated with **the development of appropriate government policies, creating incentives and facilities** (manufacturing, banking, tax and export) for Bulgarian SMEs. *By promoting the development of SMEs is possible to attract foreign investment and increase the amount of exports.*

¹⁵⁴ Op. cit.

*Important role in the implementation of support for SMEs play The Bulgarian Small and Medium Enterprises Promotion Agency (BSMEPA). It was established in 2004 with the Ministry of Economy and Energy of Republic of Bulgaria. BSMEPA is a Government institution and its main functions are focused on the implementation of the Bulgarian Government's policy for SMEs.). In this respect the Agency provides to Bulgarian SMEs information and consulting services, organizes training courses and implements promotion activities in supporting the increase of SMEs competitiveness and strengthening their international positions. **One of the basic arms of BSMEPA is to promotion of the internationalization of the Bulgarian SMEs**¹⁵⁵.*

*General objective of this promotion is to **strengthening and expanding the presence of the Bulgarian companies at European and world markets and effective use of the advantages of the Single European market.***

It will be achieved by several activities¹⁵⁶.

*The first activity is to **Development of a National Export Internet portal**¹⁵⁷. It creates and support data base of Bulgarian companies with export potential.*

*The second activity is to create **export strategies, analysis and policies for 18 the priority economical sectors.** It increases the competitiveness of these sectors with export potential by identifying:*

- ✓ the priority export sectors and the existing opportunities, trends and perspectives for export;
- ✓ target international markets in which the Bulgarian products from the priority sectors will be competitive;
- ✓ opportunities to imposing competitive Bulgarian products on the target markets.

*The third activity is to create **seminars and training courses for SMEs.** It increases the knowledge and capacity of the Bulgarian companies to export on international markets.*

*The fourth activity is to provide **information/consultancy services for SMEs.** It gives on SMEs specific marketing and analytical information.*

*The fifth activity is to create **Trade missions and Forums in Bulgaria and abroad.** Envisaged that will be creating: 32 Trade missions in EU member states, 28 Trade missions in third countries and 12 international Forums in Bulgaria.*

¹⁵⁵ For more details see: <http://www.sme.government.bg/en/>.

¹⁵⁶ For more details see: http://www.sme.government.bg/uploads/2013/01/project_info_bg_2012.pdf.

¹⁵⁷ See: <http://export.government.bg>.

The sixth activity is related with **advertising and publishing activities**. The aim is creation and distribution of informational and promotion materials and industries' brochures, analysis and catalogues for promotion the Bulgarian sectors and products abroad.

In conclusion we can say that the implementation of these activities give important tool that can to support the introduction and successful positioning of Bulgarian SMEs in foreign markets. Encourage of the SMEs to benefit from the growth of markets, especially outside the EU, must also be focused on alleviating the conditions for foreign trade, providing the ability to access these markets, offering assistance in training and development activities of SMEs in foreign markets.

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INVESTIGATING THE LONG CYCLES OF CAPITALISM WITH SPECTRAL AND CROSS-SPECTRAL ANALYSIS

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ABSTRACT

The persistent current phase of negative growth has already triggered the awakening of the theories of long waves. The long wave tradition asserts that deep recessions, such as the present one or similarly the ones that occurred in 1930's and 1970's, are the result of an amplified long-lasting downturn, reoccurring every 40-60 years over the history of capitalism's development. Although the long lasting cyclical evolution of capitalistic development is obvious to many researchers, even with a simple visual observation of the history of the data, there are also doubts of its existence that are expressed both by a variety of different theoretical and empirical approaches. However, the increasing number of statistical methods for long wave examination depicts exactly that the confirmation of a long-wave, as well as its exact periodization, depends both on theoretical fixations and / or the use of different empirical methodologies and data. The present paper uses the modern and helpful methodology of Spectral Analysis in order to investigate the importance of the long lasting cycles relative to cycles of other duration such as the business cycles in the periodicity of European Countries' economic evolution. Motivated by the current persistent crisis we provide a theoretical discussion and empirical evidence in order to answer question: Do these long cycles exist? And if they do, how different is the periodicity of the economic evolution among European Countries? To answer the second question, we take one step further from the relevant empirical literature. We apply Cross-Spectral analysis in order to investigate whether the long cycles of different countries interact or have the same timing and periodicity. In this manner our empirical comparisons reveal the cross-country differences over the historical cyclical evolution of capitalism.

Key words: Business Cycles, Long Waves, Spectral analysis, Cross-Spectral Analysis

JEL codes: C22, E32

1. INTRODUCTION

The financial crisis of 2008 led to one of the longest and most persistent Post War recessions of global economic activity. Similarly to corresponding periods in economic history, it generated already vigorous debates. Neoclassical growth theory considers this crisis as the stochastic downturn of a common business cycle. On the other hand, the persistent current phase of negative growth triggers the awakening of theories that belong to a different section of economic literature. Traditionally, the theories of long waves come in the foreground with the occurrence of persistent long-lasting economic recessions. The long wave tradition asserts that deep recessions, such as the present one or similarly the ones that occurred in 1930's and 1970's, are the result of an amplified long-lasting downturn, reoccurring every 40-60 years over the history of capitalism's development.

The initial empirical evidences for long-lasting cyclical economic development lead us back to the first contributions at the end of 19th century by Jevons (1884), Parvus (1901), Van Gelderen (1913), De Wolff (1924) and the following, statistically more advanced, analysis of Kondratieff (1928).¹⁵⁸ Aside to the familiar business cycles, they emphasized the continuing long waves lasting approximately half a century. Since that time, interesting questions have been raised, concentrating mostly upon the true existence of such economic movements and their theoretical explanation.

Literature on theoretical justification of long waves is quite extensive. Contributions can be divided in three different schools: Marxists (Mandel 1981, 1975 1980) interpret long waves by the falling course of the rate of profit, which is indisputably a driving force of the system. At the same time, they incorporate various exogenous factors – wars, geographical / sectoral market expansion and technological progress – which avert the systemic downward and move the economy back to a new phase of expansion.

Closely to the Marxian approach, the Social Structure of Accumulation (SSA) School provides an additional argument, offering a framework of continual cyclical movements: the social institutional arrangements such as labour relations, the banking system, the political environment etc, when they are propitious for the continuity of capital accumulation, reassure the transition to the next upswing. (Gordon 1980, 1991; Gordon et al. 1994; Gordon, Weisskopf & Bowles 1983)

Different than the above, the Schumpeterian/Innovation School focuses on a similar cyclical movement of technological progress. Based on appropriate micro-oriented arguments like entrepreneurial motivations for adapting new ideas, theorists consider the fluctuations of economic activity as the result of innovation clusters (Kleinknecht 1987, 1986; Mensch 1975; Schumpeter 1939).¹⁵⁹

¹⁵⁸ Although, the literature uses the term “Kondratieff cycles”, there are many authors who believe that the credits should be given to earlier works: “*It would, in fact be more appropriate to speak about van Gelderen – De Wolff long waves*” (Kleinknecht, A, 1992, p1).

¹⁵⁹ In the course of time, various theoretical contributions combined the arguments of the mentioned schools, in order to avoid a mono-causal interpretation of long waves. Kleincknecht (1992) encourages this mixture; neo-Schumpeterians include also SSA-arguments in their discussion (Clark et al. 1981; Freeman 1982; Perez 1985, 1983, 2010, 2002, 2004; Tylecote 1992), while other theorist combine the scarcity of natural resources with the emergence of new technologies (Rostow 1975; Volland 1987). Also Van Duijn (1977, 1983) incorporates Schumpeter's theory of innovation and the dynamic system of Forrester (1976) and Sterman (1985, 1986) in his product life cycle approach.

Despite the different significance given to the parameter of technological progress, its influence on economy's long term evolution is undoubtedly accepted. Long fluctuations of economic activity were empirically and timely closely related to the occurrence of great technological revolutions. More specifically, the first long wave appears at the end of the 18th century with the beginning of the Industrial Revolution. The second started in the mid of the 19th century and was related to the mechanically produced steam engines that became the driving mechanism of production process in many industries and transportation (mechanization, first technological revolution). Direct outcome was the geographical expansion of capitalism. The opening of new markets for the mass produced industrial products occurred within the expanding period of the next, third long wave, which lasted until the end of the Second World War. Nevertheless, also this cycle was related to another (third) technological revolution: electrification that was accompanied by the expanded use of iron and heavy engineering. The fourth long wave starts after 1940 (in 1945 for Europe) relates to the revolution in natural sciences and known as the era of atomic energy, oil, automobiles and steel technologies connected with highly structured technology research.

The end of the fourth long wave divides scholars' opinions. Some say that since the 1970 a fifth long wave began, associated with the revolution in electronics, telecommunications and informatics (Freeman & Lou 2001; Korotayev & Tsirel 2010; Perez 2010). Some believe that we are still in the longer-lasting downswing of the fourth long wave (Zarotiadis 2012; Wallerstein 1984), while others assume that now begins the sixth wave, associated with new developments in nano-bio technologies (Lynch 2004). Part of this disparity results not only from using different empirical techniques but also different theoretical arguments.

Truly, the existence of long waves is primarily an empirical exercise. There are both: a number of empirical confirmations (Kleinknecht 1986; Kleinknecht & Bieshaar 1983; Korotayev & Tsirel 2010; Reijnders 1992, 2009; Van Duijn 1977, 1983; Metz 1992), as well as many contributions that question the existence of long waves (Garvy 1943; Van der Zwan 1980; Van Ewijk 1981, 1982; Solomou 1998, 1990). As Van Duijn (1983, p. 18)(1983, p. 18) pointed out "*the longer a cycle, the harder it is to prove its existence*". Yet, the confirmation of a long-wave, as well as the exact periodization, depends both on theoretical fixations and / or to the use of different empirical methodologies and data. This is what the present paper tries to do. Motivated by the current persistent crisis, it combines alternative methodologies in different countries in order to contribute in answering the following questions:

- 1) Do economies present cyclical movements that last longer than a common business cycle?
- 2) Could these movements be considered as periodical?
- 3) Are their movements related?
- 4) Is their development synchronised as an international economic phenomenon?

ANSWERING QUESTIONS WITH NEW METHODOLOGY.

Until present the most widespread methodologies for detecting long cycles are decomposition approaches and the most recent spectral analysis. With decomposition approach (Kondratieff's method, 1928), time series are decomposed between trend and cycles (cyclical components) of different duration. This approach was used by Kondratieff,

who estimated a second degree time polynomial trend and after its elimination, smoothed the residuals by using a 9-year moving average (eliminating the common business cycle component). The recent techniques however, such as spectral analysis allow for simultaneous estimation of the importance of cycles of different duration, avoiding in such manner, bias estimations over a specific size of cycle.

Thus, *Spectral Analysis* or analysis in the *frequency domain* is a helpful methodology in order for a researcher to see how important are the long lasting cycles relative to cycles of other duration in the periodicity of the series/variable chosen to express economic activity. In this paper, we use spectral analysis to investigate the different periodical movements of 6 economies, France, England, Sweden, Italy, Netherlands and Germany for the period 1850-2010 using the most recent Maddison Project datasets¹⁶⁰. In order to investigate whether the cycles of the different countries interact or have the same timing and periodicity we take one step further and apply cross-spectral analysis.

Answering the first question.

Despite the skepticism of some researchers long waves do exist and this is obvious even to a naked eye. The graphs below depict, though not so clearly, long waves occurring from 1850 until present. Despite the reasoned (due to technological progress upward trend), we can see an expansion phase lasting approximately until approximately 1870 in almost all countries (except Italy and Holland where it is not that obvious). Then, there is a downward movement until approximately 1890 where another expansion phase begins. After 1925, we have a downward movement until 1945. Since then, all economies move closely together upwards, until 1990, where the previously observed convergence starts perishing¹⁶¹. These movements in all 6 countries' GDP become more obvious by smoothing the series with the help of Hodrick Prescott Filter.

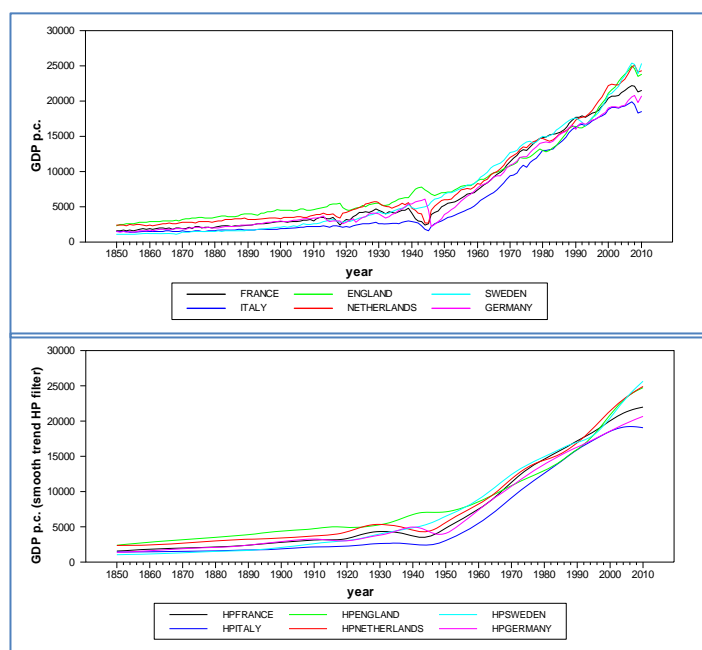


Fig 1: Long Waves of GDP from 1850-2010.

¹⁶⁰ Bolt, J. and J. L. van Zanden (2013). The First Update of the Maddison Project; Re-Estimating Growth Before 1820. Maddison Project Working Paper 4. <http://www.ggdc.net/maddison/maddison-project/data.htm>

Before discussing the results of spectral analysis, we should mention that there is an obvious difference in the importance of periodicities according to the de-trending technique. Linear trend elimination favours the presence of longer economic cycles, while, on the contrary, de-trending by the use of filtering techniques does the opposite. This gives us a great opportunity to repeat something that has been widely notified in the relevant literature: to confirm the existence and the duration of a long-wave depends to a great extent on the pre-existing theoretical fixations

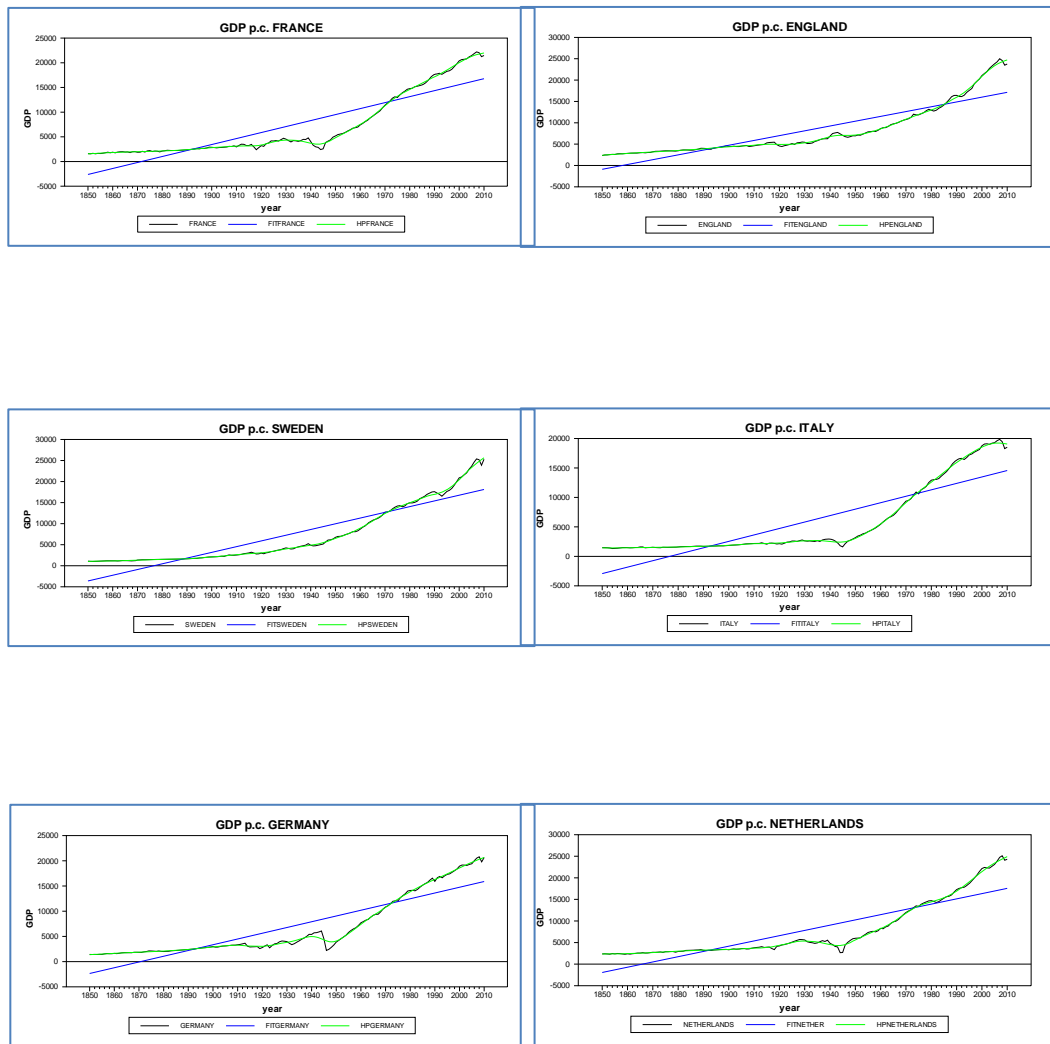


Fig 2: Real series (FRANCE, SWEDEN etc), linear trend estimation (FITFRANCE, FITSWEDEN etc) and smoothing HP trend (HPFRANCE, HPSWEDEN etc.) of each country's GDP.

Above, we depict the course of GDP of each country. As we can see there is an upward movement which is depicted more clearly by estimating a linear trend. However, by taking out of the series the linear trend it is quite obvious that there will remain cyclical components of long duration (in the above graphs we can clearly see three waves up and down the trend line). That is the reason why, the presence of long lasting cycles depends on

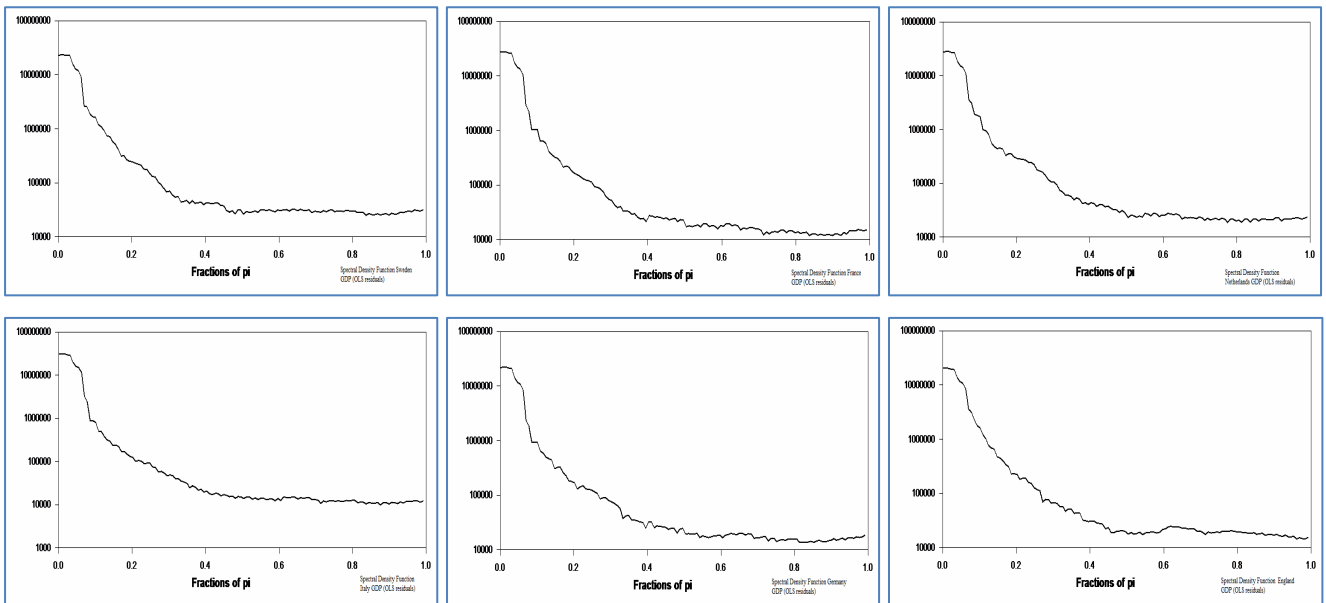
a great degree upon the theoretical assumptions of each researcher about the trend curve that fits better to the series. “As there are obviously no statistical criteria for choosing the “true” trend curve, the existence of long waves depends solely on subjective criteria related to the trend.” (Metz 2011, p. 211). On the other hand, de-trending the series with HP trend estimation, poses the danger of excluding long wave movements. Truly, if we take the residuals that remain after estimating a more sensitive, flexible trend – for instance by the use of HP – waves of more than 40 years disappear. Does this mean that they do not exist, or that the sensitive trend itself reproduces actually the deeper regularity of longer lasting periodicity? We believe that the second argument is true that is why we use only de-trending techniques to GDP per capita levels and then to growth rates.

Answering the second question with Spectral Analysis:

Each time series can be expressed as a sum of cosines and sines in case it is stationary. Thus, each time series can be expressed as periodic function that depicts a periodicity at π . This is achieved with Fourier Transformation of the series' auto covariance function. In this manner the series are presented as a function of frequencies ($\theta \in (0, \pi)$) (the number of cycles per period). This means that the series can be plotted upon the points at which the series present a proportion/number of periodical movements (cycles). For example at π we have 0,5 cycle, at 2π one cycle etc. This function is named as **power spectral densities function** or **power spectrum** and depicts the importance of periodic components in the total variance of the series. This is because if we integrate the function for all possible frequencies (from 0 to π), the area under the function is equal to the total variance of the series. For a more detailed analysis of the spectral methodology one can find at Granger and Hatanaka (1994) and Hamilton (1994) and for a comprehensive interpretation should also look in Engle (1976).

Below, we present the results of the spectral density function estimations of 6 countries, France, England, Sweden, Italy, Netherlands and Germany for the period 1850-2010. We start with an analysis of GDP per capita annual series and next, we proceed with an analysis of GDP growth rates.

Period (in years)	Frequency Fractions of pi,	Frequency Fractions of pi,	pi
NONE	0	0	0
32	0,06	$\pi/16$	0,1964
16	0,13	$\pi/8$	0,3927
10	0,19	$3\pi/16$	0,5891
8	0,25	$1\pi/4$	0,7854
6	0,31	$5\pi/16$	0,9818
5	0,38	$3\pi/8$	1,1781
45.714	0,44	$7\pi/16$	1,3744
4	0,5	$1\pi/2$	1,5708
35.556	0,56	$9\pi/16$	1,7671
3.2	0,63	$5\pi/8$	1,9635
29.091	0,69	$11\pi/16$	2,1598
26.667	0,75	$3\pi/4$	2,3562
24.615	0,81	$13\pi/16$	2,5525
22.857	0,88	$7\pi/8$	2,7489
21.333	0,94	$15\pi/16$	2,9452
2	1	π	3,1416

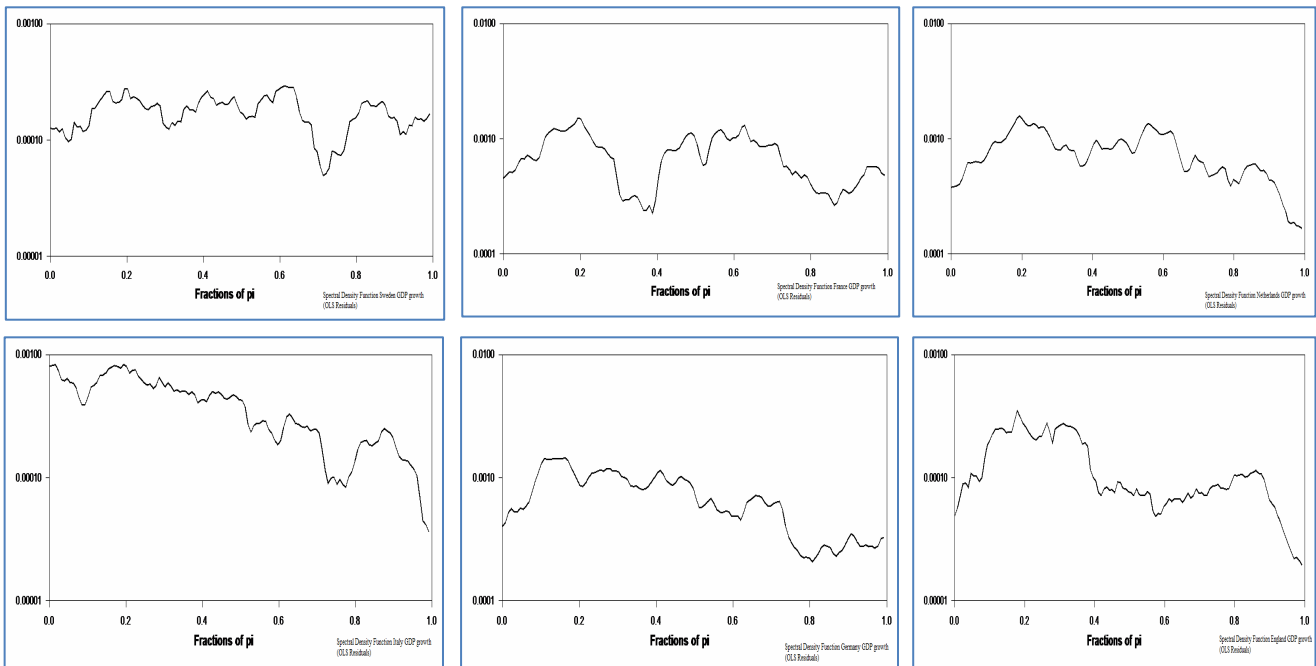
Fig 3: Spectral Density Functions of GDP de-trend time series

As expected from the above, the spectral density estimations after the elimination of a linear trend depict clearly the presence of long cycles or differently cycles of low frequencies' periodicity. In the horizontal axes we see the frequencies - fractions of π . As we mentioned above at π (3,14) the Fourier transformed series depict half periodical movement meaning a half cycle in 1 periods of time (example if we use years as periods' measure units, 1 year) and one full cycle in 2 periods of time, thus 2 years. Thus, π in the horizontal axis corresponds to a full cycle with a periodicity of 2 years. As we move towards the beginning of the axis, the frequencies of the cycles are lower and correspond to cycles of larger duration (ex. $\pi/2$ (1,5) corresponds to a cycle of 4 years duration etc.). On the table you can see how the proportions of pi correspond to a frequency of a cycle. The function gets higher estimated values at cycles that have a duration of more than 32 in each country, thus our series depict high possibility to be periodical every 32 (and more) years.

Additionally, we estimated the spectral density functions for annual growth rates, using again the same de-trending procedure. As obvious, now the functions get flatter supporting apart from long waves, the presence of Juglars, Kuznets and Kitzin cycles in most of the countries.

Period (in years)	Frequency Fractions of π	Frequency Fractions of π	Frequency Fractions of π
NONE	0	0	0
32	0,06	$\pi/16$	0,1964
16	0,13	$\pi/8$	0,3927
10	0,19	$3\pi/16$	0,5891
8	0,25	$1\pi/4$	0,7854
6	0,31	$5\pi/16$	0,9818
5	0,38	$3\pi/8$	1,1781
4,5714	0,44	$7\pi/16$	1,3744
4	0,5	$1\pi/2$	1,5708
3,5556	0,56	$9\pi/16$	1,7671
3,2	0,63	$5\pi/8$	1,9635
2,9091	0,69	$11\pi/16$	2,1598
2,6667	0,75	$3\pi/4$	2,3562
2,4615	0,81	$13\pi/16$	2,5525
2,2857	0,88	$7\pi/8$	2,7489
2,1333	0,94	$15\pi/16$	2,9452
2	1	π	3,1416

Fig 4: Spectral Density Functions of GDP growth de-trend time series



Answering the third and the fourth question with Cross-spectral Analysis:

Using almost the same methodology, one can examine the periodicity of two variables inter-related. More specifically, it is possible for a researcher to examine how two variables interact or how they are related in the frequency domain. This is achieved with the use of cross-spectral analysis and by estimating the Fourier Transformation of the series' cross-

covariance function. However, the presentation of the results of cross-spectral analysis is different than the above. With cross-spectral analysis, we examine mainly two statistics: the coherence (squared) and phase:

The coherence is like a correlation coefficient and takes values between 0, 1. It depicts the correlation between two series in the frequency domain.

The phase depicts whether one variable leads the other. It is measured in fractions of a cycle, hence, as we described before in fractions of π .

In the present paper we applied cross-spectral analysis on the same data using GDP p.c. series levels and annual growth rates of GDP p.c. and we present the results in the two figures below (figures 5, 6). For both kinds of series we have estimated the coherence and phase function in all frequencies. In this manner, we can see whether one economy is related to another under the same low frequency, hence, a long cycle. And if it does which one of the two leads the other. Thus the two functions were estimated for pairs of countries. The coherence values are presented in the left-hand axis whereas the phase values are depicted in the right-hand axis. The minimum phase lag is -1π (a half cycle lag) and the maximum phase lead is $+1\pi$ (a half cycle lead).

As it can be seen in the first figure, all countries appear to have a strong synchronization in all frequencies and thus in all periodicities. Moreover, all countries' GDP p.c. series appear to have strong linear dependence. Exceptions to the above, relatively to coherence, appear to be England and Germany. England's GDP p.c. series do not present strong linear correlation to the other countries' GDP p.c. series and especially at low frequencies (at longer lasting periodical movements). Similar behavior present the series of Germany, which as depicted in the figures below, they do not depict high linear correlation with the rest countries' series and this is particularly obvious at low frequencies.

The results of cross-spectral analysis of the growth rates are a little different to that of GDP p.c. levels. High linear correlation is presented in most of pairs of the six countries, apart from those that include England and Sweden. Sweden's growth rate presents small coherence with almost all countries and its long cycles appear to be leading relatively to those of other countries apart from Netherland. Similarly with the analysis of GDP p.c. levels, England also here presents the lowest coherence (under 0, 75) with all countries. Moreover, it appears to lag in longer cycles and leading in shorter ones. Finally, Germany's growth rate presents low correlation with that of England's and Sweden's relatively to the other 3 countries. Moreover, Germany's longer lasting cycles lag to almost all long cycles of other countries (apart from England's).

Fig 5: Cross-Spectrum of GDP p.c. de-trend time series

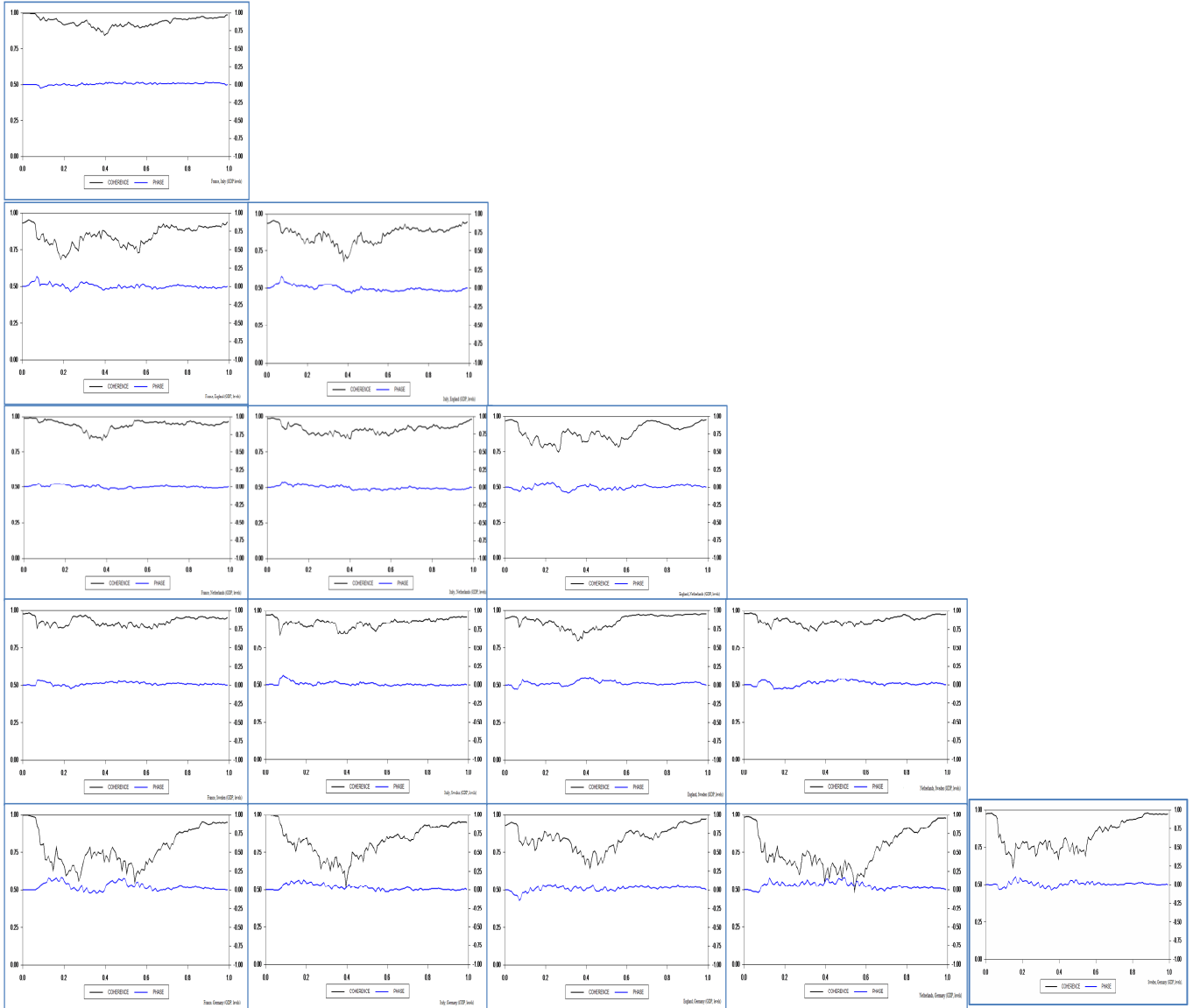


Fig 6: Cross-Spectrum of GDP p.c. growth de-trend time series**CONCLUSIONS:**

Our empirical estimations confirm long wave's significant contribution in GDP p. c. series. The spectral density estimations after the elimination of a linear trend depicted clearly the presence of long cycles in the series. However, in case of the GDP p.c. growth rates the results support, apart from long waves, the presence of Juglars, Kuznets and Kitzin cycles in most of the countries. Trying to answer whether these long movements are related with the use of cross-spectral analysis, we found that they have a strong synchronization and a strong linear dependence especially in the GDP p.c. levels. However, exceptions do exist. England, in both two analyses (levels - growth rates), depicts clearly a different character from all

other European countries examined. Additionally, Germany appears to be always a follower especially in lower frequencies. This maybe could be explained due to the fact its economy was mostly influenced in long economic periods such as the one after the Second World War

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MEASURING MACROECONOMIC TECHNICAL EFFICIENCY WITH DESIRABLE AND UNDESIRABLE OUTPUTS

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ABSTRACT

Purpose - This paper focuses on environmental performance at a macro level in the construction of (environmental) efficiency indices for the European Economic Area (EEA) 32 countries. We consider five components of production: outputs - GDP and greenhouse emission, inputs- capital stock, employment and energy use, from 2006 to 2011.

Methodology framework - The issue is to treat the undesirable output in a production function framework. The approach assumes the production of desirable outputs comes jointly with a set of polluting wastes and weak disposability on undesirable output constraint by environmental protection. Färe et al. (1989) propose a hyperbolic technical efficiency measurement under strong and weak disposability of bad output and computes a hyperbolic environmental efficiency index.

Following the same methodology, we compute the opportunity costs for environmental regulations measures in terms of a lower feasible expansion of desirable outputs. Data are processed sequentially. This means that each observation for a given year is compared to the all other observations in the same year and to the observations in previous years.

Findings - The results show that East and South regions seem more inefficient, and the gap increases over the period. Developing economies seem to be less efficient than those advanced. In addition, if the disposability for pollutants were strictly restricted as a result of an environmental regulation, the total value of output loss to the GDP countries would correspond between 2% and 3% of the hyperbolic environmental efficiency for the six years. We can conclude that the opportunity cost of imposing environmental regulations is not very high.

Keywords: macroeconomic efficiency, undesirable outputs, Data Envelopment Analysis.

JEL classification: C61, D24, O52

1. Method

Two assumptions are becoming commonly accepted: null jointness and weak disposability.

In the null jointness assumption bad outputs are considered as a sort of byproduct of the main production process at producing desirable outputs. Therefore, it is impossible to observe a positive amount of good outputs without observing also a positive amount of bad outputs.

Weak disposability is the notion that there is a cost associated with disposing of undesirable outputs. With environmental protection, bad output reduction cannot occur for free because it is costly in technological terms.

According to joint production of desirable and undesirable outputs and the weak disposability hypothesis, the environmental non-parametric technology, associated with the observed data K that exhibits constant returns to scale (CRS), can be expressed as

$$P^w(\mathbf{x}) = \left\{ (\mathbf{y}, \mathbf{b}) : \sum_{k=1}^K z_k y_{mk} \geq y_m, \quad m = 1, 2, \dots, M \right.$$

$$\left. \sum_{k=1}^K z_k b_{jk} = b_j, \quad j = 1, 2, \dots, J \right.$$

$$\left. \sum_{k=1}^K z_k x_{nk} \leq x_n, \quad n = 1, 2, \dots, N \right.$$

$$\left. z_k \geq 0, \quad k = 1, 2, \dots, K \right\}$$

where z_k indicates the intensity variables, and \mathbf{x}_k , \mathbf{y}_k , \mathbf{b}_k respectively the vectors of inputs, desirable outputs and undesirable output.

The constraints state that the desirable outputs are strongly disposable (their quantities can be reduced at no cost), while the equality $\sum_{k=1}^K z_k b_{jk} = b_j$ allows a weak disposability of undesirable outputs (their production can be reduced only at the cost of a reduction in the other outputs or an increase in inputs).

In contrast to weak disposability, the concept of strong disposability allows any output to be disposed without imposing any private costs

$$P^s(\mathbf{x}) = \left\{ (\mathbf{y}, \mathbf{b}) : \sum_{k=1}^K z_k y_{mk} \geq y_m, \quad m = 1, 2, \dots, M \right.$$

$$\left. \sum_{k=1}^K z_k b_{jk} \geq b_j, \quad j = 1, 2, \dots, J \right.$$

$$\left. \sum_{k=1}^K z_k x_{nk} \leq x_n, \quad n = 1, 2, \dots, N \right.$$

$$\left. z_k \geq 0, \quad k = 1, 2, \dots, K \right\}$$

The inequality $\sum_{k=1}^K z_k b_{jk} \geq b_j$ allows a strong disposability of undesirable outputs.

Following the work of Pittman (1983), that offered a framework for assessing productivity when some outputs are undesirable and cannot be freely disposed, Färe et al. (1989) developed the notion of hyperbolic output efficiency measures under weak (H^W) and strong disposability (H^S), providing an asymmetric treatment of desirable and undesirable outputs. The hyperbolic environmental efficiency measurement $HEE = (H^S / H^W)$ is considered a measure of regulatory impact, conceived in terms of reduced productivity due to a forced departure from strong disposability of undesirable outputs. The output loss is given as $y_{mk}(H^S - H^W)$.

2. Empirical analyses

According to the model outlined above, we employ EEA32 over the period from 2006 to 2011 in a sequential frontier. This means that, each observation for a given year is compared to all other observations in the same year and to the observations in previous years¹⁶².

With respect to imposing weak disposability of GHGE, on average, we distinguish the H^W efficiency score in three clusters.

The first cluster is the most efficient and is made up of the advanced countries in the North and West, excepting Turkey. The third cluster is the least efficient, and is comprised both of advanced and emerging countries, all found in Eastern and Southern Europe, excepting Iceland.

¹⁶² Thus, starting with a reference sample of 32 observations for the year 2006, the frontier is built by the next enlargements that include the observations for all the years. In this manner, the efficiency for the observations in the last year, 2011, is estimated by constructing the frontier based on all observations between 2006 and 2011

Table - Average of: hyperbolic efficiency index, environmental efficiency and GDP loss.

Sub region	market classification	cluster	country	H^W	H^S	HEE	GDP loss (in mil. 2005US\$)
N	A	1	IRL	1.000	1.000	1.000	0
W	A	1	CHE	1.001	1.063	1.062	19,258
N	A	1	NOR	1.002	1.025	1.023	6,589
N	A	1	SWE	1.006	1.145	1.138	43,177
E	E	1	TUR	1.063	1.063	1.000	0
W	A	1	LUX	1.082	1.082	1.000	0
N	A	1	EST	1.083	1.083	1.000	0
N	A	1	GBR	1.084	1.153	1.064	138,484
E	E	2	BGR	1.110	1.110	1.000	0
S	A	2	ITA	1.119	1.163	1.039	73,739
S	A	2	MLT	1.125	1.145	1.018	174
N	E	2	LTU	1.125	1.147	1.020	1,125
W	A	2	AUT	1.132	1.180	1.043	14,359
N	A	2	DNK	1.140	1.168	1.025	5,271
S	A	2	ESP	1.152	1.200	1.042	57,480
W	A	2	NLD	1.158	1.184	1.022	16,306
W	A	2	BEL	1.161	1.161	1.000	0
W	A	2	DEU	1.162	1.198	1.031	100,547
S	A	2	PRT	1.169	1.198	1.025	6,386
W	A	2	FRA	1.182	1.212	1.026	57,416
S	A	2	GRC	1.189	1.194	1.004	1,307
N	E	2	LVA	1.190	1.279	1.075	2,711
E	E	2	POL	1.195	1.196	1.001	441
N	A	2	FIN	1.216	1.216	1.000	0
E	A	3	SVK	1.227	1.278	1.042	5,161
E	E	3	HUN	1.235	1.314	1.064	12,851
S	E	3	HRV	1.242	1.271	1.023	1,985
E	E	3	ROU	1.248	1.274	1.021	6,011
S	A	3	SVN	1.280	1.334	1.042	2,593
S	A	3	CYP	1.283	1.292	1.006	142
N	A	3	ISL	1.312	1.312	1.000	0
E	A	3	CZE	1.329	1.364	1.027	8,366

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